

CEE LEGAL MATTERS COMPARATIVE LEGAL GUIDE: CORPORATE GOVERNANCE 2023



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FOREWORD

By Branko Gabric, Counsel, Gecic Law



Although there is no ultimate definition, corporate governance is a collection of rules, practices, and processes that guide and control a corporation. These include the mechanisms of management accountability to shareholders and other stakeholders and methods of setting and meeting objectives. The legal aspect of corporate governance involves the laws, regulations, and industry standards that govern the operations of a corporation, as well as the legal responsibilities and obligations of the corporation's management and board

of directors. Additionally, it includes the oversight and enforcement of these laws and regulations by government agencies and regulatory bodies. Corporate governance is essential for protecting shareholders' rights and interests and for the overall integrity and sustainability of the corporation.

Corporate governance's role in contemporary business is a matter of discussion. On the one hand, corporate governance is essential as it is about controlling risks,

ensuring regulatory compliance, and enabling the decision-making process based on viable criteria, which is crucial to achieving objectives. Good corporate governance practices can reconcile and define the relationship between stakeholders, owners, and management of a company and, therefore, permanently influence the company's operations. On the other hand, some see the framework as a bottleneck of regular business flows, discouraging entrepreneurial spirit, and reducing flexibility.

However, the price of non-compliance may often go beyond the regulatory, financial, and reputational. In the long run, a lack of sound corporate governance leads to missed opportunities due to the lack of as a result of poor organization. Therefore, implementing the right size-right shape concept is vital to the success of a business.

Corporate governance rules, regulations, and practices in jurisdictions across the CEE do differ as they address issues of doing business in specific ways. This guide aims to provide a comprehensive overview of some of the region's most critical aspects as this complex area increasingly comes into the limelight. I hope you will find it informative and thought-provoking and that it will contribute to the ongoing discussion in the field. I want to thank CEE Legal Matters for understanding the importance of the topic and the authors for shedding light on it. ■



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If you like what you read in these pages (or even if you don't) we really do want to hear from you. Please send any comments, criticisms, questions, or ideas to us at: press@ceelm.com

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1. Corporate Structure Of The Companies

1.1. General legal framework

In Bosnia and Herzegovina, corporate matters are regulated at the level of each of the entities of B&H (FB&H and RS) as well as at the level of Brcko District of B&H (hereinafter BD B&H), which forms a separate self-governing administrative unit.

A. BD BiH

A Limited Liability Company (Ltd.) has as the management body an assembly and a board that can consist of one (director) or more members. Ltd. can have a maximum of 50 members/founders (can have more if approved by the government). Members of the ltd. can be natural or legal persons. Members of the ltd. are liable for the company's liabilities up to the amount of the nominal capital, while they will be liable for the company's liabilities with their entire assets without limitation, only in the following cases:

1. if one represents the company before the company was registered in the Company's Register in the court of the BDB&H
2. if one uses the company to achieve personal goals that are not in accordance with the goals of the company and other owners of the company as a whole,
3. if one manages the affairs or assets of the company as if they were his own,
4. if one uses the company to defraud the creditors of the company, or
5. if one causes or influences the occurrence of waste or consumption of the company's assets for one's personal benefit or the benefit of third parties or if one causes or influences the creation of the company's liabilities, even though they knew or should have known that the company would not be able to settle such liabilities.

A Joint Stock Company (JSC.) has as management bodies an assembly and a board of directors and a supervisory board is required if:

- the nominal capital of the company higher than BAM 1 million,
- the average annual number of employees in the company is higher than 250,
- if the shares of the company are listed on the stock exchange, or
- if the number of registered shareholders is higher than 100.

A Joint Stock Company can be registered by natural or legal persons. A shareholder is liable for the obligations of the company in the same way and under the same conditions as a

member of d.o.o. The law does not define the minimum/maximum number of JSC. members.

According to the *Companies Act* of the BD BiH, companies and entrepreneurs are classified as small, medium, or large, based on the following criteria:

1. number of employees,
2. revenues, and
3. the average level of assets according to the annual accounting calculation for the last business year.

According to the same criteria, entity (FBiH and RS) laws on accounting and auditing distinguish between micro, small, medium, and large companies.

B. FBiH

A Limited Liability Company has an assembly and a board that can consist of one (director) or more members as management bodies. In addition to the assembly and management, a Limited Liability Company must also have a supervisory board, if it has more than 10 members and if it has a nominal capital in the amount of more than BAM 1 million and at least two members.

Members of the ltd. can be natural or legal persons (the minimum/maximum number of members is not stipulated). Members of the d.o.o. are liable for the company's liabilities up to the amount of the nominal capital, while for the company's liabilities they will be liable with their entire assets without limitation only in the following cases:

- uses the company to achieve a personal goal that does not agree with the goals of other members and the company as a whole,
- manages the assets of the company as its own assets,
- uses the company to defraud or damage its creditors, or
- influences the reduction of the company's assets for their own benefit or the benefit of third parties, or influences the company to assume obligations even though they knew or should have known that the company was not or would not be able to fulfill its obligations.

A Joint Stock Company has an assembly of shareholders, a board that can consist of one (director) or more members, a supervisory board, and an audit committee as its management bodies. A Joint Stock Company can be established by one or more founders (natural or legal entities). Joint Stock Companies can be open (they cannot limit the transfer of shares to third parties) and closed.

A shareholder is liable for the obligations of the company in the same way and under the same conditions as a member of d.o.o.

C. RS

A Limited Liability Company has an assembly and a board that can consist of one (director) or more members as management bodies. Members of a d.o.o. can be natural or legal entities (one or more).

A ltd. can have a maximum of 50 members.

Members of a ltd. are liable for the company's liabilities up to the amount of the nominal capital, while they will be liable for the company's liabilities with their entire assets without limitation if they were assumed before the establishment of the company, if they misuse the company for illegal or fraudulent purposes, or if they dispose of the company's assets as if they were their own assets, in the manner as that the company does not exist.

A Joint-Stock Company has an assembly of shareholders and a director or a board of directors (if it is an open Joint Stock Company) as management bodies. An open Joint Stock Company, whose shares are listed on the official stock market, must have an internal audit.

A Joint Stock Company can be established by one or more founders (natural or legal entities). Joint Stock Companies can be open (they cannot limit the transfer of shares to third parties) and closed.

A shareholder is liable for the obligations of the company in the same way and under the same conditions as a member of a ltd.

1.2. The function of the Supervisory Board

The Supervisory Board supervises the company's operations, adopts business strategies and business plans, appoints the management and supervises its work, and approves decisions of strategic importance.

In the FBiH, the Supervisory Board approves the disposal of the company's assets (purchase, sale, exchange, leasing, taking or giving loans, and other transactions with assets), whose value during the business year is in the range of 15% to 33% of the book value of the total assets of the Joint Stock Company according to the balance sheet at the end of the previous year.

The members of the Supervisory Board are responsible to the company and shareholders for any violation of the standards of conduct, which stipulate that every responsible person in the company is obliged to perform their duties with the care of a good businessman and in a way that they reasonably believe is in the best interest of the company.

The Chairman and members of the Supervisory Board are jointly and severally liable for damages caused by failure to perform or improper performance of their duties.

1.3. The function of the Executive Board

Management organizes the work and manages the business, represents the Joint Stock Company, and is responsible for the legality of the business. If the Board has more members, decisions are made by majority vote, and in case of a tie, the vote of the Chairman of the Board will be decisive.

Any person who fulfills the requirements prescribed by law (that they have not been convicted of a criminal offense, that they have not been prohibited from engaging in the profession, and other conditions depending on whether they are elected as a Member of the Board in FBiH, RS, or BD BiH) can be appointed as a Member of the Board. Management members are obliged to perform the tasks within their competence in accordance with the material legal regulations and internal acts of the company.

Board members are jointly and severally liable for the damage the company suffers by acting contrary to the aforementioned obligations.

1.4. Conflicts of interest and related party transactions

According to the provisions of positive legal regulations, persons with special obligations towards the company (members with a majority share in the capital, members of the Board of Directors, Supervisory Board, authorized agents, representatives, etc.) have the obligation to avoid conflicts of interest. This obligation is reflected in the duty to correctly and completely present all facts that may be of importance for making a decision and obtaining prior approval from the competent body of the company when undertaking legal affairs in which there is a personal interest.

A member of the assembly, Supervisory Board, or Management may not decide on affairs where they have a personal interest.

1.5. Legal framework for large companies

See Section 1.1.

2. Corporate Governance Framework

2.1. Transparency and public disclosure

All companies have an obligation to inform their members/shareholders about their operations and financial situation, as well as to make available to them information and documents that must be made available in accordance with positive legal regulations and the founding acts of the company.

Joint Stock Companies have the obligation to compile and publish their financial statements on their website in accordance with IAS and IFRS. Joint Stock Companies (whose shares are listed on the stock exchange) also have the obligation to submit financial statements to the competent stock exchange,

which publishes these reports. Furthermore, Joint Stock Companies have the obligation to publish all decisions/events that may have a significant impact on the company's operations (e.g., changes of members of the Supervisory Board, notices on convening meetings of assemblies, increase/decrease of capital, changes of predominant activity, codes of conduct/standards of corporate governance, Statute, rules of procedure for the work of the assembly, etc.).

The Joint Stock Company should publish the decisions of the assembly and the Supervisory Board.

2.2. Public authorities responsible for the monitoring of corporate governance

The Securities Commission has adopted the **Standards for the Management of Joint Stock Companies** (Corporate Governance Standards), which determine the mechanisms for the functioning and protection of interests in the mutual relations of various stakeholders in a Joint Stock Company.

Joint Stock Companies should apply the Governance Standards for Joint Stock Companies.

2.3 ESG

Taking into account that Bosnia and Herzegovina is not a member of the European Union as well as the fact that non-financial reporting is in principle regulated by directives adopted by the EU in terms of obligation, there are no regulatory requirements for non-financial reporting in Bosnia and Herzegovina, i.e. reporting of any of the kind that would include the contribution of business operations to sustainable development. However, there is no obstacle for business entities to prepare and publish non-financial reports on a voluntary basis. The above refers to entities of the real sector.

For certain industries, it is necessary to fulfill the conditions stipulated by the law, which could indirectly indicate non-financial reporting, such as, for example, the issuing of an environmental permit or acting in accordance with the law on occupational safety.

In Bosnia and Herzegovina, there is no public authority responsible for the control, submission, and publication of non-financial reports.



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2.4. Internal controls and fraud measures

BD B&H

The annual accounting of large limited partnerships, large and medium-sized joint-stock companies, large limited liability companies, and all other companies whose securities are traded will be audited in accordance with special regulations, within six months after the end of the business year.

FB&H

The audit committee is obliged to audit the half-yearly and annual accounts and at the same time control the compliance of the company's operations and the functioning of the company's organs with the law, other relevant regulations, and basic principles of corporate governance and submit a report on this to the assembly and the supervisory board no later than eight days after the end of the audit.

RS

An open joint-stock company, whose shares are listed on the official stock market, must have an internal audit. The internal auditor performs tasks within their jurisdiction in accordance with the law, the founding act, and the company statute. An open joint-stock company has an independent auditor whose position and powers are determined by the law regulating accounting and auditing.

An open joint-stock company publishes the half-yearly and annual report on operations and the external auditor's report on its website and submits them to the stock exchange for publication on the stock exchange website.

3. Shareholder And Board Committees

Positive legal regulations do not stipulate the obligation to form special committees of shareholders/members and management of the company.

The remuneration of members of the Board of Directors and Supervisory Board is optional. The remuneration policy for the members of the Board of Directors and Supervisory Board is established by the company in its internal acts. The remuneration of Board members of a Joint Stock Company should be publicly disclosed.

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1. Corporate Structure Of The Companies

1.1. General Legal Framework

There are several types of legal entities through which investors can do business in Bulgaria such as a limited liability company (LLC), joint-stock company (JSC), general and limited partnerships, European company (SE), and others. The most commonly used type by foreign investors are LLCs and JSCs, hence they are the focus of the information below.

The corporate structure of companies in Bulgaria does not depend on the size of the company, i.e., micro, small, medium size, and large companies, but it depends rather on their type.

1.1.1. LLCs Corporate Bodies

The mandatory corporate bodies of an LLC are the General Meeting of Shareholders, and the Executive(s). Where all shares are held by a single person (a single-member LLC) the sole owner assumes the competence and powers of the General Meeting of Shareholders. Appointment of a Controller(s) in an LLC is also allowed by the law but is only optional.

The General Meeting of Shareholders is comprised of all shareholders. The Executive (if not a shareholder) and employee representatives where the company has more than 50 employees are allowed to participate in a general meeting of the shareholders in a consultative role.

The Executive organizes and directs the activities of the company in accordance with the law and the decisions of the General Meeting of Shareholders. Relations between the company and the Executive are regulated by a management agreement concluded in writing.

An LLC may have one or more Executives and is allowed to determine the manner of representation (basically jointly or severally) where Executives are more than one or a general commercial proxy is appointed for the purposes of management.

As indicated above, the articles of association may provide for a Controller to be appointed to supervise the observance of the articles of association and the preservation of the company's assets. In such a case, the Controller is appointed by and reports to the General Meeting of Shareholders. A Controller should be a natural person other than the Executives, their deputies and company employees, or other groups of related persons. Persons who have been deprived of the right to hold a position of financial accountability also cannot be elected as Controllers.

1.1.2. JSCs Corporate Bodies

As to JSCs, the corporate bodies of this type of company are comprised of the General Meeting of Shareholders and, depending on the type of management system, a Board of Directors where the company is set up with a one-tier management system or an Executive Board and a Supervisory Board in JSCs with a two-tier management system.

In a single-member JSC, the sole owner of the capital assumes the competencies and powers of the General Meeting of Shareholders.

In JSCs, the General Meeting of Shareholders is comprised of all voting shareholders. Employee representatives in a JSC with more than 50 employees are allowed to participate in the General Meeting of Shareholders in a consultative role while shareholders holding non-voting preference shares, as well as the members of the boards who are not shareholders may participate in the General Meeting of Shareholders without having the right to vote.

Board members in both one and two-tier management systems may assume a mandate of up to five years and those of the first boards may be elected for a term of up to three years. A board member may be any natural person of full legal capacity to act and, where the articles of association so provide, a legal entity whose functions as a board member are carried out by a person designated thereto. Relations between the company and management boards are regulated by a management agreement in writing.

In JSCs with a one-tier management system, the Board of Directors is comprised of at least three but not more than nine members. One or more of the board members can be appointed to act as Executive Directors, the number of which should in any case be lower than the rest of the board members.

The Executive Board of a JSC with a two-tier management system is comprised of at least three but not more than nine members appointed by the Supervisory Board, which in turn may have three to seven members appointed by the General Meeting of Shareholders.

Both LLCs and JSCs may appoint one or more general commercial proxies to perform management functions in addition to executives/board members.

1.1.3. Shareholding in LLCs and JSCs

There is no statutory limitation as to the number of shareholders of a company. Company shares can be held by one or more local or foreign legal entities and/or natural persons in full legal capacity to act.

If the shareholder is a legal entity, its shareholder's rights are exercised by its statutory representative or by a person designated thereby.

In general, shareholders in LLCs and JSCs are not liable for the obligations of the company and their liability may be enforced in a limited number of cases set out in the law, e.g., the joint liability of founding shareholders for obligations assumed on behalf of the company prior to its registration.

Further, the liability of a shareholder in an LLC towards the company can be enforced in case of a breach of its obligation to make contributions and, where applicable, additional contributions as per the shares owned, to assist the company in its business activities, to comply with the decisions of the general meeting and not to act against the interests of the company.

Lastly, in certain specific circumstances defined by the law, majority shareholders in LLCs and JSCs may be liable for taxes and social security contributions due by the company in question.

1.1.4. Criteria for Differing Small and Medium vs. Large Companies

The criteria to determine the type of a legal entity from a size perspective depend on the purpose, i.e., implementation of state aid policy for the setting up and development of small and medium size companies, or accountancy and tax purposes.

1.1.4.1. State Aid Policy Criteria

With respect to the implementation of state aid policy for setting up and developing small- and medium-sized companies, the division of legal entities is based on the total annual turnover, balance value of assets, and the number of employees, as follows:

- medium size companies – with a total annual turnover of not more than BGN 97.5 million (approximately EUR 49.85 million), and/or balance value of assets of not more than BGN 84 million (approximately EUR 42.94 million), and an annual average number of employees of fewer than 250;

- small size companies – with a total annual turnover of not more than BGN 19.5 million (approximately EUR 9.97 million) and/or balance value of assets of not more than BGN 19.5 million (approximately EUR 9.97 million), and an annual average number of employees of fewer than 50;

- and micro size companies – with a total annual turnover of not more than BGN 3.9 million (approximately EUR 2 million) and/or balance value of assets of not more than BGN 3.9 million (approximately EUR 2 million), and an annual average number of employees of fewer than 10.

1.1.4.2. Accountancy and Tax Criteria

For accountancy and tax purposes, legal entities are divided on the basis of their net sales revenues, balance value of assets, and average number of employees for the reference period, provided that at least two of the criteria set out for each of the entities are met as of December 31 of the respective year, namely:

- large entities – balance value of assets is more than BGN 38 million (approximately EUR 19.42 million), net profit from sales is more than BGN 76 million (approximately EUR 38.85 million), and the average number of employees for the reference period exceeds 250;

- medium entities – balance value of assets is less than BGN 38 million (approximately EUR 19.42 million), net profit from sales is less than BGN 76 million (approximately EUR 38.85 million), and the average number of employees for the reference period is lower than 250;

- small entities – balance value of assets is less than BGN 8 million (approximately EUR 4.09 million), net profit from sales is less than BGN 16 million (approximately EUR 8.18 million), and the average number of employees for the reference period is lower than 50;

- micro entities – balance value of assets is less than BGN 700,000 (approximately EUR 358,000), net profit from sales is less than BGN 1.4 million (approximately EUR 716,000), and the average number of employees for the reference period is lower than 10.

1.2. The Function of the Supervisory Board

1.2.1. Functions

As indicated above, only JSCs with a two-tier management system have a Supervisory Board. Its function is to represent the company in its relations with the Executive Board only and does not take part in the management of the company.

The Supervisory Board reviews the activity reports of the Executive Board and may request from the latter, at any time, to submit information or report on any issue that concerns the company. Also, the Supervisory Board may carry out checks/studies in the course of performing its duties, and, in doing so, its members have access to all of the necessary information and documents, and they may require support from experts.

1.2.2. Board Members

Specific requirements apply to all board members including to members of the Supervisory Board so as to ensure performance in the best interests of the company.

To be elected as a board member a person needs to have not been a member of a management or supervisory body of a company dissolved on grounds of bankruptcy in the last two years preceding the date of the judgment on the declaration of bankruptcy if unsatisfied creditors have remained; have not been an executive, member of the executive or supervisory board of a company that violated specific obligations related to creation and storage of amounts of certain reserves or does not meet other requirements provided for in the articles of association.

Board members have equal rights and obligations, regardless of any internal division of functions among them and the delegation of management and representation rights to any of them. They must perform their functions with due care and in the interest of the company and of all shareholders.

A person nominated to be a member of a board must, prior to their appointment, notify the General Meeting of Shareholders, or the Supervisory Board, as the case may be, of their participation in any other company as a general partner, of holding over 25% of the capital in any other company, as well as of their participation in the management of other companies or cooperatives as a general commercial proxy, executive director or a board member. An active board member must notify the company of the occurrence of any such circumstance without delay.

Board members are not allowed to disclose any information they have become aware of in that capacity, if that could affect the activity and development of the company, including after they no longer occupy this position. However, this obligation does not apply to information that, pursuant to a law, is accessible to third parties or has already been disclosed by the company.

In addition, members of the boards are required to provide a management guarantee in the amount set by the General Meeting of Shareholders but not less than their gross remuneration for three months. Also, members of the boards are jointly liable for damages caused by them to the company.

If a legal entity is elected as a board member, some of the obligations above, i.e., confidentiality obligation, a duty of care, and notification obligations apply also to the natural persons who represent it in this capacity. Also, as a board member, the legal entity is jointly and severally liable with the rest of the board members for obligations arising from the actions of its representative.

1.3. The Function of the Executive Board

1.3.1. Executive Body in LLCs

An LLC has no Executive Board as a corporate structure, the executive functions are assigned to the Executive(s). The Executive organizes and directs the company's business activity and represents the company before third parties in compliance with the law and the decisions of the General Meeting of Shareholders.

An LLC Executive can be a natural person who has not been declared insolvent, has not been an executive, member of a managing or controlling body of a company declared insolvent within the last two years preceding the date of the court order declaring insolvency if any creditors have remained with unsatisfied claims. Further restrictions refer to persons who have been executives or members of a managing or supervisory board of a company breaching the obligations related to the creation and storage of certain amounts of reserves. No legal entity can be an Executive in an LLC (i.e., only a natural person can be appointed). There are no limitations in terms of citizenship or requirements for the Executive to be residing on the territory of Bulgaria.

Where more than one Executive is assigned in an LLC, they are all jointly liable to the company for damages caused to it by any of them.

1.3.2. Executive Board in JSCs

In a JSC, the management and representation of the company are assigned to the Executive Board or the Board of Directors, depending on the type of management system. Members of both boards must comply with the requirements and perform their duties as set out in Section 1.2.

Members of the Board of Directors and of the Executive Board represent the company collectively unless otherwise provided in the articles of association. The Board of Directors, respectively the Executive Board, subject to approval by the Supervisory Board, may authorize one or more of its members to represent the company. Limitations of the representative powers of the Board of Directors and the Executive Board and of the persons authorized by them have no effect in respect of third parties.

It should also be noted that a member of the Executive Board cannot be simultaneously elected as a member of the Supervisory Board.

1.4. Conflicts of Interest and Related Party Transactions

1.4.1. Rules for Preventing Conflicts of Interest

Certain statutory restrictions apply to the voting rights of shareholders whereby a shareholder in a JSC, either in person or by proxy, is not allowed to vote on actions brought by the company against him/her or on steps to enforce their liability to the company. Similarly, a shareholder in an LLC is not allowed to participate in the voting process on their expulsion.

LLC Executives are not allowed, without prior approval by the company, to engage in commercial transactions in their own or in a third party's name; participate in general and limited partnerships and in limited liability companies, or hold positions in management bodies of other companies with similar (competing) activity.

Similar rules apply also to members of the Board of Directors and the Executive Board of a JSC who, unless otherwise prescribed by the articles of association or explicitly approved by the electing body, are not allowed, on their own behalf or on behalf of another, to engage in commercial transactions, to participate in other companies as general partners, or to be appointed as general commercial proxies, executives or board members of other competing companies. If a legal entity is elected as a board member, this obligation applies also to the natural person who represents it in this capacity.

Further, statutory representatives of an LLC/JSC are prohibited from engaging in transactions with themselves without the prior approval of the company. However, this restriction does not apply to transactions between legal entities in which the same natural person acts as the statutory representative of both parties. Also, this rule does not apply to agreements between the sole owner and the company, when represented by the sole owner.

1.4.2. Regulation of Related Party Transactions

A decision of the General Meeting of Shareholders of a JSC is required for the assumption of obligations or furnishing security to related parties, the amount of which exceeds half of the company's value of assets as per the most recent audited annual financial statement. Where the articles of association allow such a decision to be adopted by the Board of Directors or Executive Board, it must be unanimous and, in JSCs with a two-tier management system, pre-approved by the Supervisory Board.

Board members are required to notify the Board of Directors/ Executive Board if they or parties related to them engage in transactions with the company if the transaction falls outside of the scope of its activity or significantly deviates from the market conditions. In such a case, the transaction should be pre-approved by the respective board.

Transactions between related parties are not forbidden from a

tax perspective, however, they should take place under market conditions in line with the arm's length principle.

Publicly traded/listed companies (Public Companies) apply additional measures when it comes to various related party transactions, including prior approvals by the General Meeting of the Shareholder.

1.5. Legal Framework for Large Companies

There is no difference in the legal framework for large companies compared to small and medium size companies.

