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European Bank
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Corporate Governance in Transition Economies

Serbia Country Report

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Prepared by:
Gian Piero Cigna
Pavle Djuric
Yaryna Kobel
Alina Sigheartau

With the assistance of:
Nestor Advisors

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If you believe that the information has changed or is incorrect, please contact Gian Piero Cigna at cignag@ebrd.com

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This Report – along with all other country reports prepared within this initiative – is available at: http://www.ebrd.com/what-we-do/sectors/legal-reform/corporate-governance/sector-assessment.html

Foreword

As part of its Legal Transition Programme, the European Bank for Reconstruction and Development ("EBRD") has been assessing the state of legal transition in its countries of operations. These assessments provide an analysis of the progress of reform and identify gaps and future reform needs, as well as strengths and opportunities.

In 2012, the Legal Transition team within the EBRD Office of the General Counsel (LTT) developed with the Assistance of Nestor Advisors a methodology for assessing corporate governance frameworks and the governance practices in the EBRD countries of operations. This assessment was implemented in 2014-2015 (the "Assessment").

The Assessment aims at measuring the state of play (status, gaps between local laws/regulations and international standards, effectiveness of implementation) in the area of corporate governance

The Assessment is meant to provide for (i) a comparative analysis of both the quality and effectiveness of national corporate governance legislation (including voluntary codes); (ii) a basis to assess key corporate governance practices of companies against the national legislation; (iii) an understanding whether the legal framework is coupled with proper enforcement mechanisms (e.g., sanctions) and/or with authorities able to ensure proper implementation; (iv) a support to highlight which are the major weaknesses that should be tackled by companies and legislators for improving the national corporate governance framework; and (v) a tool which will enable the EBRD to establish "reference points" enabling comparison across countries.

This country report is part of a series of 34 country reports. A general report synthesising all countries will close the Assessment.

Methodology

This Assessment is based on a methodology designed to measure the quality of legislation in relation to best practices requirements and the effectiveness of its implementation as evidenced by companies' disclosure, also taking into consideration the capacity of the institutional framework (e.g., courts, regulators) to sustain quality governance. The analytical grid developed for assessing the governance framework is based on international recognised best-practice benchmarks (e.g., OECD Corporate Governance Principles, Development Financial Institutions, EBRD, IFC and World Bank ROSC governance methodologies). The methodology is applied identically across all the countries reviewed. The process for gathering, analysing and reporting information is applied identically for each of the countries assessed, which allows comparing countries to each other across a long a set of benchmarking points.

For the purpose of the Assessment, the corporate governance framework and the practices were divided in five key areas: (i) Structure and Functioning of the Board; (ii) Transparency and Disclosure of company information; (iii) Internal Control; (iv) Rights of Shareholders; and (v) Stakeholders and Institutions. Each of these key areas is further divided in sections (for instance, the area "Structure and Functioning of the Board" is divided in five sections: Board composition; Gender diversity at the board; Independent directors; Board effectiveness; and Responsibilities of the board). Each section is further divided in subsections (for instance, the section "Independent Directors" is divided in three subsections: "Requirement to have independent directors"; "Definition of Independence"; and "Disclosed practices").

The assessment started by sending a questionnaire to law firms, audit firms, national regulator(s), ten largest (listed) companies, and stock exchange(s) in each country. Questions were different according to the respondents, which were asked to provide information on the legislation and on how they believe the legislation is implemented.

Responses were assigned to the corresponding subsection(s) and validated by the EBRD corporate governance specialists by looking at the applicable framework and at the disclosure offered by the ten largest (listed) companies in each country. In this respect, the working hypothesis was that the ten largest listed companies are those offering the best disclosure in each country. As such, we presumed that when certain practices were not disclosed by them, they were unlikely to be disclosed by smaller or unlisted companies. The ten largest companies were identified according to their market capitalisation. When a country did not have a stock exchange, there were less than ten listed issuers or there were no data on capitalisation of issuers, the ten largest companies were identified according to their revenues and size of the labour force. In case the largest companies were mostly of one sector (e.g., financial institutions), then the sample of ten companies was corrected to reflect other sectors of the economy.