Specific legal regulations apply to Public Companies. In addition, there are special rules for specific categories of companies, among others, banks, insurance companies, companies operating pension funds, special purpose vehicles, and others. Overall, the information in this Guide does not cover the special rules for such specific categories of companies.

Public Companies are JSCs whose shares are registered with the Bulgarian Financial Supervision Commission register for trading on a regulated market or which have more than 10,000 shareholders on the last day of two consecutive years. The mandatory corporate bodies of a Public Company are those of a standard JSC (see Section 1.1.), however, stricter standards and requirements apply to their members (e.g., independence of a number of the members, no conviction for relevant criminal activities, etc.).

It is worth mentioning that there are certain statutorily defined positions in Public Companies, however, they hardly might be treated as "corporate bodies," such as an investor relations director or bond holders' trustee (in the case of the issuance of bonds).

2. Corporate Governance Framework

2.1. Transparency and Public Disclosures

2.1.1. Standard LLCs and JSCs

The names of shareholders in LLCs, sole shareholders in JSCs, Executive(s), and members of the boards are publicly disclosed and registered with the *Bulgarian Commercial Register* and *Register of Non-Profit Legal Entities* (Commercial Register).

Limitations on the representative powers of the Executives of LLC (e.g., in the case of more than one appointed Executive, they may be required to act jointly vis-a-vis third parties), are subject to registration. Other limitations are not subject to disclosure and registration and they only apply to the internal relations between the Executive(s) and the LLC. Executive members in a JSC are also indicated in the Commercial Register.

The annual financial statements of companies are subject to public disclosure. Auditor reports (when the company is subject to a mandatory audit) and annual activity reports (in the case of a JSC) are published with the Commercial Register along with the annual financial statements.

Certain categories of decisions adopted by the Board of Directors, Supervisory Board, Executive Board, and the General Meeting of the Shareholders shall be publicly disclosed, among others: decisions to amend the articles of association or any of the company data subject to mandatory entry in the Commercial Register, e.g., company name, registered seat and business address, statutory representatives and manner of representation, shareholders and allocation of shares, capital, company transformation, and winding-up. Subject to public disclosure are also certain JSC-specific decisions, e.g., the decision of the Board of Directors/Executive Board to convene a General Meeting of Shareholders and the invitation thereto, the decision of the General Meeting of Shareholders to buy out shares, decisions on the issuance and conversion of bonds.

2.1.2. Public Companies – Specific Features

Public Companies have greater transparency obligations. Such companies and their shareholders are subject to disclosure requirements that ensure adequate transparency of ownership information – the disclosure threshold is 5% of the shares. Certain changes related to the shares (e.g., changes in the rights attached to the different classes of shares, and changes in the company's capital) shall also be disclosed to the public.

The annual financial statements and annual activity report of Public Companies contain supplementary information and additional documents in comparison to those of a standard JSC, which shall be disclosed, e.g., a corporate governance declaration and a remuneration policy implementation report. Six-month financial statements, notifications for their financial status/position, and others are among the regulated information which Public Companies shall make publicly available.

Public Companies are required to have a website where certain categories of documents and information shall be published, e.g., prospectuses, notifications for public offerings, protocols of the General Meeting of the Shareholders, invitations for General Meeting of the Shareholders, code of corporate governance, remuneration policy, etc. Public Companies shall provide the necessary information for the facilitation of the exercise of shareholders' rights.

The Financial Supervision Commission shall be notified of changes in the Executive Board, Supervisory Board, Board of Directors, changes in the articles of association, and reorganization of a Public Company. This information along with other information is published in a special register held by the

Financial Supervision Commission.

2.2. Public Authorities Responsible for Monitoring Corporate Governance

There are no public authorities responsible for monitoring corporate governance for the standard LLC and JSC.

Public Companies shall either apply the corporate governance code adopted by the company itself or the National Corporate Governance Code approved by the Financial Supervision Commission. The code typically implements good practices and principles in corporate governance, including in the area of sustainable development.

2.3. ESG

ESG reporting obligations in the strict sense have not yet been implemented. However, disclosure of non-financial and diversity-related information by certain large companies and groups is mandatory.

Large companies (see Section 1.1.1.) which are public-interest entities exceeding the average number of 500 employees during the financial year shall include in the management report a non-financial statement containing information to the extent necessary for an understanding of the undertaking's development, performance, position and impact of its activity relating to, as a minimum, environmental, social and employee matters, respect for human rights, anti-corruption and bribery matters, including: a brief description of the undertaking's business model; a description of the policies pursued by the undertaking in relation to those matters, including the due diligence processes implemented; the outcome of those policies; the principal risks related to those matters linked to the undertaking's operations including, where relevant and proportionate, its business relationships, products or services which are likely to cause adverse impacts in those areas, and how the undertaking manages those risks; non-financial key performance indicators relevant to the particular business. Additional requirements apply with respect to consolidated non-financial statements.

Auditors shall check whether the non-financial statement has been provided and shall express an opinion on whether the statement has been drafted in line with the applicable regulations.

2.4. Internal Controls and Fraud Measures

The internal control in the standard LLC and JSC is related mostly to the usual exercise of the functions of the Supervisory Board/the Board of Directors and the Controller.

Certain entities which provide services of fundamental public

interest (e.g., Public Companies, credit institutions, insurance companies, companies operating pension funds, etc.) shall have an Audit Committee as a special monitoring and consulting body whose main functions are, among others, monitoring of the financial reporting process, the risk management system, and the internal audit procedures.

The Registered Auditors Public Supervision Commission develops rules and methodological guidelines with respect to the activities of Audit Committees and it makes recommendations for improving their functions.

The non-financial statement (see Section 2.2.3.) should contain information on the general features of the system for internal control and the system for risk management applicable in the process of preparation of the financial statement for companies that have an obligation to prepare and publish such a statement.

3. Shareholder And Board Committees

3.1. What Committees Are Prescribed by Law?

In respect to standard LLCs and JSCs, there is no specific regulation requiring the setting-up of Committees outside of the mandatory corporate governance bodies (i.e., Board of Directors, Executive Board, Supervisory Board, Executive(s)), neither are specialized Committees foreseen within the structure of the abovementioned boards.

Public-interest entities shall have Audit Committees (see Section 2.2.4.).

Public Companies may have a Remuneration Committee, which is an optional, not mandatory structure and its members shall be appointed by the General Meeting of Shareholders among the Supervisory Board/the Board of Directors members. Its main functions are related to drafting and submitting to the Supervisory Board/the Board of Directors the remuneration policy, as well as proposals for the individual remuneration of the Executive Board members/executive directors in the Board of Directors. Other Committees might be set up at the discretion of a Public Company.

3.2. What Committees Are Mandatory for Large Companies?

Please refer to Section 3.3.1. The rules apply irrespective of the size of the company.

3.3. Remuneration of Supervisory and Executive Board Members

In LLCs, the remuneration of the Executive is determined by the General Meeting of Shareholders.

In JSCs with a one-tier management system, the General Meeting of Shareholders determines the remuneration of the members of the Board of Directors who will not be assigned the management of the company and the Board of Directors determines the remuneration of all executive Directors elected thereby.

In JSCs with a two-tier management system, the General Meeting of Shareholders determines the remuneration of the members of the Supervisory Board and the latter determines the remuneration of all members of the Executive Board.

Public Companies apply a remuneration policy with respect to their executive and supervisory bodies. The policy shall be prepared by the Supervisory Board/the Board of Directors in cooperation with the Remuneration Committee (if any, see Section 3.3.1.) and it shall be approved by the General Meeting of the Shareholders, which is also the corporate body which shall decide on the remuneration and the amounts of the royalties. The policy is required to be reviewed every four years unless there is a need for substantial amendments in the meantime. The policy and the policy implementation report, which is part of the annual financial statement of the company, shall be published on the company's website.

The members of the executive and supervisory bodies of Public Companies shall provide a financial guarantee whose amount is usually in a certain correlation with the remuneration. Typically, the remuneration consists of permanent and variable components. Special rules on the provision of the variable component in the form of equity shares, options, or other financial instruments or regarding the rescheduling of the variable remuneration apply.

None of the information above should be considered or interpreted in any manner as legal advice and/or the provision of legal services. This guide has been prepared for the purposes of general information only. PETER-KA & PARTNERS does not accept any responsibility for any omission and/or action undertaken by you and/or by any third party on the basis of the information contained herein.



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1. Corporate Structure Of The Companies

1.1. General Legal Framework

The supreme body and the executive officer(s) are mandatory for all companies.

The supreme body functions as the decision-making organ of the members of the business association. The principal duty of the supreme body of a business association is to adopt decisions on fundamental business and personnel issues. In single-member companies, the founder or the sole member shall function as the supreme body.

The executive officer(s) shall manage the operations of the business association independently, based on the primacy of the business association's interests. In this capacity, the executive officer shall discharge their duties in due compliance with the relevant legislation, the articles of association, and the resolutions of the company's supreme body. The executive officer may not be instructed by the members of the business association (exception: in the case of single-member business associations, the sole member may instruct the management) and their competence may not be negated by the supreme body. Companies limited by shares (*reszvenytársaság (Rt.)*) shall be managed by the management board, which is comprised of at least three natural persons.

When it comes to other bodies of the companies, the differences do not come from the size of companies, but from their form.

For example, the establishment of a supervisory board (see below) and a statutory auditor are not always mandatory. All companies limited by shares shall employ an auditor. Public companies limited by shares (*Nyrt.*) are required to set up audit committees, which shall assist the supervisory board or the board of directors (instead of the executive officer). Where so provided for by the articles of association of private companies limited by shares (*Zrt.*), the general director shall function as the chief executive officer in exercising the powers of the management board.

Furthermore, the company's supreme body can provide for the setting up of other organs in addition to the bodies and officers defined in the *Civil Code (Act V of 2013 on the Civil Code)*.

As a general rule, all companies are required to have at least one member. The exceptions are the general partnerships (*közkereseti társaság*) and the limited partnerships (*betéti társaság*).

If the number of members of a general partnership drops to one, within six months from that time the partnership shall report to the court of registry the admission of a new member to the partnership, or shall resolve the transformation, merger,

or dissolution without succession of the partnership.

If the membership of all general partners or all limited partners ceases to exist, within six months from that time the partnership shall report to the court of registry that its memorandum of association was amended so as to reinstate the conditions for functioning as a limited partnership, or that the limited partnership has been converted into a general partnership, or that the transformation, merger, dissolution without succession of the partnership has been resolved.

As a general rule, companies that have a separate legal personality (e.g., a company limited by shares (*Rt.*) or a limited liability company (*Kft.*)) shall be liable for their debts with their own assets; members and founders of a company shall not be held liable for the company's debts.

An exception to the above rule is that in the event of abuse of limited liability on the part of any member or founder of a company, on account of which any outstanding creditors' claims remain unsatisfied at the time of the company's dissolution without succession, the member or founder in question shall be subject to unlimited liability for such debts.

Members of a general partnership shall undertake joint and several liability for the partnership's obligations not covered by the assets of the partnership.

When it comes to limited partnerships the general partner(s) undertake(s) joint and several liability for the partnership's obligations not covered by the assets of the partnership, while the limited partner(s) is/are not liable for the obligations of the partnership.

There are no specific requirements set by law for a person, to become a shareholder of a company, but the Court of Registration may prohibit a member or officer of a company from practicing if the conditions laid down by law are met. A person subject to a prohibition may not acquire a majority influence in a company, may not become a member of a company with unlimited liability, a member of a sole corporation, or an executive officer of a company.

1.2. The Function of the Supervisory Board

The supervisory board must consist of at least three members. A supervisory board is required in any of the following circumstances: **(a)** in the case of public companies limited by shares (except if a council of directors is appointed) or **(b)** in the case of private companies limited by shares, if the shareholders holding together at least 5% of the voting rights so require or **(c)** the company employs more than 200 full-time employees and the works council did not relinquish the employee participation in the supervisory board. Members of the supervisory board may be natural or legal persons. If the

supervisory board member is a legal person, that legal person shall designate a natural person to discharge the functions of the supervisory board member in its name and on its behalf. The rules pertaining to supervisory board members shall apply to the designated person as well. The members of the supervisory board are elected by the members of the company.

The supervisory board shall assess all motions brought before the decision-making body of members or founders, and shall present its opinion thereof at the meeting of the decision-making body.

The supervisory board shall have access to the documents, accounting records and books of the legal person, and shall be entitled to request information from the legal person's executive officers and employees, and to inspect the legal person's payment account, cash desk, securities portfolio, inventories and contracts, or to have them inspected by an expert.

If the supervisory board wishes to engage the services of experts in the course of its supervisory activities, management shall fulfill the supervisory board's request.

If the company has a supervisory board, the supreme body of the company may adopt a decision concerning the financial report in possession of the written report of the supervisory board.

If, in the judgment of the supervisory board, the activity of the management is contrary to the law, to the instrument of constitution, or to the resolutions of the business association's supreme body, or otherwise infringes upon the interests of the business association, the supervisory board shall have the right to convene the meeting of the business association's supreme body to discuss that issue and to take the necessary decisions.

It is also possible under the instrument of constitution to establish a "peremptory supervisory body." In this case, the supervisory board is given responsibility under the instrument of constitution for the taking or approval of decisions that otherwise fall within the competence of the supreme body or management.

Members of the supervisory board are obliged to perform their duties prescribed by the *Civil Code*. They shall be held liable for damages caused to the legal person resulting from their omission of supervisory responsibilities.

1.3. The Function of the Executive Board

The persons who are elected as managing directors (or members of the management/executive board) represent the company in relation to third parties and have full powers of management. Business associations are represented by their executive officers vis-à-vis third parties and before the court and

other authorities. Any restriction of the power of representation vested upon the legal person's authorized representative shown in the company registry, or rendering such representative's actions conditional or subject to approval must not be effective towards third parties, except if the third party knew or should have known about the restriction or about the condition or approval requirement and the lack thereof. However, it is also possible to deviate from the general provisions and appoint an executive officer without any power of representation. In this case, it shall be indicated in the company register that the executive officer has no power of representation towards third parties. In practice, this may be a practical solution for *RtS*, when not all members of the board of directors have the right to represent the company.

As mentioned before, companies limited by shares (*RtS*) shall be managed by the management board. The management board represents the company in relation to third parties and has full powers of management. The management board exercises its powers as a corporate body. The management board is comprised of at least three natural persons.

Where so provided for by the articles of association of private companies limited by shares, the general director shall function as the Chief Executive Officer in exercising the powers of the management board.

In addition to the duties assigned to the executive officer, the management board shall prepare a report on the management, the financial situation, and the business policy of the company at least once every year for the general meeting, and at least once every three months for the supervisory board (if the company limited by share has one).

Where the articles of association of a public company limited by shares so provides, the limited company shall be controlled by the board of directors under a one-tier system instead of the management board and the supervisory board. The board of directors shall perform the duties of the management board and the supervisory board conferred upon them by law.

The majority of the board of directors shall be made up of independent persons. A board member shall be considered independent if apart from their seat on the board of directors and apart from any transaction conducted within the company's usual activities aiming to satisfy the board member's personal needs, they are not holding any other position.

As far as limited liability companies (*Kft.*) are concerned, the member's meeting (as the supreme body) and the management (one or more managing directors) are the main organizational bodies. Those provisions, however, are non-restrictive, i.e., as a general rule, further bodies may also be established within the company. Therefore, in accordance with the Hungarian

court practice a management board (or executive board) can be established at limited liability companies (*BDT2015. 3272.*) as well (not only for public companies limited by shares) that could also include the managing directors as board members (it is recommended to have an odd number of board members for a clear decision-making process).

1.4. Conflicts of Interest and Related Party Transactions

The executive officers may not acquire any share in the capital of a business association – except for the shares of a public company limited by shares – and may not be executive officers in a business association which is engaged in the pursuit of the same economic activity as its main activity, as the business association in which they hold an executive office.

In the event of accepting a new executive office, within 15 days of accepting such office, the executive officer shall notify any other company in which they already serve as an executive officer or a supervisory board member.

With the exception of everyday dealings, an executive officer and their close relatives may not conclude any transactions falling within the scope of the main activities of the business association in their own name and on their own behalf.

There are no rules prohibiting related party transactions, but if in the agreements and contracts between affiliated companies a higher or lower consideration is applied than the fair market price, the taxpayer takes the difference between the fair market price, and the consideration applied and shall deduct it from the pre-tax profit. If the value of related party transactions reaches HUF 50 million per year, the company must prepare a transfer pricing report.

1.5. Legal Framework for Large Companies

There are no specific legal provisions regarding large companies in terms of mandatory corporate bodies. As mentioned before, the differences do not come from the size of the companies, but from their form.

2. Corporate Governance Framework

2.1. Transparency and Public Disclosures

Each of the 19 Hungarian counties and Budapest has its own Court of Registration, which supervises business entities, ensures that all corporate documents, such as articles of association, are in accordance with statutory rules and checks that corporate decisions conform with the articles of the company. All changes, for example, of the board of directors, capital structure, or head office, must be reported to the Court of Registration. Each Court of Registration can provide informa-

tion regarding which particular Court of Registration maintains the records of a specific company.

As a general rule, if there is a publication obligation for legal persons, it must be satisfied by way of publication in the Company Gazette (*Cégközlöny*). For example, such an obligation arises if a change in the company needs to be registered. The Court of Registration is a public office. The register of enterprises and their documents may be inspected by anyone. Photocopies and certified copies of the documents are available.

Each of the 19 Hungarian counties and Budapest has a computerized registry of business enterprises which constitute the central database. The records are available online at the website www.e-ceggyezek.hu/?cegkereses. The companies may be searched by their names, registration numbers, tax numbers, or registered seat. The *Tarolt cégkivonat* (stored company extract) contains certain basic data – including the changes – pertaining to the registration number, company's name (and short name), company's legal form, date of registration, headquarters' address, addresses of the permanent establishments and branch office, date(s) of the incorporation document, amount of capital, tax number, data of the authorized persons to represent the company, data of the auditors, data of the predecessor company, statistics number, company's activities, account number, electronic contact details, subscribed capital, European Unique Identifier, and authorized business activities. In addition, there are data depending on the legal form of the company such as the data of the members of the company, the data of the member or representative who has been prohibited from practicing a profession, an indication if there is any lien filed on a business share, the commencement and closure of the deletion, bankruptcy or winding-up proceedings.

'*Cégadatok*' (data of the company) contains only the actual data pertaining to the company's name, headquarters' address, addresses of the permanent establishments and branch office, company's activities, subscribed capital, tax number, commencement and closure of the deletion, bankruptcy or winding-up proceedings, the data of the member or representative who has been prohibited from practicing a profession.

People search: www.e-ceggyezek.hu/?szemelykereses.

Search on prohibited persons: www.e-ceggyezek.hu/?eltiltottkereses.

Information is only available in Hungarian. Some central registry partner services offer English language material. See the list of resellers at <http://occsz.e-ceggyezek.hu/?szerzodeskotes>. This lists resellers who offer services including people search.

Details of registered firms are also published in the *Cégközlöny* (Company Gazette) available online at www.cegkozlonny.hu free

of charge.

Information is searchable by company name or registration number and by document category such as bankruptcy (www.cegkozlonny.hu/kereses). The Gazette includes the following information on each new company registered and any amendments: registration number, company's name, company's registered address, date of the company's articles of association, the scope of the company's activities indicated in the articles of association with statistical codes, amount of capital including cash and in-kind contribution, means of representation (sole or joint), names of representatives, company's tax, social security account and statistical number, company's bank account numbers, date of registration, the company's address for electronic service of process.

Enterprise annual reports and financial statements, where required to be filed, can be downloaded for free from the website <https://e-beszamolo.im.gov.hu/oldal/kezdolap>, which is operated by the *Igazságügyi Minisztérium Céginformációs és az Elektronikus Cégeljárásban Közreműködő Szolgálat* (Ministry of Justice Information and Electronic Company Registration Service).

In connection with the accounts of enterprises, the last year's net revenue and the number of employees are also available at www.ceginformacio.hu both in English and in Hungarian.

Public companies limited by shares shall make their general meeting resolutions (the Shareholders' Assembly decisions) and their remuneration policy and remuneration report available to the public on their website. The decisions of the Supervisory Board do not need to be publicly disclosed.

Details of the shareholders of a *Kft* and the shareholders of a *Zrt* having at least 50% shareholding or a qualified majority interest in the *Zrt* are available at the Court of Registration. The following details are provided: the natural person's name, address, date of birth, mother's maiden name; the legal entities' seat, registration number, as well as disclosing that a shareholder has at least 50% of the shareholding or qualified majority interest in the *Kft*.

Further information about shareholders (for example, the number of shares or interim shares, and the percentage of control of shareholders for each series of shares) may be found in the publicly available articles of association and in the register of shareholders.

Hungary is introducing a register of ultimate beneficial owners. The content of the register will be provided in several phases and shall be managed by the National Tax and Customs Administration of Hungary (Tax Authority). As a first step, banks managing commercial bank accounts were responsible for submitting the names of their clients' beneficial owners

to the Tax Authority until June 12, 2021. From then onwards, the banks have to report monthly. After February 1, 2022, other service providers also gained access in order to compare their client's beneficial ownership data with the content of the register. From the same date, in compliance with their legal obligations, authorities, prosecutors, and the courts are able to download and disclose data, while third parties will have access to the content of the UBO Register for a fee only after July 1, 2022. The Hungarian UBO Register will only be linked to the European Central Register as of February 1, 2023.

2.2. Public Authorities Responsible for Monitoring Corporate Governance

Corporate governance, auditing, and reporting rules are regulated by statutory provisions. Compliance with the rules on auditing and reporting is primarily monitored by the National Tax and Customs Administration, but also by the company registration court in the course of its judicial oversight proceedings. Compliance with the legislation on corporate governance is monitored by the court of registration in the context of its judicial oversight proceedings.

The *Civil Code* declares that general legal supervision is exercised by the court registering the legal entity, and if the measures taken by the court to restore lawful operation fail, the court of registration shall dissolve the legal entity.

2.3. ESG

Large companies which are public-interest entities where on the balance sheet date in the previous two consecutive financial years either two of the following three indices exceed the limits indicated below:

- a) the balance sheet total exceeds HUF 6,000 million,
- b) the annual net turnover exceeds HUF 12,000 million,
- c) the average number of employees in the financial year exceeds 250 persons;

and the average number of employees in the given financial year exceeds 500 persons;

shall publish a non-financial statement containing information to the extent necessary for an understanding of the company's development, performance, position, and impact of its activity, relating to, as a minimum, environmental, social and employee matters, respect for human rights, anti-corruption and bribery matters.

The annual report also shall contain environmental protection-related information.

The above provisions are the result of European Union legislation. There is no other explicit authority in Hungary that sets

such requirements. The legal possibility to conduct a judicial oversight proceeding exists, but in practice, this is not really the case.

2.4. Internal Controls and Fraud Measures

The supervisory board is responsible for internal control. A supervisory board must be established if the annual average number of full-time employees employed by the business association exceeds 200 persons, and the works council did not relinquish employee participation in the supervisory board. Public limited companies shall establish a supervisory board mandatorily. In the case of private limited companies, if so requested by a group of shareholders together controlling at least 5% of the voting rights, a supervisory board shall be established.

The supervisory board is not audited and its decisions do not need to be published.

3. Shareholder And Board Committees

3.1. What Committees Are Prescribed by Law?

There are no committees that must be established based on a legal requirement, except the audit committee. Only public companies limited by shares are required to set up audit committees, which shall provide assistance to the supervisory board or the board of directors in supervising the financial report regime, in selecting an auditor and in working with the auditor.

The general meeting (shareholders' assembly) shall elect the audit committee from among the independent members of the supervisory board or the board of directors. At least one member of the audit committee shall have competence in accounting or auditing. The audit committee is comprised of at least three members.

According to the *Civil Code*, the members and founders of the company may deviate in the articles of association from the provisions of the *Civil Code* regarding the organizational structure and operational arrangements of the company. Therefore, in addition to the mandatory structure, further bodies (e.g., committees) may also be established within the company.



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3.2. What Committees Are Mandatory for Large Companies?

As mentioned before, the differences do not come from the size of the companies but depend on their form.

3.3. Remuneration of Supervisory and Executive Board Members

The executive officers, supervisory and executive board members perform their duties under a mandate agreement or under an employment contract concluded with the company. The amount of remuneration shall be specified in the underlying mandate agreement or employment contract. If the supervisory and executive board members perform their duties within the framework of an employment relationship, the remuneration shall reach at least the minimum wage in force.

Besides this, there are no rules in force concerning the amount of remuneration of the supervisory and executive board members.

However, in public companies limited by shares, the general meeting shall have exclusive jurisdiction to put the remuneration policy to an advisory vote. The remuneration policy shall be put on the agenda of the general meeting (shareholders' assembly) in the case of significant changes therein, or at least every four years. Furthermore, the remuneration report of the most recent fiscal year shall be put on the agenda of the general meeting and submitted to an advisory vote. These decisions are only advisory, so they do not strictly determine remuneration policy and reporting. However, if shareholders do not consider the remuneration report to be acceptable, they may even recall the directors or supervisory board members whose remuneration they have concerns about.

As mentioned before, public companies limited by shares shall make their remuneration policy and remuneration report available to the public on their website. The remuneration policy must be available on the website of the company for the duration of its validity and the remuneration report must be available on the website for at least 10 years.



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1. Corporate Structure Of The Companies

1.1. General Legal Framework

In a limited liability company, there is no shareholder limit despite the company being a private (UAB) or public one (AB).

Another popular legal form – a small partnership (MB), which is also a limited liability legal entity, has a maximum member count of 10. However, such members can only be natural persons. This legal form is often chosen by startups due to no requirements for initial contributions in the authorized capital, simplified accounting, ability to work as a CEO under a service agreement (in a public or private limited liability company (UAB and AB) an employment contract is mandatory for the CEO, naturally applying higher tax rates).

In general, there are no specific requirements a shareholder must meet to own shares in a Lithuanian company. Certain legal forms (e.g., credit unions) and companies (e.g., banks) have stricter capital and UBO transparency requirements. However, if an investor intends to start a regular business in Lithuania, the freedom of establishment is usually not limited. However, banks can refuse to open bank accounts for the company if the incorporator does not comply with AML requirements (e.g., the source of capital leads to untransparent jurisdictions or states subject to international or EU sanctions).

Generally, a shareholder is not liable under the obligations of a limited liability company. However, in case a shareholder abuses the limitation of his liability and acts in bad faith (e.g., adopts a decision to distribute dividends when the company is in debt to its creditors), courts can apply direct liability to the shareholder.

Separate legal acts establish different criteria under which a business is regarded as very small, small, medium, or large.

The criteria mostly are: **(i)** held asset value; **(ii)** turnover per business year; **(iii)** average employee amount.

For example, the *Law on Corporate Accounting*, which sets different accounting requirements depending on the company's size, distinguishes accordingly:

■ A company is regarded as very small if at least two of the following criteria are not exceeded:

- Asset value specified in the balance sheet – EUR 350,000;
- Net annual turnover – EUR 700,000;
- Average annual employee count – 10.

■ A company is regarded as small if at least two of the following criteria are not exceeded:

■ Asset value specified in the balance sheet – EUR 4 million;

■ Net annual turnover – EUR 8 million;

■ Average annual employee count – 50.

■ A company is regarded as medium if at least two of the following criteria are not exceeded:

■ Asset value specified in the balance sheet – EUR 20 million;

■ Net annual turnover – EUR 40 million;

■ Average annual employee count – 250.

■ A company is regarded as large if at least two criteria of a medium company are exceeded.

1.2. The Function of the Supervisory Board

A Supervisory Board supervises the company's business operations. If a Supervisory Board is absent, an Executive Board can take upon its functions.

It is responsible for:

■ election of the members of the board (if no board is formed, the CEO) and their removal from office (if the company operates at a loss, the supervisory board must advise on the suitability of the members of the board (if no management board is formed, the CEO) to exercise their office);

■ supervising the activities of the board and the CEO;

■ submitting proposals and comments to the general meeting of shareholders regarding the company's business strategy, the annual financial statements, the company's draft of profit/loss distribution and the annual report of the company as well as the business activities of the board and the CEO;

■ proposing the repeal of decisions of the CEO or the board if they contradict the laws of the Republic of Lithuania, the Articles of Association of the company, or the decisions of the general meeting of shareholders;

■ deciding on other issues which fall within the competence of the supervisory board in the Articles of Association and decisions of the general meeting of shareholders.

To ensure competencies of long-term viability, a Supervisory Board must be re-elected not longer than every four years. Its functions cannot be assigned to other organs, only in the exceptional case provided above.

To ensure a proper strategical direction and the best inter-

ests of the company, the members of the Supervisory Board have an obligation to protect all trade secrets and commercial information obtained throughout the period they are in such a position. They are also obliged to avoid any conflict of interest or, if it arises, inform other organs of the company.

1.3. The Function of the Executive Board

The Executive Board discusses and decides on the business strategy of the company, the annual and interim report of the company, the management structure of the company and the positions of the employees, the positions to which employees are recruited through competition, regulations of branches, and representative offices of the company.

The board is also responsible for the appointment and dismissal of the CEO of the company. Their salary, working conditions, etc. are also determined by the board. It is also responsible for the timely and proper convening of the general meeting of shareholders. The board determines which information of the company shall be considered to be commercial/trade secret and confidential.

The Executive Board makes decisions on:

- the company to become an incorporator or a member of other legal persons;
- the opening of branches and representative offices of the company;
- the investment, disposal, or lease of fixed assets with a balance sheet value higher than 1/20 of the company's share capital (calculated separately for every type of transaction), unless the company's Articles of Association provide for a different value;
- the pledging and mortgaging of fixed assets with a balance sheet value higher than 1/20 of the company's share capital (the total amount of transactions is calculated), unless the company's Articles of Association provide for a different value;
- the provision of a guarantee or a warranty for the liabilities of third parties whose amount is higher than 1/20 of the company's share capital, unless the Articles of Association of the company provide for a different value;
- the acquisition of fixed assets whose purchase price is higher than 1/20 of the company's share capital, unless the Articles of Association of the company provide for a different value;
- other matters which are within the competence of the board in the *Law on Companies*, in the Articles of Association of the company, or by the decisions of the general meeting of share-

holders.

The members of an Executive Board are obliged to follow fiduciary duties, which mean, among other things, being loyal to the company (e.g., avoiding conflict of interest), and acting in the best interest of the company. Other duties include acting with extra professional care and integrity and abiding by the law and decisions of organs that are in higher command. Members of the Executive Board also have the duty of protecting confidential information and trade secrets of the company.

If the board *in corpore* has made an unlawful decision or the decision against the interest and purpose of the company, such action can be declared void, if: **(i)** it violates the mandatory laws; **(ii)** the incorporation documents of the company; **(iii)** or the principles of reasonableness and fairness.

In case of a violation of these duties, the Executive Board members may be subject to civil liability, meaning the members may have to reimburse the damages caused by their unlawful acts. Liability can be addressed from two perspectives: liability of the whole Executive Board (*in corpore*) or liability of each individual member.

1.4. Conflicts of Interest and Related Party Transactions

In general, the Executive Board members and governing bodies have a duty to avoid any conflicts of interest with the company.

To mitigate the risks of any transactions with related parties, a member of the Executive Board of a company shall be obliged to inform other governing bodies and shareholders of the circumstances where his interest conflicts with the company's interests. Such notice must indicate the nature and, where possible, the value of the interest. This information shall be given in writing or recorded in the minutes of the meeting of the organs company.

1.5. Legal Framework for Large Companies

See Section 3.1.

2. Corporate Governance Framework

2.1. Transparency and Public Disclosures

Although the general rule is that in Lithuania corporate decisions made by bodies of a legal entity are not publicly available, information about some of them (the fact of their adoption and the most important circumstances) shall be disclosed publicly. This applies to, for example, capital reduction, name change, reorganization (merger, division), conversion, and liquidation.

The law imposes a statutory obligation on the Articles of Association of a legal person to provide for the sources in which the mentioned facts shall be published. Such sources may be a daily newspaper of the Republic of Lithuania or an electronic publication for public announcements issued by the manager of the *Register of Legal Entities*. In practice, the second option is more common.

A very large part of the data on natural and legal persons is held in national registers. The data from the *Register of Legal Entities*, the documents held in it, and other information submitted to the register are public. Some of the services and data in this register are provided and made available free of charge, but normally a fee, set by the Government, must be paid for the service provided. For a fee, an extract of the company can be ordered and documents such as the Articles of Association and financial statements can be accessed.

The data of the *Real Estate Register* on immovable property, the rights *in rem*, the holders of these rights, the restrictions on the rights *in rem*, and other indications registered in this register are also public.

In addition, a register of beneficial owners was launched in Lithuania this year. This register is in place to prevent money laundering and terrorist financing and ensure transparency. Financial institutions and other obliged entities, such as auditors, bailiffs, and notaries, have a duty to check the information contained in it. However, the data in this register is also available to the public, who can request, for example, an extract of the identification data of the beneficial owners of a particular legal entity.

Listed companies as the ones with a higher degree of publicity should be singled out. For instance, they must publish the following information: annual and semi-annual financial information; notifications about the acquisition or loss of a package of shares and other financial instruments that grant voting rights; notifications about the acquisition or loss of own shares; notifications about the choice of its home Member State.

2.2. Public Authorities Responsible for Monitoring Corporate Governance

There is no universal set of good governance rules that can be applied to all companies, nor is there a specific body whose main function is to oversee the implementation of good governance.

It is different in the case of state-owned and municipal-owned enterprises because the state has approved the management policy of these entities (the policy is based on the *OECD Guidelines on Corporate Governance of State-Owned Enterprises*). The Management Coordination Centre has to monitor the govern-

ance of the mentioned enterprises, and the good governance index is used to assess the quality of their governance.

Companies whose securities are admitted to trading on a regulated market in the Republic of Lithuania are subject to the *Corporate Governance Code for the Companies Listed on NASDAQ Vilnius*. Although it is a recommendatory document, issuers must indicate in the annual report how they comply with this code, and if it is not complied with, the reasons for such non-compliance must be reflected in the said report.

The governance of companies operating in supervised sectors is monitored by supervisors, but only through the lens of regulatory compliance (the legislation itself enshrines many governance principles). For example, the Bank of Lithuania, the State Tax Inspectorate, the State Territorial Planning and Construction Inspectorate, the State Labour Inspectorate, and the State Data Protection Inspectorate.

2.3. ESG

This is regulated by the *Law on Corporate Accounting*, the *Law on Consolidated Reporting of Groups of Companies*, and the *Law on Public Sector Accounting*.

These laws provide for social responsibility reporting or similar information in certain forms of annual reports of legal entities.

The social responsibility report shall contain information relating to environmental questions, distinguishing climate, social and human resources issues, human rights, and anti-corruption and anti-bribery issues, with a special focus on bribery of foreign officials in international business transactions, as well as other information required under Article 8 of *Regulation (EU) 2020/852*. The information shall be provided to the extent necessary to understand the development, performance, condition, and impact of the undertaking.

Small and medium-sized enterprises shall have the right not to provide the reports and analyses mentioned above.

Public sector undertakings are required to provide a narrative analysis of their non-financial performance as a necessary part of the annual activity report.

Annual activity reports of public sector undertakings are submitted to the National Audit Office of Lithuania or municipal control and audit offices. For other companies, the annual report, together with the auditor's report (where an audit has been carried out), is made public in the *Register of Legal Entities* and, in some cases, on the companies' websites. Failure to comply with these obligations is subject to legal liability.

The content requirements for the relevant reports are deter-

mined by the directly referenced laws and it is recommended to follow the recommendations set out in the *European Commission Communication on the “Guidelines for non-financial reporting” (2017/C 215/01)*.

2.4. Internal Controls and Fraud Measures

An internal audit is mandatory for public legal entities that are public sector entities.

Additionally, the audit of financial statements is mandatory for the following companies: **(i)** state and municipal companies, **(ii)** public interest companies; **(iii)** joint stock companies; **(iv)** private limited liability companies in which the State and/or the municipality is a shareholder; **(v)** private limited liability companies whose prices of goods/services are regulated by law; **(vi)** private limited liability companies, cooperative societies (co-operatives), general partnerships and limited partnerships in which all the full members are joint-stock companies or private limited liability companies if at least two of their indicators on the last day of the financial year exceed the following values: net sales revenue during the reporting financial year – EUR 3.5 million; the value of assets indicated in the balance sheet – EUR 1.8 million; and the average annual number of registered employees during the reporting financial year is 50.

The compilation of financial reports, the annual report, and the audit report must be submitted to the *Register of Legal Entities* within 30 days after the general meeting of shareholders, which are publicly available, meaning every person is authorized to obtain a copy of it. A copy of it can be obtained from the *Register of Legal Entities* upon request or directly downloaded from the internet. These services are subject to a fee.

The independence of the internal audit is regulated by the *Law on Internal Control and Internal Audit* of the Republic of Lithuania, as well as by the *Order of the Minister of Finance of the Republic of Lithuania No 1K-402 of 23 December 2019 “On Implementation of Internal Audit.”*

The independence of the audit of financial statements is regulated by the *Law on the Audit of Financial Statements* of the Republic of Lithuania; international standards and *Regulation of the European Parliament and the Council (EU) No. 537/2014*.

3. Shareholder And Board Committees

3.1. What Committees Are Prescribed by Law?

First of all, it should be mentioned that the main bodies in a company are the General Meeting of Shareholders and the sole management body – the CEO. The Executive and the Supervisory Boards are often a matter of company decision-making, i.e., the company is free to decide whether such a

body is necessary.

In specific cases, the law foresees an obligation to establish one or both collegial bodies (the Executive Board and the Supervisory Board). For example, in a public limited liability company (AB), either an Executive Board or a Supervisory Board is mandatory. Other situations are mainly related to individual groups of undertakings, considering the importance of such companies to society, the scale of operations, the number of customers, etc. For example, in a credit union, the Executive Board is a mandatory collegial governing body, while in a bank, both the Executive and the Supervisory Board must exist.

A similar principle applies to the establishment of committees and commissions. In many cases, companies themselves assess the need for their creation and the scope of the issues to be addressed. However, there are exceptions to this rule.

Legislation requires some public interest entities, such as listed companies (where securities are traded on a regulated market in Lithuania and/or a Member State), banks, and insurance and reinsurance companies, to establish an Audit Committee.

A few examples of when the establishment of a Remuneration Committee is mandatory: **(i)** for a brokerage firm, where the average value of on-balance-sheet and off-balance-sheet assets for the four-year period prior to the last day of the financial year exceeds 100 million euros; and **(ii)** for a management company, where it is important because of its own/or the collective investment undertaking's it manages size, organizational structure, and the nature, scale, and complexity of its activities.

Depending on the field of activity, certain companies are required to set up special purpose committees. For instance, credit unions are required to have Loan Committees (that consider loan applications from credit union members, determine the terms and conditions of the loan disbursement and repayment, etc.), while a brokerage firm that has exceeded the above-mentioned financial ratios is required to have a Risk Committee (to advise the management of the brokerage firm on the risks it has taken on, the firm's risk-management strategy, and to assist them in overseeing the implementation of that strategy by senior management).

According to the aforementioned *NASDAQ Vilnius Corporate Governance Code*, issuers falling under the scope of the code are required to establish Audit, Remuneration, and Nomination Committees. If they choose to have less than these three committees, such an alternative approach should be explained. The functions of the Nomination Committee are to select candidates for vacancies in the supervisory and management bodies and to recommend them to the collegiate body for consideration, to regularly assess the structure of the supervisory and management bodies, etc.

3.2. What Committees Are Mandatory for Large Companies?

See Section 3.1.

3.3. Remuneration of Supervisory and Executive Board Members

Members of the Executive and Supervisory Boards may be paid bonuses for their work on the Board. In such a case, the decision of the General Meeting of Shareholders on the distribution of a company's profit/loss must indicate, among other things, the portion of profit allocated for the payment of annual bonuses to members of the Executive and the Supervisory Boards.

The portion of the profit of the reporting financial year allocated for the payment of annual bonuses to members of the Executive and the Supervisory Boards may not exceed 1/3 of the portion of the profit allocated for the payment of dividends.

If a company fails to pay the taxes prescribed by laws within the established time limits, it may not pay the annual bonuses to members of the Executive and the Supervisory Boards. It shall be prohibited to pay bonuses to the members of the Executive and the Supervisory Boards in advance.

According to the case law of the Lithuanian courts, the shareholders' meeting or other authorized bodies of the company may set different sizes of bonuses for different members of the same collegial body (the Executive/Supervisory Board). Such differentiation must be based on specific criteria, and the choice of criteria for the distribution of bonuses is at the discretion of the shareholders' meeting or other authorized bodies of the legal person.

In this context, public limited companies whose shares are admitted to trading on a regulated market (i.e., listed companies) again stand out. Under the current legal framework, their General Meeting of Shareholders must approve the Remuneration Policy. The CEO is responsible for drafting such a policy and publishing it on the company's website.

The Remuneration Report must also be published on the listed company's website, so the remuneration data of certain individuals (the CEO, members of the Executive/Supervisory Board) is publicly available.



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CEE LEGAL MATTERS COMPARATIVE LEGAL GUIDE: CORPORATE GOVERNANCE 2023 MOLDOVA



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1. Corporate Structure Of The Companies

1.1. General Legal Framework

Moldovan legislation provides for different types of legal forms of business entities. Conventionally, these could be divided into three broad categories:

- (1) Companies (General Partnership, Limited Partnership, Limited Liability Company, and Joint Stock Company)
- (2) Cooperatives (entrepreneurial and productive), and
- (3) Enterprises (state and municipal enterprises).

The most common forms are Limited Liability Companies (LLC) and Joint Stock Companies (JSC). From a foreign investor's perspective, the choice is usually an LLC due to simple and flexible registration and operation. According to the information provided by the Agency of Public Services, as of November 1, 2022, there are 94,742 LLCs and 1,822 JSCs from a total number of 125,375 legal entities (profit and non-profit).

Both the LLC and JSC legal forms may be incorporated by one or more shareholders (which can be both individuals or legal entities, Moldovan residents, or non-residents). An LLC can have a maximum of 50 shareholders, while the maximum number of shareholders in a JSC is not limited. In both cases, the shareholders are responsible for company obligations within the limits of their contributions to the share capital.

Law on LLC No. 135/2007 and *Law on JSC No. 1134/1997* provide a similar structure of corporate bodies:

- a) Supreme decision body: General Meeting of the Shareholders (GMS) or the Sole Shareholder;
- b) Supervisory body: Supervisory Board or Council;
- c) Executive body: one or more Administrators; and
- d) Control body: a Censor or a Censor Committee.

The Supreme decision body and the Executive body are required in all legal forms of business entities. The Supervisory body is mandatory in JSCs with more than 50 shareholders. The Control body is mandatory in LLCs with more than 15 shareholders.

Moldovan legislation does not provide for any differences in respect of corporate bodies depending on the company's size: whether this is a micro, small or medium-sized company. In this regard, it is worth mentioning that in Moldova, this classification is done depending on the number of employees and the number of the company's total assets.

Public interest entities are required to comply with certain specific requirements in respect of their corporate bodies. These requirements are provided in special legislation on the capital

market, banks' activity, and insurance companies.

1.2. The Function of the Supervisory Board

The Supervisory Board represents the interests of the shareholders in the period between the general meetings and, within the limits of its powers, exercises general management and control over the company's activity. The Supervisory Board is subordinated to the GMS.

The main powers of the Supervisory Board are as follows:

- decides on the convening of the GMS, and also decides on the drawing up of the list of candidates for the election of the management bodies of the company;
- approves the market value of the goods which are the subject of a large transaction;
- decides on the conclusion of large-scale transactions and of transactions with a conflict of interest not exceeding 10% of the value of the company's assets;
- concludes contracts with the managing organization of the company;
- approves the prospectus of the offer of securities to the public;
- approves the report on the results of the issue of the shares and thereby modifies the company's charter;
- decides, during the financial year, on the distribution of the net profit, the use of the reserve capital, and the special funds of the company;
- provides to the GMS proposals on the payment of annual dividends and decides on the payment of intermediate dividends;
- approves the amount of remuneration of the company's employees.

Matters falling within the competence of the Supervisory Board may not be referred for examination to the company's Executive body. If the company's Council has not been established, does not meet the necessary quorum, or its powers have ceased, the duties of the board, except for those of convening and holding the general meeting of shareholders, shall be exercised by the GMS.

The members of the company's Supervisory Board are elected by the GMS for a term that does not exceed one year in LLCs and four years in JSCs. The same people can be re-elected an unlimited number of times. The Supervisory Board has not less than three members and, in case the JSC has more than

100 shareholders, a minimum of five members.

The member of the Supervisory Board may not be the person who:

- is convicted of fraud, theft of property by appropriation, embezzlement or abuse of office, deception or abuse of trust, forgery, false deposition, giving or taking bribes, as well as for other similar crimes;
- is a member of five councils of other companies registered in the Republic of Moldova;
- is a member of the executive body of the company or a representative of the company's management organization;
- is a member of the audit committee of the company.

Meetings of the company's Supervisory Board are held no less than once per quarter.

By the decision of the GMS, the powers of any member of the company's Supervisory Board may be terminated at any time, before the expiration of its mandate.

The *Law on JSCs* contains an entire chapter on the responsibility of the officials: members of the Supervisory, Executive, and Control bodies. The officials are obliged to act in the interests of the company and are liable for the damage caused to the company, in accordance with civil, criminal, contravention, and labor legislation.

The *Law on LLCs* provides that the rules regarding the diligence, loyalty, and liability of the executive body are accordingly applicable to the members of the Supervisory Board.

1.3. The Function of the Executive Board

The Executive Board shall cover all matters relating to the management of the company's business, except for matters falling within the competence of the GMS or of the Supervisory board.

The Executive Board is formed of one or more Administrators, designated by the Supervisory Board or the GMS, according to the procedure established by the company's Charter. The individuals appointed as Administrators of a company must be registered in the *Register of Legal Entities*.

The Executive Board ensures the fulfillment of the decisions of the GMS and Supervisory Board and is subordinated either to the company's Supervisory board or to the GMS (if this is provided for by the company's Charter).

The Administrator is entitled, within the limits of his duties, to act on behalf of the company without a power of attorney,

including carrying out transactions, approving the staff lists, to issue orders. If more than one Administrator is appointed by GMS or the Supervisory Board, such Administrators will have equal powers of company's representation, except when otherwise is decided by the GMS, Supervisory Board or is stipulated in the company's Charter.

The Executive Board shall submit reports on the results of its activity on a quarterly basis to the Supervisory board or to the GMS.

The *Law on JSCs* provides the same restrictions, limitations, and responsibilities for members of the Executive Board as for the members of the Supervisory Board.

The *Law on LLCs* expressly provides that the Administrator must manage the company so that the purposes for which it was established are achieved as efficiently as possible. In the exercise of their duties, the Administrator will show diligence and loyalty. The Administrator bears full material liability for the damage caused by them to the company.

1.4. Conflicts of Interest and Related Party Transactions

The *Law on JSCs* contains extensive provisions dedicated to transactions with conflict of interest. According to Art. 84 (1), the conflict-of-interest transaction is a transaction or several mutually related transactions that meet the following *cumulative* conditions: **(a)** it is carried out, directly or indirectly, between the company and the interested person and/or its related persons; and **(b)** the value of the related transaction(s) exceeds 1% of the value of the company's assets.

Members of the Executive Board, Supervisory Board as well as the shareholders that hold alone or together with the affiliated persons more than 25% of the voting shares are considered interested persons. They must inform the Executive and Supervisory Boards of the existence of the conflict of interest. Failure to comply with this requirement could lead to compensation to the company for the failed income.

Any transaction with a conflict of interest may be concluded or modified by the company only by a decision of the Supervisory Board (if the value of the transaction does not exceed 10% of the value of the company's assets), or by a decision of the GMS.

The transactions with conflict of interest are subject to disclosure.

The *Law on LLCs* contains basic provisions in respect of conflict-of-interest transactions. The main requirements refer to the **(a)** approval by the GMS of any legal act between the administrator or a person affiliated with the administrator, and the company, and **(b)** an interdiction to exercise the right

to vote for the shareholders in cases related to the legal acts concluded between them or their affiliated persons and the company or regarding his liability towards the company.