The validation of responses was undertaken by the corporate governance specialists within the Legal Transition Team through desktop research. This research was conducted both on legislation and on the practices disclosed by the largest (listed) companies (e.g., companies' websites, annual reports, stock exchanges database etc.). In addition, the relevant reports by international financial institutions (e.g., IMF, World Bank, IFC, Transparency International, etc.) were analysed and taken into consideration. Answers received by respondents that were not grounded by specific references to legislation or consistent with the disclosed practices were not taken into consideration.

Following the validation process, each subsection was compiled by adding specific references to legislation and practices. Conclusions were then formulated for each subsection, each rated as per their adherence to international governance standards. The score ranges from 1 (very weak) to 5 (strong). The rating for each section was then calculated by averaging the ratings of the subsections.

Because understanding corporate governance requires a "holistic perspective", where each component needs to have a place in the overall picture – pretty much like a puzzle - in case one of the subsection was rated "weak" or "very weak", the resulting average was decreased by 0.2; in case more than one subsection was rated “weak” or “very weak”, the resulting average was decreased by 0.5. This is because if just one component is not fitting well with the others, then all others are weakened. Similarly, the overall strength diminishes if there are more weak components.

Conversely, in order for the framework to be strong, all components need to be well fitting with each other. Hence, in case all subsections were scored “moderately strong” or “strong”, then the resulting average was increased by 0.5. However, this “positive” adjustment was used with some care as the assessment looked at the top ten largest companies in the country, hence findings tended to be often overly optimistic.

Key areas were then rated according to the same criteria.

The ratings are presented through the colours detailed in the box below and they demonstrate the adequacy or need of reform in respect to each governance area and section.

Rating:

“Strong to very strong” (DARK GREEN) - The corporate governance framework / related practices of companies are fit-for-purpose and consistent with best practice.

“Moderately strong” (LIGHT GREEN) - Most of the corporate governance framework / related practices of companies are fit-for-purpose but further reform is needed on some aspects.

“Fair” (YELLOW) - The corporate governance framework / related practices of companies present some elements of good practice, but there are a few critical issues suggesting that overall the system should be assessed with a view of reform.

“Weak” (ORANGE) - The corporate governance framework / related practices of companies may present few elements of good practice, but overall the system is in need of reform.

“Very weak” (RED) - The corporate governance framework / related practices of companies present significant risks and the system is in need of significant reform.

We believe corporate governance cannot be captured and measured simply by numerical values. Hence, alongside the “quantitative” assessment obtained according to the methodology described above, a “qualitative” assessment was also undertaken, by classifying our findings for each section as “strengths” and “weaknesses”. Because understanding corporate governance requires a “holistic perspective”, when the “quantitative” assessment was finalised, the assessment team compared it with the “qualitative” assessment, and when any inconsistency (i.e. material weaknesses or strengths) was noticed, the average scores of the sections were adjusted by up to ±0.5.

A preliminary version of the Assessment was made public for consultation. The comments and corrections received during the process were analysed by the corporate governance specialists. When confirmed, the corrections were reflected in the final ratings and in this Assessment.

Overview

Legislative framework

The primary sources of corporate governance legislation in Serbia are the Law on Companies; the Law on Banks; the Law on Accounting, the Law on Auditing and the Law on Capital Market. In 2008, the Belgrade Stock Exchange issued a Corporate Governance Code addressed to listed companies, to be implemented under the "*comply or explain*" approach.[1] This approach was institutionalised in 2011, when the Law on Companies was amended and listed companies were required by law to disclose their compliance with a corporate governance code or explain the reasons for non-compliance. In 2012, the Chamber of Commerce and Industry of Serbia also developed its own corporate governance code, addressed to all companies (including family owned companies and state owned enterprises). The code is voluntary and companies are recommended to implement it by adapting their articles taking into considerations the recommendations of the code. Among the ten largest listed companies, it appears that the majority have developed their own codes, however a few companies also refer to the Code of the Chamber of Commerce and Industry.