1.5. Legal Framework for Large Companies

According to the Moldovan legislation, banks, insurance companies, private pension funds, and entities whose securities are admitted to trading on a regulated market are considered *public interest entities*. These are specifically regulated by provisions of *Law No. 171/2012 on the Capital Market*, *Law No. 202/2017 on Banks' Activity*, *Law No. 407/2006 on Insurance*, and specific regulations approved by the National Commission of Capital Market (NCCM) and the National Bank of Moldova (NBM).

The management body of a bank is represented by its Supervisory and Executive Boards. All members of the management body shall be approved by the NBM. Similarly, the officials of an insurance company have to be approved by the NCCM.

Unlike the general rule, the legislation regulating the corporate governance of banks, credit organizations, and insurance companies may establish specific rules regarding the formation of corporate bodies. For instance, the Executive Board of a bank shall consist of three individuals, elected for a term specified in the bank's Charter. The *Law on Banks' Activity* contains extensive regulation of the application of governance principles. Detailed provisions on the management bodies, competence criteria, and evaluation procedure of the officials of the banks and insurance companies are established in Regulations approved by the supervisory authorities.

2. Corporate Governance Framework

2.1. Transparency and Public Disclosures

Public interest entities, including issuers whose securities are traded on the regulated market, are subject to special disclosure obligations. The information that is to be disclosed by a public interest entity is expressly regulated by the *Law on Capital Market* and includes:

- 1) annual and quarterly reports of the entity;
- 2) interim statement of the entity's management;
- 3) information about events impacting the economic and financial activity of the entity; and
- 4) the entity's articles of incorporation.

In addition, the Law regulates specific *ad hoc* disclosure obligations, that include notification of corporate developments that have an impact on the issuer's activity, such as:

- amendments to voting rights related to different categories of securities;

- new issuances of securities;

- payment of dividends;

- conversions, fractioning, or consolidation of securities from previous issuances;

- events that may influence the activity of the issuer or the price of the securities admitted to trade.

The legislation expressly provides the obligation of all JSCs to publish information on any changes in their share capital. Public interest entities must publish in the *Official Gazette of the Republic of Moldova* and on their website the announcement on the convocation of the GMS, the agenda, and other relevant information. Voting results shall be also placed on the entity's website.

Moldovan banks must report annually on the conditions under which the bank's activity management framework is carried out, in accordance with the normative acts of the National Bank of Moldova.

The responsibility for disclosing the information lies with the executive bodies of the company.

2.2. Public Authorities Responsible for Monitoring Corporate Governance

The NCCM is the independent regulatory agency that supervises the securities market, insurance sector, and non-banking financing in Moldova. Banks' activity is supervised by the National Bank of Moldova.

A public interest entity must comply with the *Corporate Governance Code* approved by the NCCM in 2015 (Code). All other companies that are not public interest entities may follow the Code on a voluntary basis.

Public interest entities are also required to report their compliance with the Code in relation to **(i)** international corporate governance standards, **(ii)** protection of the legitimate rights and interests of shareholders, **(iii)** clarification of the roles of its governing bodies, **(iv)** functionality of the entity in a non-corrupt environment, and **(v)** promotion of the interests of managers, employees, and shareholders, as well as by other measures.

The Code prescribes specific independence requirements for the directors of public interest entities. According to the Code, at least 1/3 of the board must be composed of independent directors. The number of board members is to be sufficient to ensure the organization of the board's activity, including the ability to create board committees and allow shareholders to elect the candidate for which the shareholder has voted. The Code also requires the board to create committees for the

preliminary examination of the most important issues related to the entity's activity, such as a remuneration committee, a risk management committee, etc.

2.3. ESG

No special ESG considerations are expressly regulated by Moldovan legislation. However, in practice, public entities integrate the ESG considerations in their *Corporate Governance Codes*, namely:

- social responsibility and relations with interested parties;
- relations with employees and organizations that represent their interests;
- relations with clients;
- relations with investors;
- relations with the regulating and supervisory authorities;
- community responsibility; and
- protection of the environment.

2.4. Internal Controls and Fraud Measures

The mandatory audit of the annual financial statements is carried out at the public interest entity and at the company where the state share exceeds 50% of the share capital. The audit company may not be an affiliate of the audited company and its managing organization.

Any JSC is to publish the annual report and full audit report by April 30 and to take the necessary measures to ensure that the report remains available to the public for a period of at least five years.

3. Shareholder And Board Committees

3.1. What Committees Are Prescribed by Law?

General provisions on JSCs and LLCs are silent on the necessity of the creation of any committees, giving the entity freedom in the creation of their own organizational structure.

3.2. What Committees Are Mandatory for Large Companies?

The *Law on Banks' Activity* provides that the bank shall establish an audit committee and a risk management committee, established by the Supervisory Board.

In addition, in large banks, considerable in terms of their size, organization, and nature, extent, and complexity of their activities, the Supervisory Board shall set up the appointment

committee and the remuneration committee.

The powers, functions, and responsibilities of the specialized committees, as well as the requirements for their members, are established in the normative acts of the NBM.

3.3. Remuneration of Supervisory and Executive Board Members

The GMS approves the amount of remuneration of the members of the Supervisory Board. Remuneration of the Executive Board is established either by the GMS or by the Supervisory Board, depending on the Charter's provisions.

The *Law on Banks' Activity* contains specific provisions on the remuneration policy. According to Art. 39, a bank is obliged to establish and apply remuneration policies for the members of the executive body and for the persons holding key positions within the bank, as well as for any other employee who receives a total remuneration that places them in the same remuneration category as that of the members of the executive body and of the persons holding key positions, respecting, in a manner and to an appropriate extent in relation to the size and internal organization of the bank, its nature, scale and complexity, specific principles provide by law.

According to the NBM regulations on the requirements for the banks to publish the information, banks must publish the information on the bank's remuneration policy and practices. However, the exact remuneration granted to each member of the management bodies in a private company represents confidential information and is not subject to public disclosure.



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1. Corporate Structure Of The Companies

1.1. General Legal Framework

Polish company law is primarily regulated by the *Commercial Companies Code* of September 15, 2000, (*Kodeks Spolek Handlowych*) (CCC) with additional regulations applicable to listed companies provided for in the *Act on Public Offerings, Conditions Governing the Admission of Financial Instruments to Organised Trading and Public Companies* of July 29, 2005 (*Ustawa o ofercie publicznej i warunkach wprowadzania instrumentów finansowych do zorganizowanego systemu obrotu oraz o spółkach publicznych*) (Act on Public Offer). Moreover, the Warsaw Stoch Exchange (*Giełda Papierów Wartościowych w Warszawie*) has adopted a corporate governance related soft-law, the *Best Practice for GPW Listed Companies 2021* (WSE Best Practice), which applies to all companies listed on the WSE's Main Market (*Rynek Główny*) according to the comply-or-explain approach.

Barring the European Company (*Societas Europaea*) regulated in the *Council Regulation (EC) No 2157/2001 of 8 October 2001 on the Statute for a European company (SE)* with only a handful of entities registered in Poland, there are three types of companies provided for and regulated under Polish law: a limited liability company (*spółka z ograniczoną odpowiedzialnością*), a simple joint-stock company (*prosta spółka akcyjna*), and a joint-stock company (*spółka akcyjna*), with the limited liability company and the joint-stock company being the preferred and most-used by investors. In broad terms, a Polish limited liability company is the equivalent of the German *Gesellschaft mit beschränkter Haftung* (GmbH) or the French *Société à Responsabilité Limitée* (SARL), while the Polish joint-stock company is the equivalent of the German *Aktiengesellschaft* (AG) or the French *Société Anonyme* (S.A.).

While there are no legal requirements regarding the type of company in which a business of a certain size should operate, the form of a limited liability company is considered to be more suitable for small- and medium-size businesses with a small number of shareholders or lower capital requirements, while the form of a joint-stock company being the advisable type for the larger ones. It is worth noting that only joint-stock companies (following complying with other applicable regulatory requirements) are eligible to be listed on a stock exchange. Moreover, specific kinds of activities, mainly related to banking and other financial activities, cannot be performed by a limited liability company and should be performed by a joint-stock company. The main examples of such prohibited activities are: banking activities (involving granting credit facilities), financial holding activities, other financial intermediation, insurance activities, activities of pension funds, and trust activities.

Depending on the size of the company or the shareholders' choice, the corporate bodies of a limited liability company are:

- (i) the Shareholders' Meeting;
- (ii) the Management Board; and
- (iii) the Supervisory Board and/or an Auditors' Committee; a Supervisory Board/Auditors' Committee is, in most cases, optional.

The corporate governance of a limited liability company may operate in a one-tier or a two-tier system. The two-tier system with the Management Board (*zarząd*) as the executive body running the operations of the company and the Supervisory Board (*rada nadzorcza*) or Auditors' Committee (*komisja rewizyjna*) exercising permanent supervision over the company's activities is mandatory for limited liability companies with share capital exceeding PLN 500,000 and with more than twenty-five shareholders. Companies that do not meet both of the above requirements may choose whether to operate in a one-tier (with only the Management Board) or two-tier system.

An obligatory corporate body in each limited liability company is the Shareholders' Meeting (*zgromadzenie wspólników*) – the body making decisions concerning the company's key issues, such as (by the book, i.e. unless the articles provide otherwise, where possible): the examination and approval of annual financial statements, amendments to the articles of association of the company (*umowa spółki*), disposal or encumbrance of the company's business as a going concern or organized part thereof, acquisition or disposal of real property, appointment or dismissal of Management Board members, and other fundamental corporate activities, such as approving mergers, divisions, or transformations of the company or its dissolution. It is worth noting that most Shareholders' Meeting resolutions may be recorded in the form of minutes taken in simple written form. However, Shareholders' Meeting resolutions amending the company's articles of association, approving mergers, divisions and transformations, approving the dissolution of the company or transfer of its registered seat abroad need to be recorded in the form of minutes taken by a notary public.

The CCC grants shareholders some discretion to determine the corporate governance of a limited liability company, including the organization and powers vested in the specific corporate bodies (especially the shareholders' meeting), allowing the company's articles of association to provide for modifications relative to the statutory model.

The corporate bodies of a joint-stock company are:

- (i) the General Meeting;
- (ii) the Supervisory Board; and
- (iii) the Management Board.

Unlike in the case of limited liability companies, a joint-stock company may only operate in a two-tier system, with the Man-

agement Board as the executive body running the day to day operations of the company, and the Supervisory Board as the non-executive body, supervising the Management Board.

The corporate body representing all the shareholders of a joint-stock company is the General Meeting (*walne zgromadzenie*). Similar to the Shareholders' Meeting in a limited liability company, the General Meeting is the body making decisions on the most important company matters such as (by the book, i.e. unless the statute provides otherwise, where possible): examination and approval of annual financial statements, amending the company's statute (*statut*), disposal or encumbrance of the company's business as a going concern or an organized part thereof, acquisition or disposal of real property, appointment or dismissal of the Supervisory Board members and other fundamental corporate activities, such as approving mergers, divisions, or transformations of the company or its dissolution. All resolutions of the General Meeting need to be recorded in the form of minutes taken by a notary public.

The shareholders of a joint-stock company are granted less leeway in determining the company's corporate governance since in the case of joint-stock companies the CCC allows for fewer deviations from the statutory model.

The founders/shareholders of both a limited liability company and a joint-stock company may be one or more of the following: natural persons (*osoby fizyczne*), legal persons (*osoby prawne*), or unincorporated organizational entities that have legal capacity (*jednostki organizacyjne niebędące osobami prawnymi, którym ustawa przyznaje zdolność prawną*), e.g., partnerships.

There is no minimum number of shareholders required by law. Both a limited liability company and a joint-stock company may be incorporated by a single entity and operate as a single-member company. In such companies, the sole shareholder exercises all the powers vested in the Shareholders' Meeting and the General Meeting respectively, however, while still observing the requirements regarding the form of taking the minutes prescribed by law. To the above rule, there is one exception: neither a limited liability company nor a joint-stock company may be incorporated solely by a single-member limited liability company.

It is worth noting that for a joint-stock company to be eligible to enter any listing on the WSE, either on the Main Market (being the regulated market) or on NewConnect (being a multilateral trading facility), it must meet certain criteria regarding the free-float of the shares.

The share capital of a limited liability company shall amount to at least PLN 5,000 and is divided into shares (*udziały*) with the nominal value of one share being not less than PLN 50. In

case of a joint-stock company, the share capital shall amount to at least PLN 100,000 and is divided into shares (*akcje*) with the nominal value of one share being not less than PLN 0.01. In order to incorporate a limited liability company, shares taken up in exchange for in-kind contributions shall be fully paid up no later than one year after the company's registration. In joint-stock companies, in the case of shares taken up in exchange for cash contributions, at least one-fourth of the nominal value thereof shall be paid up prior to the company's registration. Moreover, where shares are taken up exclusively in exchange for in-kind contributions or in exchange for both in-kind and cash contributions, the contributions amounting to at least PLN 25,000 shall be paid up prior to the company's registration.

Under Polish law, in the case of both a limited liability company and a joint-stock company, a shareholder is a separate legal entity from the company and, as a matter of principle, takes no liability for the company's obligations. From a practical point of view, the business risk is limited to the capital contributed to the company; save for certain exceptions discussed in more detail below, Polish corporate law does not provide for piercing the corporate veil regulations.

There are two statutory exceptions to the above-mentioned principle. First relates to the liability of shareholders of companies "in organization," i.e., during the period following their formation (execution of the articles of association or the statute, respectively) and until their registration with the court registry. Shareholders of companies in organization shall be liable, jointly and severally with the company, for the company's liabilities up to the value of the unpaid contributions set forth in, respectively, the articles of association or statute of the company.

The second exception relates to the recently adopted "holding law." The new regulations allow to formalize existing corporate groups into so-called "groups of companies" with one dominant company. In a formalized group of companies, the dominant company may (if this is justified by the group's interest) issue binding instructions to its subsidiaries. As a result, certain additional requirements being met, the dominant company may be held liable towards the subsidiary, its remaining shareholders, but also towards third parties – the subsidiary's contractors, for damage resulting from the performance by the subsidiary of such binding instruction.

1.2. The Function of the Supervisory Board

As indicated in Section 1.1., a Supervisory Board or an Auditors' Committee are – in the vast majority of cases – optional in limited liability companies. Shareholders of limited liability companies enjoy a right of direct supervision over the Management Board's and the company's activities. However, such

right of individual supervision may be excluded in the articles of association in case a Supervisory Board or an Auditors' Committee is established.

If a Supervisory Board is established in a given limited liability company, it exercises permanent supervision over the company's activities in all aspects of its business. The Supervisory Board may inspect all documents of the company, request reports and explanations from the Management Board and employees, and audit the company's assets. The specific duties and powers of the limited liability company's Supervisory Board include:

- (i) evaluation of the Management Board's report on the operations of the company and the financial statements for the previous financial year with regard to their compliance with books, documents, and facts;
- (ii) preparation and submission to the shareholders' meeting of a written report on the activities of the Supervisory Board for the past financial year (Supervisory Board report);
- (iii) requesting the Management Board, proxies, and persons employed by the company under an employment contract or performing certain activities for the company on a regular basis under a contract for work, a contract of mandate; etc. to prepare or submit any information, documents, explanations, etc. concerning the company, its subsidiaries, and affiliated companies (the Management Board shall not restrict access to such information and shall submit it promptly, no later than within two weeks of notification);
- (iv) the possibility of establishing an *ad hoc* or standing committee consisting of members of the Supervisory Board to perform specific supervisory activities;
- (v) the power to pass a resolution to have a certain matter relating to the company's business or assets examined by a selected advisor (advisor to the Supervisory Board) at the company's expense.

The articles of association may extend the powers of the Supervisory Board, and, in particular, provide for the obligation of the Management Board to obtain the consent of the Supervisory Board prior to performing the actions specified in the articles of association, and transfer to the Supervisory Board the right to suspend all or individual members of the Management Board in performance of their duties for important reasons (reserved for the Shareholders' Meeting in the statutory model).

If an Auditors' Committee is established in a given limited liability company, its duties include evaluation of the Management Board report on the operations of the company, the financial statements for the previous financial year, and motions of the Management Board concerning the distribution of profit or coverage of losses as well as drawing up and

submitting to the Shareholders' Meeting annual written reports presenting the outcome of the above-mentioned evaluation. Where there is no Supervisory Board in a company, the articles of association may provide for a broader scope of duties of the auditors' committee.

The Supervisory Board or an Auditors' Committee of a limited liability company shall be composed of at least three members appointed and removed by the Shareholders' Meeting, however, the articles of association may provide for a different manner of appointing and removing members. Members of the Supervisory Board shall be appointed for a one-year term of office, unless the articles of association provide otherwise. A member of the Management Board, holder of a commercial proxy (*prokurent*), liquidator, head of branch or plant, chief accountant, attorney-at-law, or advocate employed with the company shall not, at the same time, be a member of the Supervisory Board or the auditors' committee.

Establishing a Supervisory Board is mandatory in a joint-stock company as it shall exercise permanent supervision over the company's activities in all aspects of its business. Shareholders of a joint-stock company are not entitled to exercise direct supervision over the Management Board and the company's activities. Instead, they are entitled to request the Management Board to provide information concerning the company. However, the Management Board may refuse to provide such information if it could inflict damage on the company, an associated company, or a dependent company, partnership, or co-operative, in particular through the disclosure of technical, commercial, or organizational secrets of the business enterprise.

The Supervisory Board cannot direct or manage the affairs of the company. The key duty and power of the Supervisory Board are to continually supervise the company's operations. For that purpose, the Supervisory Board may scrutinize any and all of the company's documents, demand reports and explanations from the Management Board and employees of the company, and audit the state and condition of the company's assets. The specific duties and powers of the joint-stock company's Supervisory Board include:

- (i) appointment and dismissal of Management Board members, unless the statute provides otherwise;
- (ii) representation of the company in contracts between the company and a member of the company's Management Board and in disputes with him;
- (iii) granting consent for payment of interim dividends;
- (iv) appointment of a statutory auditor to carry out a mandatory audit of the company's financial statements if the statute provides so;
- (v) indication of the dividend date, if the relevant resolution

of the Shareholders' Meeting does not indicate it.

The Supervisory Board may also suspend from the Management Board all or individual members thereof for important reasons and delegate members of the Supervisory Board, for a period of no longer than three months, to temporarily perform the duties of members of the Management Board who have been removed, resigned or who, for other reasons, are incapable of performing their duties. The statute may provide for a broader scope of powers of the Supervisory Board, and, in particular, provide for the obligation of the Management Board to obtain the consent of the Supervisory Board prior to undertaking actions set forth in the statute.

The Supervisory Board should be composed of at least three, and in public joint-stock companies – at least five, members appointed and dismissed by the General Meeting. However, the statute may provide for a different manner of appointing as well as dismissing the Supervisory Board members. The term of office of a member of the Supervisory Board shall be no longer than five years. A member of the Management Board, a liquidator, persons reporting directly to a member of the Management Board or a liquidator, holder of a commercial proxy, head of a branch or a plant, as well as chief accountant, attorney-at-law, or advocate employed at the company shall not, at the same time, be a member of the Supervisory Board.

Both in the case of limited liability companies and joint-stock companies, in performance of their duties, members of the Supervisory Board (or the Auditors' Committee if applicable) shall exercise due diligence arising from the professional nature of their activities and be loyal to the company. A member of the Supervisory Board (or the auditors' committee) shall, in the performance of their duties, exercise due diligence arising from the professional nature of their activities and be loyal to the company, e.g., not disclose company secrets, even after their mandate has expired.

To avoid the risk that one Supervisory Board member, by abusing their supervisory powers, adversely affects the ordinary conduct of the company's operations, the general rule under the CCC is that the Supervisory Board exercises its duties collectively, i.e., each supervisory action requires an appropriate resolution of the Supervisory Board. An exception to this rule is the possibility of establishing an *ad hoc* or standing committee of the Supervisory Board or, only in joint-stock companies, the delegation of a Supervisory Board member to individually perform certain supervisory actions – this also requires a specific resolution by the Supervisory Board. Establishing a committee of the Supervisory Board or delegating a Supervisory Board member to individually perform certain supervisory actions shall not relieve other members of their responsibility for exercising supervision in the company.

Members of the Supervisory Board (or the Auditors' Committee) are liable towards the company for any damage inflicted through an act or omission contrary to the provisions of law or, respectively, the articles of association or statute of the company unless no fault is attributable to such member. However, members of the Supervisory Board (or the auditors' committee) shall not be in breach of the obligation to take due care arising from the professional nature of their activities if, acting loyally to the company, they act within the limits of reasonable economic risks (the so-called business judgment rule), including on the basis of information, analyses, and opinions which should be taken into account in the relevant circumstances when carrying out a careful assessment.

1.3. The Function of the Executive Board

The Management Board is the sole executive body of the company authorized to act for and on its behalf. The main function of both limited liability companies' and joint-stock companies' Management Boards is to represent the company towards third parties (i.e., binding the company) and manage the company's affairs. The scope of these duties entails an obligation to act in the company's best interest and the Management Board members, who owe a duty of care towards the company, are obliged to focus on the company's welfare, rather than the interests of its shareholders or the holding group. Both in the case of a limited liability company and a joint-stock company, their shareholders may be appointed to the Management Board.

The limited liability company's Management Board comprises at least one person. Its members are appointed by the Shareholders' Meeting unless the company's articles of association provide otherwise. A shareholders' meeting resolution or the articles of association may specify the requirements that Management Board member candidates should meet, e.g., regarding their qualifications or education.

There are no statutory limitations regarding the maximum length of the Management Board members' term of office. A Management Board member may at any time resign or be dismissed, either for cause (in particular for a breach of the articles of association) or without cause, but the articles of association may limit the right to dismiss a member to significant reasons.

In the case of joint-stock companies, Management Board members are appointed by the Supervisory Board, unless the statute provides otherwise. In practice, the statute often provides for deviations from this rule, e.g., granting the individual shareholders the right to directly appoint and dismiss members of the Management Board. Requirements to be met by the Management Board member candidates may be specified by the company's statute or the General Meetings' resolution.

The term of office of the joint-stock company's Management Board members should be no longer than five years. Reappointment is permitted. A Management Board member may at any time resign or be dismissed, either for cause (in particular for a breach of the statute or the Management Board's bylaws) or without cause, but the statute may limit this right to dismiss for significant reasons only. A Management Board member may also be suspended by the Supervisory Board.

Moreover, the joint-stock company's Management Board shall be obliged, without additional notice, to provide the Supervisory Board with information on:

- (i) resolutions of the Management Board and their subject matter;
- (ii) the situation of the company, including with regard to its assets, as well as significant circumstances related to the conduct of the company's affairs, in particular in the operational, investment, and personnel areas;
- (iii) progress in the implementation of the designated directions of development of the company's activities, whereas it should indicate deviations from the previously designated directions, along with the statement of reasons for deviations;
- (iv) transactions and other events or circumstances which significantly affect or may affect the financial situation of the company, including its profitability or liquidity;
- (v) changes to information previously provided to the Supervisory Board if such changes materially affect or may affect the situation of the company.

Members of both limited liability companies' and joint-stock companies' Management Boards shall, in performance of their duties, exercise due diligence arising from the professional nature of their activities and be loyal to the company. Just like members of the Supervisory Board (or the Auditors' Committee), Management Board members are liable to the company for any damage inflicted through an act or omission contrary to the provisions of law or, respectively, the articles of association or statute of the company, unless no fault is attributable to such member. No breach of the obligation to take due care arises if the Management Board member acted loyally to the company and within limits of reasonable economic risks (the so-called business judgment rule), including on the basis of the information, analyses, and opinions which should be taken into account in the relevant circumstances when carrying out a careful assessment.

The above liability exemption does not apply if the grounds to declare the bankruptcy of a limited liability company or a joint-stock company do occur, and the company's Management Board members fail to file a petition for bankruptcy in accordance with the *Polish Act on Bankruptcy Law* of February 28, 2003. In such case, if the potential execution against the

company proves ineffective, the company's Management Board members shall be jointly and severally liable for the company's liabilities towards third parties, as well as the company's tax arrears.