Structure and functioning of the board

Companies in Serbia can be organised under a one-tier or two-tier system, the latter being more common among the largest listed companies (i.e. companies whose shares are traded in the regulated market or a multilateral trading facility). Boards are generally well-sized (average 7 members). Evidence has shown that smaller boards tend to perform better, provided that they have the necessary mix of skills and support (e.g., corporate secretary). Legal entities can be board members (except in banks and other financial institutions); this approach raises some doubts. Gender diversity at the boards of the ten largest listed companies is among the highest in the EBRD region. Only banks and other financial institutions have qualification requirements for board members; however both codes provide some recommendations in this respect. In listed companies, the only qualification requirement relates to the audit committee.

The law assigns to the board most of its key functions, except for the approval of the budget, which is within the general shareholders' meeting's competence. We are not sure this is appropriate, as it may undermine the board's strategic role.

Boards of listed companies are required to have at least one independent member. In banks, the boards must be made up of at least one third of independent members. There are two definitions of "*independence*": one in the company law and one in banking regulation: both concentrate only on negative "*non-affiliation*" criteria without spelling out which positive requirements (i.e., objectivity of character and mind) are required from independent directors. All ten largest listed companies disclosed having the required number of independent directors in their boards, but the ground upon which they are considered independent is not elaborated.

Listed companies are required to create an audit committee, while banks are also required to create other committees. Committees can include "*outsiders*" (i.e., non-board members), which in practice appear to be commonly committee members. It seems that the law also allows executives to sit in committees. If this is possible, it is major weakness. From companies' disclosure, it is not clear if committees are playing a key role.

Companies are recommended to perform board evaluations and to have a corporate secretary, and the majority of the ten largest listed companies seem to comply with these recommendations.

Legislation on fiduciary duties is not comprehensive. More comprehensive is the regulation on liability of board members and conflict of interest.

[1] It seems that the Code of the Belgrade Stock Exchange is no longer considered as being in effect. It is located in the "Archive" section of the Stock Exchange's website and it is not used as a reference by the largest listed companies in the country.

Transparency and Disclosure

Companies are required to disclose a significant amount of financial and non-financial information, and largest companies appear to generally comply with the requirements. Financial statements must be in line with the IFRS. Companies must disclose a statement of application of a corporate governance code in their annual reports. Companies listed on the special segments of the Belgrade Stock Exchange must additionally fill in a Corporate Governance Questionnaire. This requirement appears to be well implemented, however disclosure is often formalistic. Disclosed information on board and committees meetings and members' qualifications, beneficial ownership and transactions in company shares is limited.

Internal Control

Companies and banks are required to establish an internal control system and have an internal auditor. Banks are also required to have standalone compliance and risk management functions. Listed companies and banks are required to establish an audit committee; however it is not entirely clear if audit committees are independent, qualified and effective. Medium, large, listed companies and banks are also required to have an independent external audit. The provision of non-auditing services by the external auditor is restricted and external auditors are required to rotate on a regular basis.

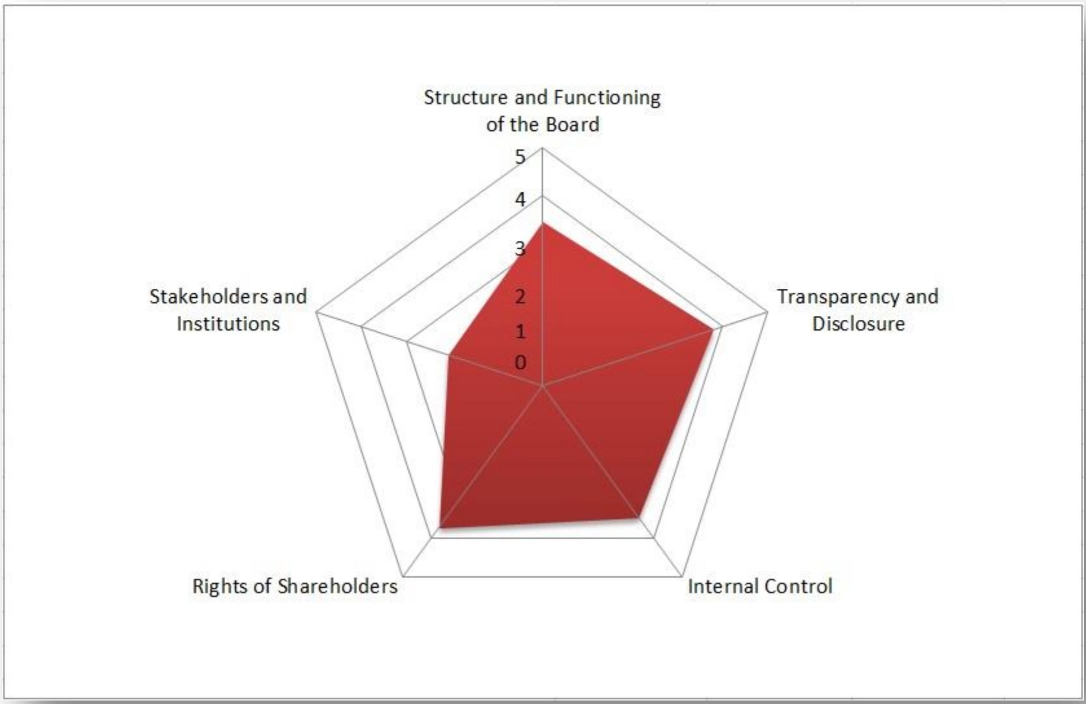
Rights of Shareholders

The law grants shareholders all basic rights related to the general shareholders meeting as well as other general protections and access to corporate documents. Minority shareholders can call a general shareholders' meeting, propose items to the general shareholders meeting agenda, nominate board member candidates and start a derivative claim. Cumulative voting is available only if provided by the Articles. Major corporate changes require qualified majority (of shares present at the meeting) but it appears that the capital can be increased by simple majority (of shares present at the meeting). Articles can also be amended by simple majority, but this majority is calculated on all issued shares with voting rights.

Stakeholders and Institutions

The institutional environment promoting corporate governance seems to be fairly developed, but key reforms would benefit the advancement of current efforts. There are inconsistencies in corporate governance legislation, while international organisations' indicators reveal that corruption is still perceived as a problem.

Corporate Governance Legislation and Practices in Serbia



Source: EBRD, Corporate Governance Assessment 2016

Note: The extremity of each axis represents an ideal score, i.e., corresponding to the standards set forth in best practices and international standards (e.g., OECD Corporate Governance Principles). The fuller the 'web', the closer the corporate governance legislation and practices of the country approximates best practices.

Key: Very weak: 1 / Weak: 2 / Fair: 3 / Moderately Strong: 4 / Strong to very strong: 5