1.4. Conflicts of Interest and Related Party Transactions

In the event of a conflict of interests between either a limited liability company or a joint-stock company and a member of its Management Board, their spouse, relatives and second-degree next of kin, and persons with whom the member of the management has a personal relationship, the member of the Management Board should disclose the conflict of interests and refrain from participating in the settlement of such issues and may request that this fact be recorded in the relevant minutes of the meeting of the board.

A member of the Management Board may not, without the company's consent, engage in a competitive business or participate in competitive entities as a partner in a partnership or a civil law partnership, or a member of the authorities of a company, or participate in any competitive legal person as a member of its authorities. The above prohibition also applies to participation in a competitive company, if a member of the Management Board holds at least 10% of shares in such company or the right to appoint at least one member of the Management Board. Unless, respectively, the articles of association or the statute provide otherwise, consent shall be granted by the authority which has the power to appoint the Management Board.

Under Polish law, there are no rules regarding a limited liability company's related party transactions. In the case of joint-stock companies, such rules are in place; different for private and listed joint-stock companies. The conclusion by a private (not listed) joint-stock company with an affiliated company of a transaction the value of which, taken together with the value of transactions concluded with the same company during a given financial year, exceeds 10% of the total assets of the company within the meaning of the accounting regulations, determined on the basis of the last approved financial statements of the company, shall require the approval of the Supervisory Board, unless otherwise provided for in the statute of the company.

In the case of listed joint-stock companies, conclusion of a transaction with an affiliated entity, the value of which exceeds 5% of the total assets within the meaning of the accounting regulations, determined on the basis of the last approved financial statements of the company, requires the consent of the company's Supervisory Board. When making a decision on granting consent to the conclusion of such a transaction, the Supervisory Board takes into account whether it is possible

to prevent the affiliated entity from taking advantage of its position and ensuring appropriate protection of the interests of the company and shareholders not being affiliated entities, including minority shareholders. The company must disclose on its website the information about such transaction no later than at the time of conclusion. Such information contains:

- (i) the business name of the affiliated entity with which a transaction is concluded, and in the case of entities affiliated being natural persons – their first and last name;
- (ii) the description of the nature of relations between the company and the affiliated entity with which the transaction is concluded;
- (iii) the date and value of the transaction;
- (iv) information necessary to assess whether the transaction has been concluded on market terms and whether it lies in the legitimate interest of the company and shareholders not being affiliated entities, including minority shareholders.

Listed companies are also subject to *Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse (market abuse regulation) and repealing Directive 2003/6/EC of the European Parliament and of the Council and Commission Directives 2003/124/EC, 2003/125/EC and 2004/72/EC (MAR)*, which provides for a reporting obligation on insiders' transactions. Pursuant to MAR, listed companies must disclose information on transactions on the company's securities done by individuals discharging managerial responsibilities as well as persons closely associated with them.

1.5. Legal Framework for Large Companies

As mentioned in Section 1.1., there are additional regulations applicable to join-stock companies listed either on a regulated market or a multilateral trading facility. Under Polish law, these are mainly the Act on Public Offer, MAR, and the WSE Best Practice, with additional regulations promulgated in other legislation.

The WSE Best Practice, nicknamed the WSE's corporate governance code, contain several postulates and recommendations regarding the listed companies' corporate governance, applied according to the comply-or-explain approach. These relate to disclosure policy, investor communications, functioning of the management and Supervisory Boards, internal systems and functions, conduct of the General Meetings, shareholders' relations, conflict of interest, related party transactions, and remuneration of corporate bodies members. In particular, pursuant to the WSE Best Practice, each listed company should maintain efficient internal control, risk management, and compliance systems and an efficient internal audit function adequate to the size of the company and the type and scale of its activity.

Moreover, pursuant to the *Act of May 11, 2017, on certified auditors, audit firms and public supervision*, listed companies must establish an Audit Committee (*komitet audytu*) (within the meaning of the *Regulation (EU) No 537/2014 of the European Parliament and of the Council of 16 April 2014 on specific requirements regarding statutory audit of public-interest entities and repealing Commission Decision 2005/909/EC*). The Audit Committee shall consist of at least three members, appointed by the Supervisory Board from its members. At least one member of the audit committee shall have knowledge and skills in accounting or auditing. The majority of members of the audit committee, including its chairman, must be independent of the company (e.g., must not be a person representing the controlling shareholder). The powers and duties of the audit committee include, in particular:

- (i) monitoring the financial reporting process, the effectiveness of internal control systems and risk management systems, and internal audits, including with regard to financial reporting and the performance of auditing activities, in particular, the performance of the audit by the audit firm;
- (ii) controlling and monitoring the independence of the auditor and audit firm, in particular when services other than audit are provided to the company by the audit firm;
- (iii) informing the Supervisory Board of the results of the audit and explaining how the audit contributed to the integrity of financial reporting in the public interest entity, as well as what role the audit committee played in the audit process.

2. Corporate Governance Framework

2.1. Transparency and Public Disclosures

Under Polish law, transparency and disclosures to be made by private (non-listed) companies are limited. The main publicly available source of information regarding Polish companies is the registry of entrepreneurs of the National Court Register (*rejestr przedsiębiorców Krajowego Rejestru Sądowego*) (NCR), containing the basic data regarding the company, including its financial statements, shareholding, the composition of the corporate bodies, and manner of representation. The scope of mandatory disclosure is statutorily regulated. All entries in the NCR shall also be published in the *Court and Business Gazette (Monitor Sądowy i Gospodarczy)*. Such information contained in the NCR is easily accessible through the NCR's website. Each company is obliged to update its information disclosed in the NCR, while the underlying documents and information concerning the company should be announced or filed with the registry court. Such documentation includes, in particular, the articles of association of the company and all its updates, acts of appointment of the corporate bodies' members, and acts regarding the share capital increase or reduction. The underlying documentation filed with the registry court is also publicly available, however, for inspection at the court's office, not on

the NCR's website. Moreover, joint-stock companies must operate their own websites, where they are obliged to publish all corporate announcements required by law or by their statute. The requirement to maintain a website is not applicable to limited liability companies.

Additionally, both limited liability companies and joint-stock companies are required to disclose their ultimate beneficial owners in the respective central register – *Central Register of Ultimate Beneficiaries (Centralny Rejestr Beneficjentow Rzeczywistych)*.

Further transparency, disclosure, and/or registration obligations may apply depending on the business activities carried out by the given company.

In the case of listed companies, the disclosure obligations are more extensive. Under Polish law, the following types of information require disclosure, and must be notified, both to the public and to the Polish Financial Supervision Authority (*Komisja Nadzoru Finansowego*) (PFSA):

- (i) periodic information – periodic consolidated financial statements and statements made by the responsible persons;
- (ii) inside information/price sensitive information – information of a precise nature, which has not been made public, relating, directly or indirectly, to the company or to one or more financial instruments, and which, if it were made public, would be likely to have a significant effect on the prices of those financial instruments or on the price of related derivative financial instruments;
- (iii) on-going information – mandatory information on certain one-off events in the life of the Company listed expressly in the regulations;
- (iv) corporate events – information on corporate events in the life of the Company provided to the stock exchange and relevant securities depository – in Poland, the Central Securities Depository of Poland (*Krajowy Depozyt Papierow Wartosciowych*) – to enable them to service General Meetings, payments of dividends and conduct similar actions;
- (v) notifications of major holdings – notifications filed by larger shareholders with information on crossing large shareholding thresholds;
- (vi) notifications on the company's acquisitions or the disposal of own shares;
- (vii) insiders' notifications (please see Section 1.4.)
- (viii) reports on corporate governance – reports on compliance or non-compliance with the WSE Best Practice.

2.2. Public Authorities Responsible for Monitoring Corporate Governance

In Poland, there is no public authority directly monitoring corporate governance. In case of the private companies, a

similar function is performed by the NCR, which inspects the documents received in connection with the application for entry for their compliance with statutory law. In the case of listed companies, the PFSA is the authority conducting their supervision, however mostly in respect of compliance with their information and reporting obligations.

2.3. ESG

Poland closely follows the ESG regulatory requirements regarding non-financial reporting and disclosures provided by the European Union. Domestically they are implemented through several laws, but mainly by the *Polish Accounting Act of September 29, 1994 (Ustawa o rachunkowosci)* (Accounting Act). Apart from the Accounting Act, there are also other regulations concerning the disclosure of information about the environment, society, and corporate governance in Poland. They focus on clean energy as well as regulating air, land, and water pollution, protecting human rights, workers, and consumers, protecting animal welfare, preventing unfair competition, and fostering equality.

The audit of the financial statements, including non-financial parts, should be carried out by a certified public accountant listed in the register of certified public accountants maintained by the National Council of Certified Public Accountants (*Krajowa Rada Bieglych Rewidentow*). The manner in which auditors perform their work is supervised by the Polish Audit Supervision Agency (*Polska Agencja Nadzoru Audytowego*). The supervision of the Polish capital market, where most of non-financial reporting and disclosures may appear is carried out by the PFSA.

2.4. Internal Controls and Fraud Measures

Audits of internal control systems are present in the public sector and focus on the proper use of public finances and the operation of public institutions.

In the private sector audits of internal controls systems are limited. The obligation to implement an internal control system and its regular audits concerns public companies and financial institutions, e.g., banks or brokers. These rules do not concern other parts of private markets but may serve as a benchmark for elaborating best practices in those other sectors.

There is a regulation defining rules for the assessment of internal audit independence in the public sector, i.e., the *Polish Act on Public Finances* dated August 27, 2009 (*Ustawa o finansach publicznych*).

3. Shareholder And Board Committees

3.1. What Committees Are Prescribed by Law?

Apart from corporate bodies described in Section 1., there are no other mandatory boards or committees in either a limited liability company or a joint-stock company. As indicated before, the articles of association or statute of the company may provide for the establishment of specialized committees within, respectively, a Shareholders' Meeting or a General Meeting, a Supervisory Board, or a Management Board, but such committees may perform only advisory functions, as they cannot be assigned with the powers and duties of the main corporate bodies.

3.2. What Committees Are Mandatory for Large Companies?

Please see our remarks in Section 1.5.

3.3. Remuneration of Supervisory and Executive Board Members

There are no statutory rules regarding the remuneration of the management and Supervisory Board members in private companies. In the case of public companies, the Act on Public Offer requires the company's General Meeting to adopt, by way of a resolution, a remuneration policy with regard to the members of the Management Board and the Supervisory Board. The solutions adopted in the remuneration policy should contribute to the implementation of a business strategy, long-term interests, and stability of the company. The remuneration policy includes in particular:

- (i) a description of fixed and variable remuneration components, together with bonuses and other cash and non-cash benefits which may be granted to the members of the Management Board and the Supervisory Board;
- (ii) an indication of mutual proportions of the remuneration

components;

(iii) an explanation of the manner in which the working conditions and remuneration conditions of the company's employees other than the members of the Management Board and the Supervisory Board were taken into account when establishing the remuneration policy;

(iv) an indication of the period for which employment contracts, mandate contracts, task-specific contracts, or other contracts of a similar nature have been concluded with the members of the Management Board and the Supervisory Board, together with an indication of the periods and conditions of termination of such contracts, and if no such contract has been concluded with a member of the Management Board or the Supervisory Board – an indication of the type and period for which the legal relationship between said member of the Management Board or of the Supervisory Board with the company has been established, as well as the period and conditions of termination of the legal relationship;

(v) a description of the main features of additional pension and disability pension schemes and early retirement schemes;

(vi) a description of the decision-making process used in order to establish, implement, and review the remuneration policy;

(vii) a description of measures taken to avoid conflicts of interest related to the remuneration policy or management of such conflicts of interest.

Additional recommendations regarding the remuneration policy and the remuneration of the supervisory and Management Board members are provided in the WSE Best Practice.

Specific regulations apply in the case of state-owned companies.



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CEE LEGAL MATTERS COMPARATIVE LEGAL GUIDE: CORPORATE GOVERNANCE 2023 ROMANIA



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1. Corporate Structure Of The Companies

1.1. General Legal Framework

The corporate bodies that Romanian must have in place depend on their specific legal form, as detailed below.

Our answers will focus on limited liability companies (LLCs) and joint-stock companies (JSCs), as they same represent the vast majority of Romanian companies (out of a total of approximately 1.1 million active Romanian companies, almost all are LLCs, with the number of Romanian JSCs being around 10,000).

Limited liability companies

Romanian LLCs must have at least one director (*administrator*).

There are no differences as regards the corporate bodies an LLC must have in place depending on whether the same is a small, medium, or large company.

Joint stock companies

Romanian JSCs may implement either one-tier management or two-tier management, as detailed below.

One-tier management

The one-tier management implies appointing at least one director. If more than one director is appointed, the number of directors must be uneven and the appointed directors will form a Board of Directors (*Consiliu de Administratie*) and the Board of Directors/shareholders will need to appoint one of the Board members as Chairman of the Board of Directors.

JSCs subject to statutory financial statements audit are obliged to appoint at least three directors to form a Board of Directors. In such a scenario, it is also mandatory for the Board of Directors to delegate the management of the JSC to one or more managers (*directorii*), one of the same being appointed as general manager (*director general*).

A JSC is subject to statutory financial statements audit if they meet at least two of the following three criteria:

- (i) the JSC's total assets exceed a value of RON 16 million (approximately EUR 3.2 million);
- (ii) the JSC's net annual turnover exceeds a value of RON 32 million (approximately EUR 6.4 million);
- (iii) the JSC's average number of employees during the financial year exceeds 50.

Therefore, the management system of a one-tier management JSC differs based on meeting at least two of the three criteria above. It thus does not depend on whether it is a small, medi-

um, or large company.

We also mention that JSCs that are not subject to the statutory financial statement can also appoint a Board of Directors that delegates the management to one or more managers.

Two-tier management

Romanian JSCs may choose to implement a two-tier management system.

The two-tier management system implies the following corporate bodies:

- (i) a directorate (Executive Board) that ensures the management of the JSC; and
- (ii) a Supervisory Board, which supervises the management undertaken by the Executive Board.

The members of the Executive Board are appointed by the Supervisory Board, which also appoints one of the members of the Executive Board as the Chairman thereof.

The members of the Executive Board cannot also hold the capacity of members of the Supervisory Board and vice versa.

Romanian LLCs may have a sole shareholder and a maximum of 50 shareholders.

Romanian JSCs must have at least two shareholders.

Regardless of the legal form, an individual and/or legal entity cannot hold the shareholder capacity in a Romanian company if:

- (i) they have been denied by a final court decision the right to hold a such position as a punishment complementary to the conviction for crimes against a property by disregarding trust, corruption, embezzlement, forgery in documents, tax evasion, offenses provided by legislation for the prevention and sanctioning of money laundering, as well as for the establishment of measures to prevent and combat the financing of terrorism or for the offenses provided by the *Romanian Companies Law no. 31/1990*;
- (ii) they have committed deeds that are subject to registration in the fiscal record.

In LLCs and JSCs, shareholders are usually liable up to the value of the company's share capital.

Nevertheless, there are certain legal provisions that regulate and expand the liability of shareholders, as follows:

- (i) creditors or other persons adversely affected by the Shareholders' Assembly decision pertaining to the amendment of the articles of association of a Romanian company may lodge a complaint before the competent court to order the company

or, as the case may be, the shareholders to cover the damages;

(ii) companies may also lodge complaints against their shareholders for damages caused thereto;

(iii) shareholders which have concluded legal acts/deeds with third parties on behalf of a company under the incorporation procedure are liable for the same towards the third parties unless the legal acts/deeds are taken over by the company after its incorporation;

(iv) shareholders which, in fraud of creditors, abuse the limited nature of their liability and the separate legal personality of the company, become liable without limitation as regards the unpaid obligations of a dissolved/liquidated company, in particular when such shareholders use the company's assets as their own or diminish the company's assets for their personal benefit or for the benefit of third parties while knowing or ought to know that the company will thus be unable to meet its obligations.

There are also various criminal offenses a shareholder may be liable for (and thus face a criminal fine or imprisonment of up to five years, depending on the actual criminal offense committed), such as:

(i) presenting, in bad faith, in the prospectuses, reports, and communications addressed to the public, false data as regards the incorporation of the company or as regards its economic or legal condition or hiding, in bad faith, such data;

(ii) acquiring, on behalf of the company, shares of other companies, at a price that the shareholder knows to be obviously higher than the actual value of the shares, or, selling, on behalf of the company, shares that the same holds, at a price that the shareholder knows to be obviously lower than the actual value of the shares;

(iii) using, in bad faith, the goods or the credit the company enjoys, for a purpose contrary to the interests of the company or for their own benefit or in favor of another company in which they have direct or indirect interests;

(iv) spreading fake news or using other fraudulent means which have the effect of increasing or decreasing the value of the shares or bonds of the company or of other securities belonging to it, for the purpose of obtaining, for themselves or for other persons, a benefit, causing damages to the company; this applies strictly to JSCs; practice shows that this could be applied in connection to LLCs as well when fake news refers to the values held by the LLC in another company;

(v) receiving or paying dividends, in any form, from fictitious profits or which could not be distributed during the financial year based on the interim and annual financial statements (i.e., the company has no profits according to the same) or contrary to the results from the financial statements;

(vi) passing their shares or debentures into the name of

another person for the purpose of forming a majority in the Shareholders' Assembly, to the detriment of other shareholders or debenture holders;

(vii) voting in Shareholders' Assemblies, in the situation referred to in point **(vi)** above, as the owner of shares or debentures which do not actually belong to him/her/it;

(viii) when, in exchange for an undue material benefit, he/she/it obliges itself to vote in a certain way in the Shareholders' Assembly or to not take part in the vote;

(ix) when involved in a fictitious transfer of shares in a company for the purpose of committing a criminal offense or evading or hindering criminal prosecution.

Romanian companies are split into the following categories:

(i) micro-entities;

(ii) small entities;

(iii) medium and large entities (the same being grouped into the same category).

Micro-entities are entities that, at the date of the financial statements, do not exceed at least two of the following three criteria:

(i) value of the total assets – RON 1.5 million (approximately EUR 338,000);

(ii) value of the net turnover – RON 3 million (approximately EUR 676,500); and

(iii) the average number of employees during the financial year – 10.

Small entities are entities that do not fall under the micro-entities category and, at the date of the financial statements, do not exceed at least two of the following three criteria:

(i) value of the total assets – RON 17.5 million (approximately EUR 3.95 million);

(ii) value of the net turnover – RON 35 million (approximately EUR 7.9 million);

(iii) the average number of employees during the financial year – 50.

Medium and large entities are entities that, at the date of the financial statements, exceed at least two of the following three criteria:

(i) value of the total assets – RON 17.5 million (approximately EUR 3.95 million);

(ii) value of the net turnover – RON 35 million (approximately EUR 7.9 million);

(iii) the average number of employees during the financial year – 50.

1.2. The Function of the Supervisory Board

The main function of the Supervisory Board of a two-tier managed Romanian JSC is to supervise the management of the company by the Executive Board.

Its attributions are as follows:

- (i) to appoint and dismiss the members of the Executive Board;
- (ii) to represent the company in its relationship with the Executive Board;
- (iii) to request from the Executive Board any information it deems necessary to exercise its control and supervision duties and to undertake appropriate checks and investigations;
- (iv) to verify the compliance of the management of the company with the law, articles of association, and Shareholders' Assembly decisions;
- (v) to report to the Shareholders' Assembly as regards its supervisory activity, at least once per year;
- (vi) in extraordinary circumstances, when the company's interests require it, to convene the Shareholders' Assembly.

The *Romanian Companies Law* does not contain specific provisions requiring guarantees from the Supervisory Board for ensuring its competencies in terms of long-term viability, strategical direction, and best interests of the company, as, in the end, the role of the Supervisory Board is to supervise the management of the company, not to undertake the same.

Nevertheless, members of the Supervisory Board must hold professional liability insurance.

There are also additional measures prescribed by the Romanian Companies Law aimed at preventing conflicts of interest, as follows:

- (i) members of the Supervisory Board cannot be members of the Executive Board;
- (ii) members of the Supervisory Board cannot be employees of the company.

Moreover, specific professional and independence-related conditions that must be met by the members of the Supervisory Board may be established in the company's articles of association or via a decision of the Shareholders' Assembly. As regards the criteria by which a member of the Supervisory Board is considered independent, the same is prescribed by the *Romanian Companies Law* (though not directly but by reference to independence criteria applicable to non-executive Board members), out of which we mention the following:

- (i) to not have held the director/Executive Board member of the company or of another company controlled by the company within the last five years;

- (ii) to not have been an employee of the company or of another company controlled by the company within the last five years;

- (iii) to not have received remuneration or other advantages from the company or from another company controlled by the company within the last five years, with the exception of those granted for holding the capacity of a member of the Supervisory Board;

- (iv) to not be a significant shareholder of the company;

- (v) to not have or have had within the last year business relations with the company or with another company controlled by the same either directly or as a result of his/her position in another company having business relations with the company or with another company controlled by the same;

- (vi) to not hold or have held the financial auditor capacity in the company or in another company controlled by the same within the last three years.

While not expressly regulated under the *Romanian Companies Law*, this can be regulated under the articles of association of the company and/or in the agreement to be concluded between the company and the members of the Supervisory Board.

In addition, the *Romanian Companies Law* contains a series of provisions that indirectly should determine Board members to perform their duties in the best interests of the company, some of which are detailed below.

A limitation imposed by the *Romanian Companies Law* that may aid in the Board members properly dealing with their duties is the fact that an individual may only hold the capacity of a member of a Supervisory Board in a maximum of five companies at the same time (such restriction not applying when the individual holds at least one-quarter of the shares of such company).

Moreover, the same restrictions applicable to shareholders detailed above also apply to members of the Supervisory Board.

Last but not least, members of the Supervisory Board can be held liable in court for damages caused to the company and may also be held liable for various criminal offenses, such as:

- (i) presenting, in bad faith, in the prospectuses, reports, and communications addressed to the public, false data as regards the incorporation of the company or as regards its economic or legal condition or hiding, in bad faith, such data;
- (ii) presenting, in bad faith, to the shareholder(s), an inaccurate financial situation of the company or a financial situation containing inaccurate data regarding the company's financial or legal condition, in order to hide the real situation of the company from the shareholder(s);

(iii) refusing to provide appointed experts with information necessary for the same to conduct the evaluation of goods to be included in the share capital/share capital increase of the company or preventing such experts, in bad faith, from undertaking their obligations as regards such evaluation;

(iv) spreading fake news or using other fraudulent means which have the effect of increasing or decreasing the value of the shares or bonds of the company or of other securities belonging to it, for the purpose of obtaining, for themselves or for other persons, a benefit, causing damages to the company;

(v) using, in bad faith, the goods or the credit the company enjoys, for a purpose contrary to the interests of the company or for their own benefit or in favor of another company in which they have direct or indirect interests.

1.3. The Function of the Executive Board

The main function of the Executive Board is to ensure the management of two-tier managed Romanian JSCs.

The duties of the Executive Board are not detailed by the *Romanian Companies Law*, which simply provides that the Executive Board undertakes all deeds necessary and useful for the fulfillment of the company's business object, except those reserved by law for the Supervisory Board and for the Shareholders' Assembly.

As with shareholders and members of the Supervisory Board, one cannot hold the capacity of a member of the Executive Board if:

(i) he/she (only individuals may hold the capacity of a member of the Executive Board) has been denied by a final court decision the right to hold such a position as a punishment complementary to the conviction for crimes against property by disregarding trust, corruption, embezzlement, forgery in documents, tax evasion, offenses provided by legislation for the prevention and sanctioning of money laundering, as well as for the establishment of measures to prevent and combat the financing of terrorism or for the offenses provided by the *Romanian Companies Law no. 31/1990*;

(ii) they have committed deeds that are subject to registration in the fiscal record.

The obligations detailed above as regards the members of the Supervisory Board as regards holding a professional liability insurance and a limited number of five mandates that may be held at the same time also apply to members of the Executive Board.

As with members of the Supervisory Board, members of the Executive Board cannot be employees of the company.

Moreover, members of the Executive Board cannot hold

the capacity of manager, director, Executive Board member, Supervisory Board member, censor, internal auditor, or shareholder with unlimited liability in competing companies or those having the same business object, nor can they undertake in their own name or on behalf of other parties the same type of business or a competing business to that of the company where they hold the Executive Board member capacity without the prior approval of the Supervisory Board.

1.4. Conflicts of Interest and Related Party Transactions

From a corporate perspective, there are certain provisions of the *Romanian Companies Law* that aim to prevent conflicts of interest, as follows:

■ shareholders that, as regards a specific operation have, either in their own names or on behalf of third parties, interests that are contrary to those of the company cannot take part in the deliberations/decision-making on said specific operation;

■ directors/members of the Board of Directors that, as regards a specific operation have, directly or indirectly, interests that are contrary to those of the company must inform the other directors/Board members, censors, and internal auditors of the company as regards said contrary interests and must abstain from participating to any deliberation on said specific operation; such obligation applies also in relation to operations where the spouse or relatives up to the fourth degree of the director/Board member have interests contrary to that of the company;

■ companies are prohibited to credit directors/Board of Directors members/Executive Board members/Supervisory Board members through operations such as: (i) lending money; (ii) granting financial advantages in relation to or following operations by which the same supply goods/services/works to the company; (iii) directly or indirectly securing loans/credits accessed by the same; (iv) directly or indirectly securing the execution of personal obligations thereof towards third parties; (v) the acquisition for consideration or payment, in whole or in part, of a claim relating to a loan granted by a third party to the same. Such restrictions also apply to spouses and relatives up to the fourth degree of directors/Board of Directors members/Executive Board members/Supervisory Board members.

As regards related party transactions, the same is not prohibited under Romanian law.

However, there are certain requirements for related party transactions imposed by the *Romanian Tax Code*, as follows:

(i) the same must be undertaken on an arm's length principle; (ii) the price of such transactions must be set on market value for similar transactions between non-related parties;

(iii) each member of a group must compile the transfer pricing file which must reflect transactions concluded both with members of the same fiscal group and with affiliates outside the fiscal group.

1.5. Legal Framework for Large Companies

Medium and large companies are not required to have other mandatory corporate bodies other than those detailed in Section 1.1., this also applies to listed companies and financial institutions.

Nevertheless, depending on the business object of the company, additional conditions may apply to the individuals holding management positions, for example:

- (i) companies providing medical services are required to have a director that is a medical professional;
- (ii) financial institutions need to register their management members with the National Bank in Romania and for this purpose the same need to provide documentation reflecting the good reputation and relevant experience of such members;
- (iii) conditions similar to those mentioned in point (ii) above are also applicable to executive managers of insurance companies.

2. Corporate Governance Framework

2.1. Transparency and Public Disclosures

Public enterprises (i.e. *regies autonomes* incorporated by the Romanian state or by territorial and administrative divisions, companies where the Romanian state or territorial and administrative divisions are sole shareholders, a majority shareholder or where the same exercise control and companies held by other companies where the Romanian state or territorial and administrative divisions are sole shareholders, majority shareholder or where the same exercise control) are subject to mandatory corporate governance rules that require them to publish the following documents on their websites:

- (i) the convening notice of the Shareholders' Assembly, at least 30 days prior to the Assembly;
- (ii) the Shareholders' Assembly decisions, within 48 hours of the date of the Assembly;
- (iii) the annual financial statements, within 48 hours of their approval;
- (iv) the half-yearly accounting reports, within 45 days of the end of the half-year;
- (v) the annual audit report;
- (vi) the list of directors and managers, the CVs of the members of the Board of Directors and of the managers or, as the case may be, the CVs of the members of the Executive Board and of the Supervisory Board and the remuneration level

thereof;

- (vii) the reports of the Board of Directors or of the Supervisory Board, as the case may be;
- (viii) the annual report on the remuneration and other benefits paid to directors and managers or, as the case may be, to members of the Executive Board and of the Supervisory Board during the financial year;
- (ix) their code of ethics, within 48 hours of its approval or on May 31 of each year, should such code of ethics be revised/updated.

Such obligations are not applicable to private companies – the same as not being obliged to even have a website.

Companies listed on the Bucharest Stock Exchange (BSE) may adhere to the *Corporate Governance Code* published by the same (such adherence is voluntary and not mandatory). The same contains recommendations related to corporate governance to be followed by listed companies, such as:

- (i) publishing a remuneration policy on their website;
- (ii) organizing services to maintain relationships with;
- (iii) publishing information related to corporate events such as dividends distribution, events that may lead to acquiring new rights as a shareholder or limiting rights of shareholders.

Both Romanian LLCs and Romanian JSCs are required to submit Shareholders' Assembly decisions related to the aspects registered in the *Trade Registry* (such as the registered office, business object, directors, etc.) before the competent local Trade Registry Office.

In the case of LLCs, Shareholders' Assembly decisions that lead to the amendment of their articles of association are also published in the *Official Gazette of Romania*.

In the case of JSCs, in order for the same to be opposable towards third parties, all Shareholders' Assembly decisions, irrespective of their subject, must be submitted before the *Trade Registry* for the purpose of being published in the *Official Gazette of Romania*.

Whether Supervisory Board decisions need to be publicly disclosed or not depends on the subject of the decisions (for example, decisions of the Supervisory Board appointing/dismissing members of the Executive Board need to be submitted before the Trade Registry and are published in the Official Gazette of Romania). Thus, not all Supervisory Board decisions need to be publicly disclosed.

2.2. Public Authorities Responsible for Monitoring Corporate Governance

This applies to public enterprises (See Section 2.1.), where the standards of corporate governance, reporting, and audit are set by law and monitored by the Ministry of Public Finance.

When it comes to public enterprises, corporate governance requirements are regulated by law.

As also anticipated under Section 2.1., companies listed with the BSE are encouraged to comply with the *Corporate Governance Code*/guidelines published by the BSE.

2.3. ESG

At the moment there are no regulatory requirements related to ESG reporting and disclosures by Romanian companies, though large companies are starting to make such reporting and disclosures on a voluntary basis.

At the same time, Romanian credit institutions are required under the regulation of the National Bank of Romania to include in their credit risk strategies a decision-making process that considers, amongst others, ESG matters, and thus such disclosures may need to be made for the purpose of securing finances.

2.4. Internal Controls and Fraud Measures

Public entities (i.e., public authorities, public institutions, state companies, *regies autonomes*, and companies where the state or administrative-territorial divisions) are obliged by law to have internal controls systems that are subject to audit undertaken by the following:

- (i) the Committee for Public Internal Audit;
- (ii) the Central Harmonizing Unit for Public Internal Audit;
- (iii) internal audit committees; and
- (iv) internal audit departments.

As regards private JSCs, they are subject to mandatory internal audit if they are subject to a mandatory financial audit, which occurs if the same exceeds at least two of the following criteria:

- (i) the JSC's total assets exceed a value of RON 16 million (approximately EUR 3.2 million);
- (ii) the JSC's net annual turnover exceeds a value of RON 32 million (approximately EUR 6.4 million);
- (iii) the JSC's average number of employees during the financial year exceeds 50.

JSCs managed under the two-tier management are also subject to mandatory financial audit and thus are required to be sub-

ject to internal audit.

JSCs that opt to have their financial statements audited despite not meeting the criteria for mandatory financial audit are also subject to internal audit.

The internal audit must be undertaken by financial auditors, in line with international standards of internal audit adopted by the Romanian Chamber of Financial Auditors of Romania.

Amongst others, internal auditors must consider internal control systems as part of their audit.

Internal audits must be performed by independent financial auditors, in line with the guidelines published by the Romanian Chamber of Financial Auditors of Romania. Such guidelines provide certain aspects regarding the independence of the financial auditor undertaking the internal audit, namely:

- (i) if the independence of a financial auditor is potentially impacted, the same must inform the interested parties;
- (ii) internal auditors must avoid evaluating operations in which they were involved;
- (iii) if the independence of the internal auditor may be affected as a result of consultancy services provided to the company, the internal auditor must inform the company as regards the same prior to accepting the audit mission.

Independence of the internal audit is also ensured by general obligations applicable to financial auditors (which is a regulated profession), such as:

- (i) the obligation to document any and all potential significant dangers posed on their independence such as financial interests, business relationships, personal/family relationships, other services provided to clients subject to audit, and so on;
- (ii) the financial auditor/financial audit company that undertakes the financial audit must be different from the one that undertakes the internal audit;
- (iii) audit companies must have in place that prevents their shareholders, management members, executive management, or supervisory bodies from intervening in audits carried out by the company in any way that may impact the independents of the financial auditor undertaking the audits.

3. Shareholder And Board Committees

3.1. What Committees Are Prescribed by Law?

The Board of Directors of one-tier managed JSCs may establish advisory committees formed of at least two Board members to conduct investigations and make recommendations to the Board in areas such as audit, remuneration of directors, managers, censors, and staff and the nomination of candidates for various management positions.

At least one of the members of such advisory committees must be a non-executive Board member (i.e., the same must not also hold the position of manager), while audit and remuneration committees must be formed entirely of non-executive Board members.

Similarly, Supervisory Boards of two-tier managed JSCs may also establish advisory committees formed of at least two Supervisory Board members to conduct investigations and make recommendations to the Board in areas such as audit, remuneration of Executive Board members, Supervisory Board members and staff, the nomination of candidates for various management positions. At least one member of these committees must be an independent Supervisory Board member.

Certain categories of companies may be required by special legislation to establish certain committees, for example:

- (i) credit institutions that are significant as regards their size, internal organization, and complexity of activity must establish a risk management committee, a nominalization committee, and a remuneration committee;
- (ii) non-banking financial institutions must establish an audit committee and a risk management committee.

3.2. What Committees Are Mandatory for Large Companies?

Medium and large companies are not required to establish committees (the same being optional as described under Section 3.2., unless such requirements are regulated under special

legislation dealing with the activity of such companies, as is the case for credit institutions and non-banking financial institutions as detailed under Section 3.1.

3.3. Remuneration of Supervisory and Executive Board Members

As a preliminary remark, the remuneration of members of the Supervisory Board and of the Executive Board is not mandatory.

The remuneration of such members is established by the shareholders, via the articles of association, Shareholders' Assembly decision, or a relevant contract/agreement concluded with the respective member.

There are no specific rules when establishing the remuneration, the same being usually negotiated between the company and the relevant Board member.

A Remuneration Committee is not mandatory for private companies. However, such Committee is mandatory for Public Enterprises (See Section 2.1.).

Private companies do not need to publicly disclose the remuneration of their directors/Board of Directors members/managers/Executive Board members/Supervisory Board members.

The remuneration does need to be publicly disclosed by public enterprises, by publishing the same on their websites, as mentioned in Section 2.1.



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1. Corporate Structure Of The Companies

1.1. General Legal Framework

As per the *Companies Act*, businesses (regardless of their size small, medium, or large) may be organized through a one-tier or two-tier corporate governance system. Companies organized on a one-tier basis have a Shareholders' Meeting and one or more Directors (Board of Directors/Executive Board) as corporate bodies. In a two-tier system, they have the Shareholders Meeting, one or more Directors (Board of Directors/Executive Board), and the Supervisory Board. It is entirely within the competencies of the founder(s) and in their sole discretion to decide which system shall be applicable.

Special laws regulate some industries, and their corporate government may differ from the general regime as per the *Companies Act*.

The law does not require a minimum number of shareholders when it comes to limited liability companies (*drustvo sa ogranicenom odgovornoscu* or d.o.o.) and joint-stock companies (*akcionarsko drustvo* or a.d.). In both cases, there can be a sole shareholder. There are also two other forms available for investors to establish their corporate presence in Serbia. A general partnership (*ortacko drustvo* or o.d.) and a limited liability partnership (*komanditno drustvo* or k.d.) must have at least two shareholders. Besides, there are no regulatory requirements the shareholders must meet since any natural or legal person, both local and foreign, can be a shareholder.

As to the liability, shareholder(s) of a limited liability company/joint-stock company is regularly not liable for the company's business. However, there are two exceptions. First, the so-called piercing of the corporate veil, when limited liability rules are lifted, and the shareholder becomes fully responsible for the company's business operations due to the abuse of limited liability rules/prerogatives. This may occur when shareholders have used the company's assets as if they were their own to deceive creditors or shareholders deliberately for their benefit or a third party's benefit, when a shareholder reduces the company's assets knowing the company would not be able to meet its obligations, etc. In the case of compulsory liquidation, the controlling shareholder (who owns 50% or more of the voting rights solely or in conjunction with other shareholders who are acting together) has unlimited liability for the company's business operations for three years following the completion of the compulsory liquidation procedure. Once the (mandatory) liquidation is completed, all shareholders are liable for the company's business operations, limited to the amount of received liquidated assets. On the other hand, shareholders of a general partnership are liable for the company's business. Limited liability partnership makes a specific mixture of shareholders who are regularly not liable for the

company's business operations (save to the two exceptions as mentioned hereinabove) and shareholders who are liable for the company's business operations per law.

The criteria for distinguishing between micro, small, and medium vs. large companies are the average number of employees, annual revenues, and the value of operating assets. The classification under these criteria is performed independently by the companies on the date of preparation of financial statements. The information obtained will be used for the following financial year.

Legal entities that do not exceed two of the following criteria are classified as micro-entities:

1. The average number of employees is 10.
2. Annual business turnover of EUR 700,000.
3. The operating assets value of EUR 350,000.

Legal entities that exceed two criteria relating to micro entities and do not exceed two of the following criteria and are classified as small entities:

1. The average number of employees is 50
2. Annual business turnover of EUR 8.8 million,
3. Value of operating assets of EUR 4.4 million.

Legal entities that exceed two criteria relating to small but do not exceed two of the following criteria are classified as medium entities:

1. The average number of employees is 250
2. Annual business turnover of EUR 35 million
3. Value of operating assets of EUR 17.5 million

Legal entities that exceed two criteria relating to medium entities are classified as large entities. Under the *Accounting Act*, legal entities that will always be considered large entities are the Central Bank of Serbia, insurance companies, financial leasing companies, voluntary pension funds, companies managing voluntary pension funds, open-ended and closed-ended investment funds, investment fund management companies, stock exchanges, broker-dealer companies, and factoring companies.

1.2. The Function of the Supervisory Board

In the case of two-tier management, a company has a Supervisory Board with at least three members. The Supervisory Board's main function is to supervise the company's Directors. Since the members of the Supervisory Board are appointed/removed directly by the Shareholders' Meeting, shareholders have direct powers and interests to ensure the competencies of the Supervisory Board. The terms of assignment, duration, and professional qualifications of the members of the Supervisory Board are prescribed by the company's Memorandum

of Association (corporate bylaws), which the Shareholders Meeting renders. This body also grants shareholders control over the Supervisory Board regarding the company's long-term viability, strategic direction, and best interests.

Listed companies must also adhere to the corporate rules embodied in the *Rules of Business Operation* of the Belgrade Stock Exchange. Members of the Supervisory Board of a listed company must follow principles outlined in the Belgrade Stock Exchange *Rules of Business Operation*, like legality, due diligence, reliability, fair conduct, professionalism, confidentiality, prohibition of unfair competition, and so on.

Certain fiduciary duties fall on the members of the Supervisory Board, and here particularly, the duty of care requires attention. Under the duty of care, members of the Supervisory Board are obliged to exercise their corporate powers diligently, with the care of a prudent businessperson and in the reasonable belief that they are acting in the company's best interest. A member of the Supervisory Board may owe damages to the company (or, in some cases, directly to the shareholders) for breach of the duty of care. The company or any of its shareholders may sue a Supervisory board member for damages on behalf of the company (so-called derivative claim) or any of the shareholders on behalf of the company (so-called derivative claim).

1.3. The Function of the Executive Board

The Executive Board oversees the management of the company. Generally, the law does not prescribe specific requirements or qualifications that executive board members must meet. Even the Belgrade Stock Exchange *Rules of Business Operation* do not stipulate additional requirements for the Executive Board members of listed companies. The law prescribes other requirements for entities under a special regime, like banks, insurance companies, broker-dealer companies, and investment companies.

1.4. Conflicts of Interest and Related Party Transactions

The duty of loyalty (avoiding conflicts of interest) falls onto the directors and other legal representatives of the company, but also significant shareholders (those who own 25% or more voting rights, solely or in conjunction with other shareholders who are acting together) or controlling shareholders (those who own 50% or more voting rights solely or in conjunction with other shareholders who are acting together). A person is prohibited from acting against the company's interests for their own benefit or the benefit of a third party. It refers to the usage of the company's assets, information that is not publicly available, business opportunities, and abuse of their function in the company.

They are obliged to report every company transaction where they or their related persons have a personal interest and obtain clearance from the Board of Directors/Supervisory Board to enter the transaction. A company that intends to enter a related party transaction is obliged to publicly disclose that intention on its internet presentation or in the Companies Registry of the Serbian Business Register with details of the transaction and personal interests in question immediately after receiving clearance. Moreover, according to the *Companies Act*, related party transactions subject to previous consent by the Board of Directors/Supervisory Board are also included in the company's annual financial reports, publicly available in the Companies Registry held by the Serbian Business Registers Agency.

1.5. Legal Framework for Large Companies

Public Joint Stock Companies (PJSCs) are obliged to establish an Audit Committee. The primary purpose of the Audit Committee is to provide oversight of the financial reporting, the audit process, the company's system of internal controls, and compliance with laws, standards, and regulations. The Audit Committee is responsible for the appointment, compensation, and oversight of the auditors' work. The Audit Committee is also responsible for preparing, proposing, and overseeing the accounting and risk management policies.

2. Corporate Governance Framework

2.1. Transparency and Public Disclosures

In line with the *Companies Act*, PJSCs are obliged to disclose some aspects of their corporate governance structure publicly, i.e., to display certain information regarding the Board of Directors/Supervisory Board members on the internet presentation of the company and keep the information accurate and up to date. Those are the occupation and previous employment of the Board of Directors/Supervisory Board members, as well as information on whether they are currently members of the Board in other companies and, if so, what function they perform there.

According to the *Companies Act* of Serbia, the Shareholders' decisions of non-listed companies do not need to be publicly disclosed. It is at the company's discretion whether they will publish those decisions. On the other hand, some PJSCs are obliged, under the *Companies Act*, to disclose the minutes and decisions of the Shareholders' Meeting publicly and voting results, i.e., to display that on the web page of the company within three days after the meeting for at least 30 days.

PJSCs are also governed by the *Capitals Markets Act* and, therefore, subject to specific public disclosure requirements (of financial statements, time, place, and agenda of the Sharehold-

ers' Meetings). Moreover, companies listed on the Belgrade Stock Exchange are subject to its *Rules of Business Operation* and hence obliged to publicly disclose.

According to the *Companies Act*, a company is not obliged to disclose the Supervisory Board decisions publicly, but it is instead at the company's sole discretion decision. Here should be raised the importance of business secrets protection. The legislation defines what information enjoys protection as a business secret and under which conditions. Not all confidential information is considered a business secret. A significant new development requires that the holder of a business secret has taken reasonable measures to preserve its confidentiality. In other words – if a company does not protect its business secret by itself, no legal protection will be provided by the law. The confidentiality agreement would be a reasonable measure of protection. The second condition is that the information is not generally known or readily accessible to persons who usually encounter it during their activities. Finally, the data must have commercial value. A clear distinction between legal and illegal means of acquiring/disposing of a business secret is made by precisely listing these cases.

2.2. Public Authorities Responsible for Monitoring Corporate Governance

The Chamber of Commerce and Industry of Serbia adopted the *Corporate Governance Code*, which targets all companies in Serbia. It is predominantly based on EU best practices and OECD principles. The principles and recommendations contained in this code are not binding. Still, they are recommended to all companies, particularly to the Serbian Chamber of Commerce members, as the best practice in corporate governance. Companies may directly implement the principles and recommendations of the code by adopting a decision of the competent body of the company or, if needed, elaborate them by adopting their own corporate governance code or by adopting other internal bylaws of the company.

The *Corporate Governance Code* of the Belgrade Stock Exchange also sets rules and principles to improve corporate governance practices. This is particularly expressed in the structure of the code through the recommendations based on the *comply or explain* rule and provisions indicating more closely the desirable practice of corporate governance and methods for an efficient realization of the recommendations' objectives. The implementation of the code is based on the voluntary principle and said *comply or explain* rule. Since the code is based on the outdated *Companies Act* (2004), effective implementation of the code shall follow its synchronization with the *Companies Act* of Serbia (2011) or by adopting a fresh Belgrade Stock Exchange's code.

2.3. ESG

The *Accounting Act* regulates non-financial reporting. Relevant companies (large companies of public interest whose average number of employees exceeds 500) must prepare a report on their activities dedicated to, among other things, environmental protection, social issues, human resources, and the application of human rights. Moreover, a company subject to financial report audits has to obtain clearance from the auditor that its non-financial report has been prepared according to the law.

The Tax Authority monitors companies concerning the *Accounting Act* in Serbia, hence their non-financial reporting compliance. For specific entities (banks, insurance companies, financial leasing companies, pension funds, and companies managing the voluntary pension funds), said monitoring is conducted by the Serbian central bank – the National Bank of Serbia (Ser. *Narodna Banka Srbije* or NBS).

2.4. Internal Controls and Fraud Measures

Every company regulates the system of internal controls through its corporate bylaws. According to the *Companies Act*, internal controls are not audited. However, the Audit Committee, if established, has certain powers that can be deemed interchangeable with the audit. Namely, the company's Internal Controller regularly reports to the Audit Committee (if not appointed, then to the Board of Directors in one-tier companies, i.e., the Supervisory Board in two-tier companies) on performed internal controls.

It is in the company's sole competencies to define the manner and organization of internal control (kindly see immediately above). PJSCs' duty in this regard is leveled up. Namely, the *Companies Act* of Serbia prescribes that PJSCs set out criteria for the appointment of the company's Internal Controller(s) (including professional knowledge and experience), where at least one must meet strict conditions set out for Internal Auditors in line with the *Accounting Act* of Serbia.

3. Shareholder And Board Committees

3.1. What Committees Are Prescribed by Law?

Under the *Companies Act*, the Board of Directors/Supervisory Board of a joint stock/limited liability company may establish one or more Committees. Committees assist the members of the Board in exercising corporate activities (preparing decisions to be enacted by the Board, monitoring the implementation of the Board's decisions, and conducting expert work for the Board's purposes). The *Companies Act* regulates the following Committees: **(i)** Audit Committee, **(ii)** Appointment Committee, and **(iii)** Remunerations Committee. Other Committees may also be constituted (e.g., Executive Committee, Sustainability Committee, Corporate Governance Committee,

Risk Committee).

3.2. What Committees Are Mandatory for Large Companies?

Only PJCSs are obliged to establish the Audit Committee.

3.3. Remuneration of Supervisory and Executive Board Members

The Shareholders' Meeting of the company decides on the remuneration of Supervisory and Executive Board members. The Shareholders' Meeting of a PJSC also decides on remuneration policies and reports.

A Remuneration Committee is not mandatory. The only mandatory is the Audit Committee of a PJSC.

Once a year, the Board of Directors (one-tier companies)/ Supervisory Board (two-tier companies), or Remuneration Committee, if established, of a Joint Stock Company renders a clear and comprehensive report on remunerations that the company or its affiliates paid or is obliged to pay to every single, present, or past, member of the Board. The report is made in the current year for the previous one. Joint Stock Companies are obliged to disclose this report on their internet presence. The report must be publicly available free of charge for at least ten years as of its publishing date.



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1. Corporate Structure Of The Companies

1.1. General Legal Framework

In the Slovenian legal system, companies and their corporate structure are primarily regulated in the Companies Act (*Zakon o gospodarskih družbah, ZGD-1, Official Gazette of Republic of Slovenia, nr. 65/09 as amended*). Two of the most common legal forms of companies that are used for running or real estate (RE) business in Slovenia are limited liability companies (*družba z omejeno odgovornostjo – d.o.o.*) and joint stock companies (*delniška družba – d.d.*). Thus, in this short guide, we will mainly focus on those two forms of legal entities.