Key Areas and Rating	Strengths and Weaknesses
1. Structure and Functioning of the Board *Fair*	*Companies in Serbia can be organised under a one-tier or two-tier system, the latter being more common among the largest listed companies (i.e. companies whose shares are traded in the regulated market or a multilateral trading facility). Board size is generally small (average 7 members). Evidence has shown that smaller boards tend to perform better, provided that they have the necessary mix of skills and support (e.g., corporate secretary). Legal entities can be board members (except in banks and other financial institutions); this approach raises some doubts. Gender diversity at the boards of the ten largest listed companies is among the highest in the EBRD region. Only banks and other financial institutions have qualification requirements for board members, however both codes provide some recommendations in this respect. In listed companies, the only qualification requirement relates to the audit committee.* *The law assigns to the board most of its key functions, except for the approval of the budget, which is within the general shareholders' meeting's competence. We are not sure this is appropriate, as it may undermine the board's strategic role.* *Boards of listed companies are required to have at least one independent member. In banks, the boards must be made up of at least one third of independent members. There are two definitions of "independence": one in the company law and one in banking regulation: both concentrate only on negative "non-affiliation" criteria without spelling out which positive requirements (i.e., objectivity of character and mind) are required from independent directors. All ten largest listed companies disclosed having the required number of independent directors in their boards, but the ground upon which they are considered independent is not elaborated.* *Listed companies are required to create an audit committee, while banks are also required to create other committees. Committees can include "outsiders" (i.e., non-board members), which are commonly committee members. It seems that the law also allows executives to sit in committees. If this is possible, it is major weakness. From companies' disclosure, it is not clear if committees are playing a key role.* *Companies are recommended to perform board evaluations and to have a corporate secretary, and the majority of the ten largest listed companies seem to comply with these recommendations.* *Legislation on fiduciary duties is not comprehensive. More comprehensive is the regulation on liability of board members and conflict of interest.*
1.1. Board Composition *Fair*	***Strengths:*** • *Boards appear to be generally well-sized to allow good cohesiveness, with an average of 7 members.* • *In the one-tier system, boards of listed companies are required to be comprised of a majority of non-executive members; whereas in the two-tier system, no member of the supervisory board can serve on the executive board and vice versa.* • *The roles of the chair of the board and CEO of listed companies are split by law regardless of whether the one-tier or two-tier system is retained.* • *The law requires boards or supervisory boards of listed companies to have at least one independent member. The same is recommended by the Corporate Governance Code issued by the Chamber of Commerce and Industry of Serbia (the CCI Code) for smaller companies, while for largest companies the CCI Code recommends that the board should have "a significant number of independent members". The Belgrade Stock Exchange's Corporate Governance Code (the BSE Code) recommends having at least two. The banking law requires a minimum of one-third of the board to be made up of independent directors. Companies seem to comply with these requirements.* • *The law requires audit, nomination and compensation committees of listed companies to be made up of a majority of non-executive directors, and a minimum of one independent director. The law further requires audit committees –the only one that is mandatory for listed companies – to be chaired by an independent director.* • *Members of banks' audit committees cannot be "persons related to the bank". This terminology includes members of the banks' executive board. In addition, at least two must be board members and one must be independent.* • *The CCI Code recommends that committees are made only of non-executive board members. The majority of committees and their chair should be independent board members. The CCI Code also recommends that each committee should be regulated by separate terms of reference, stipulating its objectives, tasks and responsibilities, composition, mandate and number of members, the necessary qualifications and expertise, the procedure and the reasons for the dismissal of a member, the operational arrangements, and the way it reports to the board of directors/supervisory board.* • *Both the BSE and CCI Codes recommend that the board should combine appropriate knowledge, and professional and practical experience having regard to the company structure and operations. The CCI Code recommends that the selection of directors should be based on professional qualifications – and in case of re-election – on the assessment of the work done in the previous year. Directors of banks must have the appropriate qualifications*

Key Areas and Rating	Strengths and Weaknesses
	and at least three directors must have experience in banking and/or finance. At least one member of listed companies' audit committees must be a chartered auditor or possess the relevant knowledge and experience in the field of finance and accounting whereas bank audit committees must include at least two board members with experience in banking and/or finance. • Interestingly, the CCI Code suggests family owned companies to have an Advisory Panel – as a temporary phase - to advise the board on certain issues. We tend to agree with this recommendation as in family owned business is more difficult for the family to accept non-family members to the board. In this respect, the Advisory Panel is a good step in order to allow advisors to build trust with the family and be accepted as board members in the future. **Weaknesses:** • It seems that in companies legal entities can serve as board members. However, no company among the ten largest in the country appear to have any corporation on their boards. • As mentioned below – see Transparency and Disclosure section – all public joint stock companies are required by law to "comply or explain" with the corporate governance code. In Serbia there are at least two codes and it is not clear which code should be used as a reference. When looking at the BSE Code (enacted in 2008), its language (in its English translation), is sometimes misleading and seems to be out-dated. It seems that the BSE Code was based on the previous Law on Companies (2004) which had an unclear two-tier board structure – similar to what is still present in the Law on Banks. For example, the BSE Code refers to the "management board" when regulating committees. We understand that this terminology was used in the previous company law when referring to the supervisory board, however – considering the new terminology by the 2011 law - it is now misleading and gives the impressions that – in the two tier system - committees should be created at the management level. Moreover, the BSE Code "suggests" listed companies to establish an audit committee which is now a legal requirement. Finally, it recommends committees to be comprised of a majority of "outsiders" (i.e., non-board members), which is a questionable solution. The CCI Code wording seems better aligned with the new legislative framework. The BSE seems to consider the BSE Code as no longer in force, however we could not locate any official statement in this respect. Clarity on this would be welcome. • The law seems to allow a minority of executive directors in companies – who are excluded from the decision on the committee formation – and "outsiders" (i.e., non-board members) with relevant expertise to sit in committees. This practice should be carefully considered. Executives sitting in committees (especially the audit committee – in banks this is not possible) are in clear position of conflict of interest. We believe this practice should not be allowed. With reference to "outsiders", we believe it is important that the committees include only board members if the functions delegated to the committee are typical board functions. Secondly, it is essential that those members sitting in the committee and recommending specific actions to the board, then do actually follow up on such recommendations and vote on the committee's recommendations at the board, therefore reinforcing their positions and the board "objective judgement". Further, we believe that audit committee members should have a full vision of the business of the company in order to express their determinations – while outsiders might only have a partial understanding. Finally, committees that include outsiders might create problems with confidentiality and accountability issues, since such "outsiders" might not be bound by duties of loyalty and care required to board members. While it is legitimate that the committee might need external advice or expertise on specific issues, it should be able to request such advice, but it should not allow the advisor(s) to replace the committee in its determinations and recommendations. None of the companies in our sample have executive directors on their board committees. However, the presence of "outsiders" seems to be commonplace (the ten largest listed companies have outsiders in their audit committees), which is not in line with best corporate governance practices. • Disclosure on board and committee members' qualifications is limited and from the information disclosed, it is not clear that boards have a mix of skills and experience, neither that companies fulfil the legal requirement that audit committees have members with audit or accounting expertise.
1.2. Gender Diversity at the Board (20.17%) Moderately Strong	• Serbia outperforms most of the other EBRD countries of operations. Nine out of the ten largest companies disclose their board composition. All of them have women on their boards. Two of these companies disclose having three women on their boards. In one case, women are the majority of the board. • In total, there are 13 women among 63 board members. The average female board representation within the largest listed companies is 20.17%.
1.3. Independent Directors Fair	**Strengths:** • The law requires boards or supervisory boards of listed companies to have at least one independent member. The same is included in the CCI Code, while the BSE Code recommends having at least two. The banking law requires a minimum of one-third of the board to be made up of independent directors. • Nearly all companies in our sample disclose having at least one independent director on their boards – three of them disclose having a majority of independent members. • The chair of the board is neither required nor recommended to be independent; however, the BSE Code recommends that when deciding on the board chair, board members should ensure that the appointed person has an exceptional professional reputation and personal integrity, is committed to the interests of the company and has the trust of shareholders. The CCI Code recommends that – in smaller companies – shareholders should be provided with "the necessary information for assessing the candidate's independence" before appointment at the board, while for larger companies it is recommended that the proposal for the appointment of a particular candidate for an independent director should include information on all positions currently performed by him/her and that the candidate signs a statement confirming that he/she can devote sufficient time to perform the entrusted tasks (it is also recommended that the company makes an estimate of the time required for the