Each company as a legal requirement has to have the following corporate bodies: **(i)** a legal representative that can represent the company in legal transactions – the Management Body, **(ii)** a Supervisory Body (not always mandatory), and **(iii)** a Shareholders' Assembly. There is no difference in the setup that would depend on the size of the company, but it depends on the legal form of the entity.

The Management Body of a limited liability company typically includes one (or more) legal representatives (i.e., a director of the company) that governs the company, makes decisions, and adopts resolutions on the conduct of its business. If there is more than one director, they may each represent the company in legal transactions solely or jointly. The number of directors and mode of representation is decided by the shareholder(s) and set out in the Articles of Association or Statute (in the case of a single shareholder company). If it is envisaged in their incorporation documents limited liability companies can have a Supervisory Board (except for companies of public interest where the establishment of a Supervisory Board is mandatory). The provisions of the Companies Act that govern a Supervisory Board of joint stock companies are applied *mutatis mutandis*. The Shareholders' Assembly includes all shareholders, which have voting rights, and who decide on the running of the company at meetings. In a single shareholder limited liability company instead of the Shareholders' Assembly, the shareholder governs through the adoption of resolutions that must be entered into the Book of Resolutions (either in electronic or paper form).

On the other hand, joint stock companies have more stringent requirements for their corporate structure in accordance with the Companies Act. Shareholders can choose between a one-tier or two-tier system. In a one-tier system, there is one corporate body, the Board of Directors that is responsible for supervising and managing the company. Although it is not a requirement, the Executive Directors may be selected among the Board of Directors' members, who then handle the day-to-day operations of the company and perform management duties. In a two-tiered structure, bodies consist of the

Supervisory Board, which must be appointed by the majority of the shareholders, and the Management Board. Supervisory Board appoints and supervises Management Board, which is responsible for the company's management. A Shareholders' Assembly is mandatory and it must be convened at least once a year. There are detailed rules that must be followed for the convocation and conduct of the Shareholders' Assembly.

In addition, in either form, a "procurator" can be appointed. This is a very common practice in Slovenia. Pursuant to the Companies Act, all actions that are within the authority of the legal representatives may be carried out by the procurator, apart from disposing or encumbering RE and granting powers of attorney for the legal representation in the court. The limitations regarding RE assets are very useful if the foreign investor wants to position a certain person to run the company's day-to-day business without the power to dispose of or encumber any assets. The procurator's representational authority may be further limited (by way of joint representation) in addition to any other restrictions that are entered in the court register.

The Companies Act requires a minimum of one shareholder for the establishment of both a limited liability company and a joint stock company. And in the case of limited liability without specific permission by the minister responsible for economy there cannot be more than 50 shareholders. There are no restrictions regarding local residency or nationality requirements for shareholders in the Slovenian legal system. However, the Companies Act does include the following prerequisites that a potential shareholder has to fulfill: **(i)** a record of their criminal history has to be provided, certifying they have not been convicted of a crime against the economy, social security, legal transactions, property, the environment, or natural resources; **(ii)** proof they have no outstanding tax debt and have not been published on the list of tax debtors in the last 12 months, and; **(iii)** a confirmation that they have not received two (or more) tax or employment inspection fines in the previous three years for illegal employment or payment for work, nor should they own at least a 25% stake as a shareholder in the company that has received the aforementioned fines.

The shareholders of a limited liability or joint stock company are generally not liable for the business of the legal entity. However, the Companies Act includes a specific provision regarding the possibility of "lifting the corporate veil." According to this provision, shareholders can be liable for the obligations of the legal entity in the following scenarios: **(i)** if they have abused the company as a legal person in order to attain an objective that is forbidden to them as individuals; **(ii)** if they have abused the company as a legal person, thereby causing damage to their creditors or creditors of the

company; **(iii)** if, in violation of an act, they have used the assets of the company as a legal person as if they were their own personal assets; or **(iv)** if, for their own benefit or for the benefit of some other person, they have reduced the assets of the company, when they knew or should have known that the company would not be capable of meeting its obligations to third parties.

In accordance with the Companies Act, the criteria for differing between micro, small, medium, and large companies, are: **(i)** the average number of employees in a business year, **(ii)** the net revenue from sales, and **(iii)** its assets' value. To be counted as one of the abovementioned types of companies, a company has to meet two out of three criteria for two consecutive business years.

The criteria for a micro company are: **(i)** the average number of employees in a business year does not exceed ten, **(ii)** the net revenue from sales does not exceed EUR 700,000, and **(iii)** its assets' value does not exceed EUR 350,000.

The criteria for a small company are: **(i)** the average number of employees in a business year does not exceed 50, **(ii)** the net revenue from sales does not exceed EUR 8 million, and **(iii)** its assets' value does not exceed EUR 4 million.

The criteria for a medium company are: **(i)** the average number of employees in a business year does not exceed 250, **(ii)** the net revenue from sales does not exceed EUR 40 million, and **(iii)** its assets' value does not exceed EUR 20 million.

A large company is one that does not meet the criteria of the above three, or in other words, it exceeds the numbers (criteria) of the above three (micro, small, medium).

1.2. The Function of the Supervisory Board

The main function of the Supervisory Board is to ensure that the interests of the shareholders are represented, with that in mind they always act *for the good of the company*. Pursuant to the Companies Act, the Supervisory Board's main function is to supervise the conduct of the business of the company. The Supervisory Board in a joint stock company appoints and recalls Management Board members. The Supervisory Board may inspect and examine the books and documents of the company and its treasury, the securities, stocks of goods, and other property. The Supervisory Board may also request from the Management Board any information necessary for the exercise of their supervision.

The members of the Supervisory Board must act with the legal standard of *diligence of a conscientious and honest businessperson* and safeguard the trade secrets of the company. In doing so, the members of the Supervisory Board must comply with the recommendations of best practices and codes of conduct. The duty of diligence includes the duty to participate personally in

the work of the Supervisory Board and the duty to ensure that the Supervisory Board acts properly and in a timely manner. In addition, other duties include the duty to request reports and information from the Management Board, the duty to assess the suitability of candidates for the Management Board, the duty to monitor the work of the Management Board and its members, and, above all, draw immediate attention to any irregularities that may occur in the company.

In accordance with the *Financial Operations, Insolvency Proceedings, and Compulsory Dissolution Act (Zakon o financnem poslovanju, postopkih zaradi insolventnosti in prisilnem prenehanju, Official Gazette of RS, no. 176/21 as amended)* the Supervisory Board has to regularly verify whether the company is solvent in the short and long-term viability and that the management complies with the rules included in the beforementioned Act which regulates the long-term financial solvency of the company. The members of the Supervisory Board are in the case of the mentioned duties also jointly and severally liable to the Company for any damage suffered by the Company because of a breach of their duties.

As explained above, all participants in the corporate governance of the company have to act with diligence and conscientiously while safeguarding the trade secrets of the company. Their duties have to be performed in the best interest of the company and its shareholders. As mentioned, the Board members are jointly and severally liable to the companies if they violate their duties, unless they can prove that their duties were fairly and conscientiously fulfilled.

1.3. The Function of the Executive Board

The Executive Board being understood as the management body can take different forms. Limited liability companies in Slovenia are not required to have a board as a company's body but can have a single director or more directors. In a one-tier system of governance of a joint stock company, the Board of Directors may have both *executive* and *non-executive* directors (as explained in Section 1.1.). For public joint stock companies, the Companies Act mandatorily structures the Board of Directors into executive and non-executive directors, but this does not apply to non-public companies. In a two-tier system, the Management Board performs the executive function.

Most of the responsibilities of the management bodies are mandated in the Companies Act and other applicable legislation, while others may be included in any other contract governing the manager's relationship with the company.

There are some legally prescribed requirements that the members of the company's bodies that function as legal representatives of the company have to comply with if they want to be appointed at their function. In this case, a natural person cannot be a member of any of the corporate govern-

ance bodies if a natural person: **(i)** is already a member of the company's supervisory body or; **(ii)** has been found guilty of a crime affecting the economy, social security, legal transactions, property, the environment, or natural resources (the appointment of such a representative is prohibited for five years after the person was convicted in a final judgment or two years after imprisonment), **(iii)** is subject to a preventive measure prohibiting them from practicing their profession (during the duration of this prohibition), and **(iv)** has been found guilty in a final judgment as a member of a management or supervisory body of a company for which bankruptcy proceedings had been initiated and is therefore required to pay creditors compensation.

1.4. Conflicts of Interest and Related Party Transactions

The Companies Act includes provisions that govern the conflict of interest of members of management or supervisory bodies, the procurator holder, the executive director and the manager of a public limited company, a member of the supervisory board and the procurator holder of a limited liability company. The before mentioned persons have to avoid any conflict of their own interests or duties with the interests or duties of the company which are conducted or supervised by that same person. The Companies Act also provides the definition of a conflict of interests which says: *“the conflict of interests of a person exists when impartial and objective performance of duties, or decision-making related to carrying out their function, is jeopardized due to the inclusion of personal economic interest, the interest of family members or due to special favor or any other interests connected to any other natural or legal person.”*

If a conflict of interest occurs, the person that is in conflict of interest has to notify it in writing the body of which they are a member, as well as the supervisory body, no later than three days. If the company does not have a supervisory board, they have to inform the shareholders at the next Shareholders' Assembly.

The Companies Act also includes provisions governing the transparency and approval of related party transactions. Concluding transactions with related parties refers to a wide circle of related companies and individuals as defined in the *International Accounting Standards* (e.g., associated undertakings, joint ventures, persons in the management of the company, etc.). In the case of related party transaction, the approval (i.e., consent) of the Supervisory Board is required for the conclusion of a contract between members of management, supervisory bodies or executive directors and parties related to them (including family relations) and the company, in which they hold corporate functions.

1.5. Legal Framework for Large Companies

Please see Section 1.1.

2. Corporate Governance Framework

2.1. Transparency and Public Disclosures

A company has to provide certain information to the Agency of the Republic of Slovenia for Public Legal Records and Related Services (AJPES). After the information is provided, the AJPES publicly posts the following information: **(1)** (long and shortened) name of the company, **(2)** registered office, **(3)** business address, **(4)** organizational form of the company, **(5)** share capital (and a number of shares, if it is a joint stock company, or company's shareholders if it is limited liability company), **(6)** Supervisory Board members (if it has one), **(7)** legal representatives (including Board of Directors), **(8)** tax identification and registration number, **(9)** Articles of Association or Statute, and **(10)** whether there is a winding-up process, the legal fact of the process and name of the process (e.g., liquidation, bankruptcy). Additionally, every company has to send to the AJPES its annual report within three months (for small and micro companies) or eight months (for other companies) after the end of the business year. The AJPES then publishes annual reports on its website so that they are freely accessible to the public. The eight-month deadline applies to the consolidated annual report as well.

If a company has a website, at least the following information must be made available: **(1)** name of the company, **(2)** registered office, **(3)** registration number, **(4)** share capital (and the amount of called-up capital if there is any), and **(5)** if there is a winding-up process, the legal fact of the process and name of the process (e.g., liquidation, bankruptcy).

The decisions of the Shareholders' Assembly in principle do not need to be publicly disclosed. However, if a company is publicly traded on an organized market, it has to publicly disclose the voting results two days after the Shareholders' Assembly. Further, if shareholders vote on an exceptional decision, they can also demand public disclosure of the vote, if they surpass 10 percent of the shares in the vote.

The decisions adopted by the Supervisory Board do not need to be publicly disclosed and are in practice not published unless such requirements arise from the stock exchange disclosure rules for specific decisions (for listed companies).

2.2. Public Authorities Responsible for Monitoring Corporate Governance

There is no public authority responsible for monitoring the standards.

The corporate governance framework in Slovenia consists of

a combination of legislation (i.e., the Companies Act), codes, and best practice recommendations. Corporate governance codes are voluntary, and companies can implement them and comply with them at their own discretion. However, if the company chooses to comply with a certain code, then its application becomes mandatory for such a company.

There are many different corporate governance codes in Slovenia, and once adopted, they form a part of the internal procedures of the adopting firm and must be made public. For example, the Slovenian Chamber of Commerce issued the *Corporate Governance Code for Unlisted Companies*, which can be used by companies if they want to. The Slovenian Directors' Association (SDA) is a professional, not-for-profit, and non-governmental organization that includes the members of Supervisory Boards, Directors, and other stakeholders of corporate governance, who have *inter alia* adopted guidelines and codes of corporate governance. Since the SDA plays a leading role in education, certification, and development of corporate governance and best practice for Boards in Slovenian companies and their reputation, many of their codes or recommendations are implemented by the companies. However, their acts are not legally binding but are useful as guidelines of exemplary business conduct.

In addition, legal entities that must be audited are required to adhere to a governance code when preparing the so-called *governance statement*, which is an integral part of the companies' annual report.

2.3. ESG

The company's dedication to ESG standards is treated as a part of the non-financial aspect of the business. A company that is subject to public interest and has more than 500 employees on a cut-off date in the balance sheet, has to include a statement of non-financial operations in the consolidated annual report. The statement of the non-financial aspect of the business includes information for the understanding of development, success, and position of the company and the impact of its activities, and contains at least information on environmental matters, social and human resources, respect of human rights and matters in relation to the prevention of corruption and bribery. The statement further includes: **(i)** a short description of the business model of the company, **(ii)** a description of the company's policies regarding the above-mentioned matters, **(iii)** the results of such policies, **(iv)** the main risks in relation to the above-mentioned matter, and are intertwined with the business of the company, and **(v)** crucial non-financial performance indicators.

The non-financial statement must be revised by the auditor. The auditor checks whether all information that was disclosed is in line with the law and a statement if there are any uncertainties.

2.4. Internal Controls and Fraud Measures

Companies for which auditing is obligatory must include a corporate governance statement in their business reports. The report must include a description of the principal characteristics of internal controls in connection with the financial reporting procedure.

In disclosing the internal control system and risk management the consolidated business report presents only the main characteristics of the internal control systems in the consolidated business report. The Audit Committee monitors the efficiency and effectiveness of the company's internal control and internal audit. Further, the auditor must cooperate with the Audit Committee and notify them if any major issues relating to the audit of the annual report, in particular regarding significant deficiencies in internal control.

The Companies Act provides certain rules on the work of an internal audit body. But the most important act regulating auditing is the *Auditing Act (Zakon o revidiranju, Official Gazette of RS, no. 65/08 as amended)* which confers power to adopt certain rules on (internal) auditing to a Slovenian Audit Institute. The Institute adopted a *Codex of Internal-Auditing Principles* (soft law) along with other core principles for professional practice in auditing, including the principle of internal audit independence.

3. Shareholder And Board Committees

3.1. What Committees Are Prescribed by Law?

There is only one prescribed committee by law: an Audit Committee. But the Supervisory Board (or Board of Directors) may choose to establish more committees such as Nomination Committee or Remuneration Committee.

The committees may not decide on the questions reserved for the Supervisory Board, but they can prepare decisions and advise on the respective matter. Each committee consists of at least three members: a president who must be a member of the Supervisory Board and at least two other members, experts in a concerning field. A committee must meet at least once every three months unless Statute provides otherwise. A Committee reports to the Supervisory Board on the matters they discussed. Remuneration for the other committee members, who are not Supervisory Board members, is decided on by the decision of the Supervisory Board.

3.2. What Committees Are Mandatory for Large Companies?

The Companies Act provides for a mandatory Audit Committee for companies that are subject to the public interest (e.g., they have to prepare consolidated annual report) or in the case of the Board of Directors if the employees demand their right

to take part in the company bodies.

The Audit Committee is appointed by the Supervisory Board or Board of Directors, as the case may be, and consists of at least one independent expert who is capable of accountancy or revision. Other members may be members of the Supervisory Board or Non-Executive Directors of the Board of Directors, as the case may be, as long as they are capable of working in the area of revision.

3.3. Remuneration of Supervisory and Executive Board Members

The Companies Act is the main source (mandatory law) of rules for the remuneration of board members. In addition, the *Codex of Professional Ethics of the Slovenian Directors' Association*, the *Guidelines for the functioning of the Management Boards*, and the *Corporate Governance Codex for Non-Public Companies* (soft laws) all provide certain additional aspects of the remuneration policies in the companies. If a company's shares are publicly traded or it is provided in the Statute or Articles of Association, it must adopt a Remuneration Policy for the Supervisory Board and Board of Directors. A Remuneration Policy must be confirmed at a Shareholders' Assembly and revised at least every four years. This policy must include all information about the fixed and variable aspects of remuneration.

Members of a Board of Directors may by law receive the following payments for their work: a salary, benefits (e.g., a car, a mobile phone), reimbursement of expenses (e.g., business trip, overnight stays, education), a business performance award, a share of profits, (the amount of remuneration is normally provided as a percentage of yearly profits), an insurance premium,

a commission, a severance grant, and other additional remunerations. The payments must be in an appropriate proportion to the Board of Directors member's tasks and the company's financial situation. However, the remuneration may be reduced by the decision of the Supervisory Board if the business of the company deteriorates to the extent it threatens the economic position of the company or it could cause damage to the company. Additionally, the Supervisory Board may request a proportional return of already paid bonuses for business performance under certain conditions.

Supervisory Board members can be paid if the Statute/Articles of Association or Shareholders Meeting determine that. If Supervisory Board members are paid, the payment has to be in an appropriate proportion to their tasks and the company's financial situation.

Except for the state-owned companies there are in principle no limitations on the amount of remuneration that can be agreed.

Companies are in principle not required to set up a Remuneration Committee.

Normally, the Supervisory Board and Board of Directors' remunerations do not need to be publicly disclosed. But, if a company's shares are publicly traded or it is provided in Statute or Articles of Association, a company (Board of Directors) must prepare a clear and concise report on remuneration, including all benefits of any sort, which were given to the Board members in line with the Remuneration Policy. The report must be revised by the auditor and published on the company's website once it is adopted by the Shareholders' Assembly.



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CEE LEGAL MATTERS COMPARATIVE LEGAL GUIDE: CORPORATE GOVERNANCE 2023 TURKEY



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1. Corporate Structure Of The Companies

1.1. General Legal Framework

Joint stock companies (JSC) and limited liability companies (LLC) are two of the most commonly used company types among those regulated by the *Turkish Commercial Code No.6102* (TCC). Under the TCC, the corporate bodies vary depending on the company types or whether the company is a publicly held or private one. Therefore, there is no differentiation in terms of corporate bodies between small, mid-sized, and large companies. Additionally, for publicly held companies, special committees are required to be formed as explained further in Section 3.2.

In JSCs, the required bodies are the board of directors (Board) and the general assembly of shareholders (GA). The authority of the Board arises from the TCC and the articles of association of the respective company that is required to be registered with the relevant trade registry during registration of the respective JSC. Pursuant to Article 365 of the TCC, the JSC is managed and represented by the Board. On the other hand, in the LLCs, instead of a Board, a board of managers manages and represents the company.

In both types of companies, the GA consists of shareholders and may only decide upon matters that are listed under the TCC such as the election of the members of the Board or board of managers, their removal, the distribution of profits and dividends, and the amendment of articles of association. To summarize, for both company types, the duties of the GA are parallel.

It should be noted that although it is not the rule, we see that in practice, companies that have larger capital and more sizeable transactions either qualitatively or quantitatively are established as JSCs, whereas the remaining are established as LLCs.

There is no requirement for a minimum number of shareholders. Thus, both JSCs and LLCs can be established by one shareholder as per Article 338 of the TCC for a JSC and Article 573 of the TCC for an LLC for them to be established.

Although there are no special requirements in terms of being a shareholder in principle, such requirements and criteria may be determined via the articles of association. As there are no legal restrictions, both real persons and legal entities can be shareholders.

According to Article 329 paragraph 2 of the TCC, shareholders of JSCs are only liable to the company with the capital they have committed. In LLCs, in addition to the capital they have committed, shareholders may also be liable for additional payments if it is stipulated in the articles of association. How-

ever, the additional payment liability is regulated in the Article 603 of the TCC where some conditions are set regarding the financial situation of an LLC. The limited conditions regulated in the relevant article are as follows:

- when the sum of the company's basic capital and legal reserves cannot cover the loss of the company,
- when the company cannot operate properly without these additional payments, or
- in any other circumstance specified in the articles of association that necessitates equity.

An additional payment obligation can only be established as a specific cash amount and this sum cannot be greater than double the capital's nominal value that is stated in the articles of association.

Additionally, the shareholders of LLCs are also directly liable in proportion to their capital shares for the public receivables that cannot be collected from the LLC as per Article 35 of *Law No. 6183 on the Procedure of Collection of Public Receivables*. Such liability for public debts does not exist for the shareholders of JSCs.

The provisions regarding the classification of enterprises and companies according to their scales are regulated in Articles 1522 and 1523 of the TCC. In accordance with Article 1522, the criteria as to whether enterprises are to be considered small, mid-sized, or large are determined via regulations by the Turkish Ministry of Customs and Trade. Pursuant to Article 1523, the criteria determined for small, mid-sized, or large enterprises are also valid for both LLCs and JSCs. Under Article 5 of the *Regulation on the Definition, Qualification and Classification of Small and Mid-Sized Enterprises No. 2005/9617*, enterprises are classified as follows:

- Micro Enterprise: Enterprises employing less than 10 employees and whose annual net sales revenue or financial balance sheet do not exceed TRL 5 million.
- Small Enterprise: Enterprises employing less than 50 people and whose annual net sales revenue or financial balance sheet do not exceed TRL 50 million.
- Mid-Sized Enterprise: Enterprises employing less than 250 people and whose annual net sales revenue or financial balance sheet do not exceed TRL 250 million.

Companies that exceed the criteria set above for mid-sized enterprises are considered large-scale enterprises/companies. However, the following companies are regarded as large-scale enterprises/companies irrespective of meeting the criteria set above:

- Banks, of which one of the principal areas of activity is to preserve assets in the capacity of trust for a large group of persons,

- Investment banks,

- Insurance companies, and

- Pension companies and similar companies.

1.2. The Function of the Supervisory Board

The TCC system is built on a single-tiered board structure. Thus, there is no division as a separate supervisory and executive board. However, the TCC has a flexible regime in this regard and allows the establishment of a two-tiered board structure. As such, Article 367 of the TCC regulates the transfer (delegation) of management to some Board members and/or third persons. Thus, with the provisions of paragraph 2 of Article 367 and Article 370 of the TCC, it is possible to form a supervisory board in accordance with a dualist approach. These explanations also apply to a board of managers in LLCs.

Especially in large-scale companies, an executive board is preferred with the transfer of authority, since it enables the company's business to be carried out more effectively, efficiently, and easily.

Further, in the Corporate Governance Principles (*Annex I of Corporate Governance Communiqué (Corporate Governance Communiqué)* issued by the Capital Market Board (CMB) (*serial II, No. 17.1*) dated January 3, 2014) it has been regulated that the chairman of the Board and the chief executive officer should be different persons on the grounds that the management should not remain in the hands of a single person, creating an omnipotent decision maker. Pursuant to the Corporate Governance Principles, if these titles are bestowed upon a single person, such should be disclosed on the Public Disclosure Platform (*Kamuyu Aydınlatma Platformu (KAP)*) together with its reasons.

According to Article 369 of the TCC, Board members must manage and represent the company with care and commitment. This is an objective duty of care, and it indicates that the Board member's duty of care extends beyond the care they exercise in their personal affairs. Thus, they are expected to operate with the same care and caution as a careful and prudent manager in a similarly qualified company under similar circumstances. As an extension of the duty of care, Board members are under the obligation of confidentiality, in other words, Board members cannot disclose information that is discussed in meetings or acquired outside the meeting as part of their duty. The same principles apply to the members of both the executive board and supervisory board in the case of

a two-tiered board structure.

Board of managers members' degree of care is different than that of Board members. According to Article 626 of the TCC, managers have to perform their duties with due care, have to safeguard the interest of the company in good faith, and are obliged with a duty of loyalty. Thus, while Board members' duty of care is evaluated based on being a prudent manager, members of the board of managers are not subjected to such an analogy.

1.3. Function of the Executive Board

As mentioned in Section 1.2., there is no distinction between supervisory and management bodies under Turkish law in principle and the duties of the supervisory board are fulfilled by the Board.

According to the TCC, the senior management of the company, the determination of the company's management organization, and the establishment of the necessary order for financial planning are non-transferable duties both for the Board and the board of managers.

The Board is the body that ensures the implementation of corporate governance principles in practice. The Corporate Governance Principles state that the Board's primary responsibility is to manage and represent the company by maintaining the risk, growth, and return balance at the most appropriate level, using a logical and responsible risk management approach, primarily by taking the company's long-term interests into consideration. The Board establishes the company's strategic goals, labor, and financial resources it will need and evaluates the management's effectiveness.

It is sufficient for both the Board and board of managers members to possess full capacity and power of discernment to fulfill their obligations and duties regulated under the TCC and applicable laws and regulations. However, additional special requirements regarding the members of the Board/board of managers may be stipulated by the articles of association.

Real persons and legal entities can be board members in both JSCs and LLCs. If a legal entity becomes a board member, a real person representative should be assigned in order to attend board meetings, vote, and sign on behalf of the legal entity. Additionally, there are no nationality restrictions in the TCC.

1.4. Conflicts of Interest and Related Party Transactions

There are numerous articles stipulated under the TCC that regulate the obligations of the members of the Board and board of managers to avoid conflicts of interest and related

party transactions. Relevant articles for Board members are as follows:

- Board members are obliged not to compete with the company. Accordingly, Board members cannot carry out a commercial transaction that falls within the scope of the company's business, on behalf of themselves or someone else, without the permission of the GA (Article 396 paragraph 1 of the TCC).

- Board members cannot perform transactions with the corporations, on behalf of themselves or anyone else without the permission of the GA (Article 395 paragraph 1 of the TCC).

- Non-shareholder Board members and their non-shareholder relatives are prohibited from borrowing cash from the corporation. The company cannot provide security, guarantee, or collateral to the aforementioned persons, and cannot assume liability or take over the debts of those persons (Article 395 paragraph 2 of the TCC).

- Board members cannot attend meetings in certain cases. Accordingly, a Board member cannot attend a meeting on matters where their personal interests or the personal interests of one of their descendants, spouse, or blood relatives up to the third degree, including the third degree, conflict with the interests of the company (Article 393 of the TCC).

In addition to these obligations, it is regulated in the Corporate Governance Principles that the company shall not loan money, make credit available, enlarge the term of the loan money or credit, improve conditions, make credit available via a third party as personal credit, or grant securities such as surety to any of its Board members.

Article 17 paragraph 3 of the *Capital Markets Law No.6362* (CML) regulates related party transactions. Accordingly, any related party transactions of publicly held companies that exceed the thresholds of 5% and 10% of the overall revenue of such company require a Board decision. With it exceeding each threshold, additional obligations such as valuation, an affirmative majority of independent Board members in the decision establishing the fundamentals of the transaction, and potential GA approval may also be necessary.

In the case of an LLC, managers are restricted from engaging in any activity that may put them in competition with the company. However, it is expressly stipulated that the non-compete rule is not absolute and may be repealed by the GA (Article 626 paragraph 2 of the TCC).

1.5. Legal Framework for Large Companies

There are no specific provisions regarding the mandatory bodies of large companies regulated under the TCC except as

explained in Section 3.1. and 3.2., where banks and publicly held companies must establish mandatory committees. Please refer to the relevant sections for further details.

2. Corporate Governance Framework

2.1. Transparency and Public Disclosures

According to Article 1524 of the TCC, capital companies subject to independent audit are required to launch a website within three months from the date of registration of their company with the trade registry. In general, the following information should be published on such companies' websites: commercial name, names of the chairman and members of the Board/board of managers and the auditor, and GA minutes.

In addition to the above, for publicly held companies, according to the Corporate Governance Principles, the corporate website shall include trade registry information, up-to-date information about the shareholder and management structure, detailed information about privileged shares, the final version of the companies' articles of association together with date and numbers of the *Turkish Trade Registry Gazette* in which amendments are published; financial statements, annual reports, prospectuses and other documents for public disclosure, agendas of the GA meetings, lists of attendees and meeting minutes, the form of proxy voting at the GA meeting, mandatory information forms prepared for a tender offer or proxy solicitation and similar forms, companies' policy for buy-back if any, the policy of dividend distribution, ethic rules adopted by the company in addition to the information that must be disclosed in accordance with the applicable laws. In this respect, a minimum of five years' worth of information on the aforementioned matters must be available on the company's corporate website. In addition to these, questions and complaints received by the company and responses to them must be available on the website under the frequently asked questions section and relevant information on the website must be prepared additionally in foreign languages for the use of foreign investors.

According to paragraph 2 of Article 422 of the TCC, the Board/board of managers is obliged to register and announce the notarized copy of the GA decisions at the Trade Registry Directorate. Not all matters are registered and announced, and the matters that need to be registered and announced mainly include structural changes (such as a de-merger, merger, or change of company type), amendments to the articles of association (Article 455 of the TCC) together with capital increase and decrease decisions (respectively Articles 456 and 473), address changes, the appointment of the members of the Board/board of managers and their term of duty, the appointment of the independent auditor.

As mentioned in Section 2.1., GA minutes must be also published on the company's corporate website.

The TCC does not stipulate a rule requiring the public disclosure of all Board/board of managers decisions. However, according to Article 373 of the TCC, the Board/board of managers should submit the notarized copy of their decision that identifies the person authorized to represent together their authorities to the Trade Registry Directorate for registration and announcement. In addition to the abovementioned rule, the internal directive prepared by the Board/board of managers, which comprises the rules regarding the GA's working principles and procedures is also registered at the Trade Registry Directorate and announced according to Article 419 of the TCC. Also, if the JSC adopted the registered share capital system, the Board decision approving the share capital increase must be registered and announced.

2.2. Public Authorities Responsible for Monitoring Corporate Governance

According to Article 17 of the CML, the CMB is responsible for determining the corporate governance principles for publicly held corporations.

Additionally, the Banking Regulation and Supervision Agency (BRSA) sets corporate governance rules for banks and financial institutions.

The Public Oversight Accounting and Auditing Standards Authority (*Kamu Gözetimi Mübesebe ve Denetim Standartları Kurumu* (KGK)) is a regulatory and supervisory government agency established in Turkey to protect the public interest regarding accurate and independent preparation of audit reports, to provide accurate, reliable, and comparable financial information, and to oversee the audits of large-scale companies, including listed companies, banks, and insurance companies.

The Corporate Governance Communique and the Corporate Governance Principles and its annex, are the main regulations regarding corporate governance. The respective principles apply only to public companies having their shares traded on the stock exchange and companies which are considered as publicly held as per the law. It should be noted that most of those principles are advisory, and not mandatory.

Additionally, there is the Communique on the Corporate Governance Principles of Banks dated November 1, 2006, regarding the corporate governance of banks.

2.3. ESG

Non-financial reports mainly evaluate the transparency, environmental, and social obligations of companies, and they are presented to the stakeholders. There is no legal regulation on

non-financial reporting in Turkey. Having said that, since financial reports can no longer satisfy the investor's information needs, companies are turning to alternative reporting methods. Therefore, non-financial reporting is increasing day by day.

Currently, there is no public authority in Turkey responsible for setting standards for non-financial reporting and disclosures.

2.4. Internal Controls and Fraud Measures

In accordance with the *Decree* on the Determination of the Companies Subject to Independent Audit, the following companies are subject to independent auditing:

- Companies included in List I attached to the decree,
- Companies whose capital market instruments are not traded in a stock exchange or other organized markets, but are considered publicly traded within the scope of the CMB, and
- Companies included in List II attached to the decree.

For these companies, such criteria and threshold values are also regulated separately. Accordingly:

1. Companies in List I attached to the decree are subject to independent auditing regardless of any criteria.

In the attached List I, companies are listed under a total of six separate headings, such as investment institutions, portfolio management companies, valuation institutions, banks, and factoring companies. It is regulated that these companies are subject to independent audits without being bound to any criteria.

2. The following threshold values are foreseen for companies whose capital market instruments are not traded on a stock exchange but are considered publicly traded within the scope of the CMB.

- Total assets of TRY 30 million,
- Annual net sales revenue of TRY 40 million, and
- 50 employees.

Those who fulfill at least two of the criteria in two consecutive accounting periods are subject to independent audit as of their following accounting period.

3. The following threshold values are foreseen for the companies specified in List II attached to the Decision.

- Total assets of TRY 60 million,
- Annual net sales revenue of TRY 80 million, and
- 100 employees.

Those who fulfill at least two of the criteria in two consecutive accounting periods are subject to independent audit as of their following accounting period.

4. The threshold values for companies not covered by the above are as follows:

- Total assets are TRL 75 million,
- Annual net sales revenue of TRL 150 million, and
- 150 employees.

Those who fulfill at least two of the criteria in two consecutive accounting periods are subject to independent audit as of their following accounting period.

Independent audit reports are also published on the company's website together with the financial reports.

Internal audit is related to the assurance of independent and objective activity and contributes to the efficiency of corporate governance. According to Article 29 of the *Banking Law No. 5411* (BankL.), banks are required to form an internal audit mechanism with the assistance of the Board. In a nutshell, this internal audit mechanism should govern all units, branches, and partnerships of a bank. In this framework, the bank inspectors audit the banking activities whether they comply with the legislation, internal regulations, and banking principles.

Under Article 29 of the BankL., it is clearly regulated that the internal audit activities are carried out impartially and independently with due professional care. In this respect, the internal audit report must be prepared and submitted to the Board via the audit committee at least once every quarter.

The *Regulation on Internal Systems of Banks* also sets the Board's responsibilities for selecting the audit committee. Various restrictions on who may represent the committee are contemplated under Article 6 of the BankL, some of which are as follows:

- Not being among the Board members who have executive duties in the bank,
- Not having qualified shares in the bank and partnerships subject to consolidation, and
- Prohibition on spouses or children holding the positions of general manager, assistant general manager, or other comparable positions within the bank.

3. Shareholder And Board Committees

3.1. What Committees Are Prescribed by Law?

There is no regulation that obliges companies to establish

committees, except in the case of publicly held companies. Mandatory committees for publicly held companies are explained in detail in Section 3.2. In addition, pursuant to Article 24 of the BankL., it is obligatory to establish an audit committee to assist the Board in carrying out their audit and surveillance activities.

Even though it is not mandatory by the TCC, the Board of privately held/closed companies or the board of managers may also establish committees to monitor its business more effectively, conduct internal audits, or implement certain Board decisions.

3.2. What Committees Are Mandatory for Large Companies?

The following committees must be established by the Board for publicly held companies to effectively carry out their obligations in accordance with the Corporate Governance Principles governed by the CMB:

1. The *Audit Committee* is in charge of the supervision of the company's accounting system, public disclosure of the financial information, independent auditing, and the operation and efficiency of internal control and internal audit system. Election of the independent audit institution, initiation of the independent audit process by preparing the contracts of independent audit, and the work of the independent audit institution at all levels shall be conducted under the supervision of the audit committee. The independent audit institution and the service to be purchased from this institution shall be determined by the audit committee and submitted for the approval of the Board.
2. The *Corporate Governance Committee* is in charge of determining whether the principles of corporate governance are applied. If not, it is among the duties of the committee to determine the reason for non-implementation and give advice on such issues to the Board in order to improve corporate governance.
3. The *Nomination Committee* is in charge of the establishment of a transparent system for the identification, evaluation, and training of suitable candidates for management positions with administrative responsibility, and to work on determining policies and strategies in this regard.
4. The *Early Detection of Risk Committee* is responsible for the early detection of risks that may endanger the existence, development, and continuation of the company, by taking the necessary precautions regarding the risks identified, working to manage the risk, and reviewing the risk management systems at least once every year.
5. The *Remuneration Committee* is in charge of the designations of the principles, criteria, and implementations to be used in the remuneration of the Board members and the executives

by considering the long-term targets of the company and supervision thereof and submits its advice with respect to the remuneration of the Board and the executive managers while considering the achievement level to the criteria used in remuneration.

However, according to the Corporate Governance Principles, the corporate governance committee may also perform the duties of the nomination and remuneration committees if they have not been established independently due to the Board's organizational structure.

3.3. Remuneration of Supervisory and Executive Board Members

It is not mandatory to establish a Remuneration Committee in JSCs and LLCs. As stated in Section 3.2., even publicly held corporations are not required to have a Remuneration Committee.

Under the TCC, the remuneration of members of the Board/board of managers members is not mandatory. However, according to Article 394 of the TCC, if the amount is determined by the articles of association or a GA decision, members of the Board/board of managers can be paid in the form of the attendance fee, salary, bonus premium, or a share of the annual profit. However, certain requirements have been stipulated under Article 511 of the TCC regarding the remuneration of Board members. In this respect, dividends may be given to Board members only after a certain allocation is made for the legal reserve and after the dividend is distributed to the shareholders at the rate of 5% of the paid-in capital or at a higher rate stipulated in the articles of association.

While the remuneration of Board members is clearly regulated in Article 394 of the TCC, no similar regulation has been adopted for the board of managers' members. However, in Article 616 of the TCC, it is regulated that the salaries of members of the board of managers will be determined by the GA.

The equal treatment principle prevailing in the TCC has no application in terms of remuneration. Accordingly, different payments can be made to the members of the Board and board of managers depending on their experience and contribution to the company.

In the Corporate Governance Principles, it is regulated that the financial rights provided to Board members will be determined as a result of an evaluation based on performance. In the remuneration of independent board members, share acquisition plans or payment plans based on the company's performance cannot be taken into account according to the Corporate Governance Principles. In addition, the amount of remuneration

for the said members must be at a satisfactory level to protect their independence.

Pursuant to the TCC, the determination of the remuneration of the members of the Board and the board of managers is one of the non-transferable duties of the GA. As mentioned in Section 2.1., GA meeting minutes must be registered under the Trade Registry Directorate and announced in the *Trade Registry Gazette*. These explanations are also valid for the remuneration of the members of the board of managers.

Companies who are required to establish a website should publish their GA minutes on their website. Pursuant to the Corporate Governance Principles, remunerations and all other benefits provided to the Board members and executives with administrative responsibility are disclosed to the public through the annual activity report.



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1. Corporate Structure Of The Companies

1.1. General Legal Framework

Ukrainian corporate governance rules vary depending on the organizational form of the company. There are clear legislative regulations for limited liability companies (LLCs) and joint stock companies (JSCs) in the respective since these types of companies are the most common.

Additionally, Ukrainian law contains general corporate governance provisions regarding entities established in other forms; however, in such cases, detailed provisions regarding corporate governance are expected to be included in the charter and other internal documents. Therefore, this will focus on LLCs and joint stock companies as well as exclude information on the state companies.

Ukrainian companies previously used to have only a classical two-tier corporate governance model with two mandatory bodies – a shareholders' meeting (or sole shareholder) as the highest body and an executive body (either collective or individual), as well as an optional supervisory board (public joint stock companies and joint stock companies with more than 10 shareholders).

The new *Law on JSCs* entered into force on January 1, 2023, changed this approach and allowed the companies to choose between the two-tier and one-tier model (with executive and non-executive directors on the board of directors). The law is intended to regulate JSCs, but provisions on the choice of the model apply to LLCs as well.

The said law also introduces several requirements for large companies (e.g., regarding the supervisory board committees). According to the accounting legislation, the company is deemed large if two of the three following criteria are met:

- assets value exceeds EUR 20 million,
- net revenue from sales exceeds EUR 40 million,
- the average number of employees is more than 250.

1.2. The Function of the Supervisory Board

The primary function of the supervisory board is to oversee the activity of the company's executive body. A one-tier model would vest these functions in the non-executive board members responsible for controlling executive members.

The *Law on JSCs* provides for a number of specific powers of the supervisory board (e.g., convening the shareholders' meeting, approval of the assets' market value, etc.). Alongside these powers, the charters may indicate additional matters within the competence of the supervisory board.

The shareholders of a public JSC may not be able to take over these functions – this is the only example of the limited

powers of the shareholders; in other cases, they can decide on all matters.

Comparatively, LLCs are subject to more discretionary provisions, i.e., there is no mandatory list of functions to be transferred to the supervisory board and shareholders can vote in all cases.

In terms of the supervisory board's liability, Ukrainian law provides that officials (including supervisory board members) must act in accordance with the laws and internal documents in order to protect the interests of the company and can be held liable for damages for their misconduct. There are also several specific obligations (e.g., confidentiality obligation or obligation to comply with rules regarding the related party transactions).

The new legislation also significantly improves the general concept of officials' fiduciary duties, for example, by stipulating that the officials must ensure the success of the company's activity to the maximum extent possible, act independently and with a reasonable degree of care and expertise, and provide explanations on the respective obligations.

1.3. The Function of the Executive Board

A company's executive body is responsible for managing all operational activities and controlling all matters outside of the shareholders' and supervisory board's competence. Within these limitations, the head of the executive body serves as the company's representative, concludes transactions, and issues internal orders. A company's documents may specify that other members of its executive body will be its representatives as well as the company's head.

As members of the executive body also are the company's officials, all general fiduciary duties indicated in Section 1.2. are relevant as well.

In addition, there are a few specific obligations that are applicable only to members of the executive body. As an example, it is a requirement to analyze the financial data and notify the shareholders of significant decreases in the value of the net assets (for example, when such value is less than 50% of the value of the net assets as of the previous financial period).

1.4. Conflicts of Interest and Related Party Transactions

The new *Law on JSCs* regulates conflicts of interest prevention (the previous wording was silent in this regard). A conflict of interest occurs when the official has a direct or indirect interest in using property, information, or opportunities of the company in conflict with the company's interests and may cause losses to the company. Such interests must be immediately reported by the company's officials to the respective managing body.

At that, the conflict of interest may be waived provided that the charter of the company allows (for public JSCs) or not forbids (for private JSCs) such a waiver and the procedure of granting the waiver is not violated (e.g., the person with conflict did not participate in the meetings of the body deciding on the waiver).

It is also prohibited to obtain remuneration from third parties for performing official duties.

The *Law on LLCs* also contains provisions regarding mandatory notifications of conflicts of interest and the prohibition to obtain remuneration from third persons. In addition, it clarifies that conflicts of interest may arise also in cases when a benefit is obtained by the affiliated person of the official. To this end, there is an obligation of the official to submit the list of their affiliated persons.

Related party transactions are not forbidden by Ukrainian legislation. Yet there is a specific procedure for their approval. For instance, related party transactions of the JSCs with a value from 1% to 10% of the value of the assets are to be approved by the supervisory board, with a value of 10% and up to be approved by the company's shareholders (lower thresholds may be indicated by the charter). Moreover, according to Ukrainian legislation, the supervisory board of a public JSC must involve an independent external auditor to check whether a related party transaction corresponds to normal market conditions.

For LLCs, the necessity to clear a related party transaction applies only if it is directly indicated in the charter. In practice, this mechanism is rarely used.

1.5. Legal Framework for Large Companies

According to the newly adopted *Law on JSCs*, there are special rules for large companies regarding the establishment of the supervisory board committees and mandatory appointment of the corporate secretary.

The special requirements also apply to public (listed) JSCs, banks, insurance companies, and capital markets institutions. These requirements mainly relate to:

- mandatory corporate bodies – the establishment of the supervisory board is necessary for all such companies,
- minimal number of the supervisory board and executive body members – for instance, the supervisory board of a bank should consist of no less than five members,
- independent directors – in banks one-third of the supervisory board but not less than three members must be independent,
- committees of the supervisory board and executive body – the supervisory board of an insurance company must have risk management, compliance, and internal audit committees; the

supervisory board of the capital market institutions – a risk management committee; the executive body of the bank has to establish such committees as a credit committee and an assets and liabilities management committee.

2. Corporate Governance Framework

2.1. Transparency and Public Disclosures

The requirements regarding public disclosure of regulated information are imposed on the JSCs and other types of companies issuing securities. Thus, these rules are not applicable to most LLCs.

The information is to be submitted to the National Securities and Stock Market Commission, indicated on the website, and provided to the authorized regulated information agency (SMIDA).

It is required to disclose, for example, the following information on corporate governance:

- Information on managing bodies, officials, and shareholders, management reports, including reports on corporate governance (i.e., additional requirements to the corporate governance specified at the company's level, information on the shareholders' meeting, supervisory board, executive body, powers of the company's officials), information on material, and related party transactions (for public JSCs) – annual information,
- Information on changes of officials – special information.

For public JSCs the disclosure requirements are more strict and, for instance, include mandatory disclosing on their websites the charter, regulations on the managing bodies, shareholders' resolutions, reports of the supervisory board, executive body, and other bodies. In other cases, such documents are not disclosed.

Additional management reports are also to be disclosed by all the large and medium enterprises (medium enterprises can indicate in such a report only financial information). This report can be drawn up in free form, but it is recommended to include corporate governance matters in such a report.

2.2. Public Authorities Responsible for Monitoring Corporate Governance

The main regulator authorized to monitor the fulfillment of obligations regarding corporate governance is the National Securities and Stock Market Commission. At that, its competence is limited to JSCs and other types of companies that have issued securities. LLCs have much more flexibility in terms of disclosing such information.

The activity of banks and insurance companies is overseen by the National Bank of Ukraine.

In 2020, the National Securities and Stock Market Commission

adopted the *Core Code of Corporate Governance: Requirements and Recommendations* – a set of recommended corporate governance practices. The guideline is mainly aimed at listed companies but also contains recommendations for unlisted companies.

2.3. ESG

There is a requirement to disclose information on corporate governance as specified in Section 2.1.

Apart from general rules regarding compliance with environmental protection and social policies, Ukrainian legislation does not contain any additional obligations regarding the social or environmental components of ESG.

There are several recommendations in the *Core Code of Corporate Governance* in this regard, e.g., to consider the possible contribution of the company in achieving the goals of sustainable development, develop a sustainable development policy, and report on the societal and environmental impact of the company on a regular basis.

It is also recommended to disclose information on the ecological (rational use of water, waste management, etc.) and social aspects (share of women in management positions, motivation of employees, equal employment opportunities, etc.) in the management report for large and medium enterprises.

2.4. Internal Controls and Fraud Measures

Legislation on internal audits is under development in Ukraine, and legal obligations are only set up for specific types of companies (e.g., banks).

It is also specified that the supervisory board of the JSC can appoint an internal auditor or establish the respective department. In case of such an appointment, the internal auditor reports to a member of the supervisory board – the chairman of the audit committee.

The novelties in the legislation on JSC slightly refine the competencies of the audit committee regarding the internal audit and specify that the function of this committee consists of monitoring the integrity of the financial information, analyzing accounting methods, evaluating internal audit efficiency at least annually, and recommending candidates for the positions of an internal auditor and head of the budget department to the supervisory board.

However, other details are to be regulated by the internal documents of the company.

3. Shareholder And Board Committees

3.1. What Committees Are Prescribed by Law?

According to the general rules, there are no requirements regarding the committees, and they are rarely established in practice. Exceptions are provided for public JSCs, large JSCs,

and specific types of companies.

3.2. What Committees Are Mandatory for Large Companies?

In public JSCs and large JSCs, it is required to establish audit, remuneration, and appointment committees (the last two can be combined). The independent directors must be committees' chairs and constitute the majority of their members.

There are also specific requirements for banks, insurance companies, and capital market institutions that are briefly described in Section 1.5.

3.3. Remuneration of Supervisory and Executive Board Members

Ukrainian legislation specifies the main principles regarding remuneration for JSCs, for instance:

- Remuneration may consist of fixed and variable parts,
- There should be limits for variable remuneration,
- Variable remuneration is based on clear criteria for efficiency assessment.

The exact amounts and payment procedure are governed by the agreement between the company's official and the company and by internal documents (charter, regulations on remuneration).

The *Core Code of Corporate Governance* specifies general recommendations to remuneration – transparent, fair, and sufficient to attract, motivate, and retain talent.

The members of the supervisory board in JSCs and LLCs and members of the executive board in LLCs can be appointed as contractors (not employees) based on a civil law agreement. That means that standard employment guarantees are not applicable and it is possible to conclude gratuitous contracts.

As was also stated above, remuneration from third parties is prohibited to prevent conflicts of interest.

As for disclosing information on remuneration, only information on remunerations and compensation to be paid in the case of dismissal is disclosed as part of the annual information of the public JSCs.



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