Key Areas and Rating	Strengths and Weaknesses
	performance of the function). • Members of audit committees of banks cannot be "persons related to the bank" (which includes executives), at least two must be board members and one must be independent. • The law requires audit, nomination and compensation committees of listed companies to be made up of a majority of non-executive directors, and a minimum of one independent director. The law further requires that the audit committee must be chaired by an independent director. **Weaknesses:** • Both the definitions provided by the company law and the banking legislation concentrate on negative "non-affiliation" criteria only, without spelling out which positive requirements (i.e., objectivity of character and mind) are required from independent directors. It should be pointed out that the concepts of "non-affiliation" and "independence" are different. While non-affiliation can be established by negative criteria, independence necessarily needs objectivity of mind and character, which is a positive character that should be demonstrated, disclosed and explained in practice. • Criteria retained by companies to define directors as independent are not disclosed (however in some cases, the negative "non-affiliation" criteria mentioned by law are referred to), which raises doubts about the actual independence of these members.
1.4. Board Effectiveness *Fair*	**Strengths:** • The law requires that boards of listed company meet at least four times per year while committees "shall regularly report on their work to the board, in accordance with relevant decisions on their formation. In banks, the law requires the audit committee to meet "monthly and at least quarterly at the bank's head office". The CCI Code also recommends that the agenda of board meetings should be set in advance. The CCI Code is very sharp in its recommendation specifying that "a small number of meetings leads to inadequate execution of obligations, while a large number of meetings creates excessive costs and leads to micro-management". The disclosed practices seem to confirm this (see below). • Both Codes recommend that boards conduct a self-assessment of its work at least once a year, and to determine measures for its improvement. The law provides that the nomination committee should annually draw up a report on the appropriateness of the board composition. Six among the ten largest listed companies disclosed that a regular evaluation of the board's effectiveness and appropriateness of its mix of skills takes place and that the results are presented to the general shareholders' meeting. However, the summary findings of these evaluations are not publicly available. • The CCI Code recommends newly elected board members to have proper induction and training, to be organised by the chair of the board. • The law and the BSE Code recommend companies to have a company secretary and seven of the ten largest listed companies disclose having one in place. **Weaknesses:** • Disclosure on board and committee activities and members' qualifications is limited and incomplete, not being possible to accurately assess if they have the right mix of skills and the effectiveness of their work. When the activities of committees are disclosed, this is mostly a reference to corporate documentation, without going into details of what the board and committees have done in practices, during the previous year. • One company (incorporated under a one tier system) disclosed that its board had 22 scheduled meetings in the previous year. One company discloses that its audit committee met twice in the previous year, one session attended by members in person and one correspondence session. This information raises doubts about the effectiveness of the works of board and committees.
1.5. Responsibilities of the Board *Fair*	**Strengths:** • Liability of board members and conflicts of interest seem to be comprehensively regulated, but it appears that there is little judicial practice related to these areas. **Weaknesses:** • The legal framework on directors' duties of care and loyalty is not well developed. Neither the law nor the BSE Code expressly mentions whether the board members owe their duties to all the shareholders or just to the company itself. Also, there has been little interpretation of these concepts by the courts. • The law assigns to the board most of its key functions; however, the responsibility for approving the budget rests with the general shareholders' meeting, which may undermine the board's strategic responsibilities.

Key Areas and Rating	Strengths and Weaknesses
2. Transparency and Disclosure *Moderately Strong*	*Companies are required to disclose a significant amount of financial and non-financial information, and companies appear to generally comply with the requirements.* *Companies must disclose a statement of application of a corporate governance code in their annual reports. Companies listed on the special segments of the Belgrade Stock Exchange must additionally fill in a Corporate Governance Questionnaire. We have seen that the eight largest listed companies on the Prime and the Standard Markets and one company on the Open Market among the ten largest listed companies filled in their Corporate Governance Questionnaires.* *Disclosure on board and committees meetings and members' qualifications, beneficial ownership and transactions in company shares is limited though.* *Companies are required to prepare and disclose their financial statements in line with the IFRS, and all largest listed companies seem to comply.* *Sanctions for breach of disclosure rules are limited.* *Medium, large and listed companies are required to appoint an independent external auditor and disclose its name and the auditor's report. Companies seem to follow this requirement.*
2.1. Non-Financial Information Disclosure *Fair*	***Strengths:*** • *Listed companies must prepare an annual report including non-financial information and explanations on the company's operations over the previous year to submit to the regulator and to the stock exchange. However, information provided on corporate governance is essentially limited to the company's risk, activities and related party transactions, and barely describe the company's governance practices.* • *All public joint stock companies must include a statement of application of a corporate governance code in their annual operating report. Companies listed on the Prime and Standard listing segments are further required to fill in a Corporate Governance Questionnaire and companies seem to comply with this.* • *The CCI Code recommends listed companies to use their internet website for communication with shareholders and all ten largest listed companies disclose the general shareholders' meeting's minutes and information on their share capital and major shareholders on theirs or on the stock exchange's website.* • *Overall, the websites of the ten largest listed companies are informative and up-dated, but information is scattered and not always easy to find.* ***Weaknesses:*** • *Disclosure on the board and committee members' qualifications and on their activities is not expressly required by law and information provided is very limited.* • *Disclosure on transactions with the companies' shares and beneficial ownership is very limited.* • *The Corporate Governance Questionnaire does not cover adequately all aspects of the BSE and CCI Codes though and explanations provided for deviations could be more meaningful.*
2.2. Financial Information Disclosure *Strong*	***Strengths:*** • *All companies (except for micro entities) and banks must prepare their financial statements using the IFRS, and all companies in our sample disclose their financial statements in line with IFRS on their website.* • *Listed companies must submit their annual reports, including their financial statements along with the auditor's report, to the regulator and to the stock exchange.*
2.3. Reporting to the Market and to Shareholders *Fair/Moderately Strong*	***Strengths:*** • *Listed companies must submit their annual reports, including financial and non-financial information, to the regulator and to the stock exchange. Companies seem to comply with this requirement and to further disclose annual reports on their websites.* • *All ten largest listed companies disclose the general shareholders' minutes and information on their share capital and major shareholders.* • *Listed companies are required to timely disclose to the market any price sensitive information.* ***Weaknesses:*** • *Breach of reporting rules may be sanctioned with fines; however, the fine levels seem to be insufficient to discourage breaches of the law and the regulator seems to adopt a "light-touch" approach to violations of the reporting requirements.* • *Disclosure on transactions with the companies' shares and beneficial ownership is very limited.*
2.4. Disclosure on the External Audit *Moderately Strong*	***Strengths:*** • *Medium, large and listed companies and banks are required to have independent external audit appointed by the general shareholders' meeting and to disclose their names. All the ten largest listed companies declare their auditor to be independent. The large majority of these companies are audited by international auditors.* ***Weaknesses:*** • *The external auditors are prohibited from providing non-audit services to the audited company; however it seems that this requirement is not strongly enforced in practice.*

Key Areas and Rating	Strengths and Weaknesses
3. Internal Control *Fair*	*Companies and banks are required to establish an internal control system and have an internal auditor. Banks are also required to have standalone compliance and risk management functions.* *Listed companies and banks are required to establish an audit committee. Audit committees of listed companies must be chaired by an independent member, be composed of a majority of non-executive directors and have one member with accounting or auditing expertise. In banks, audit committees must be made up of at least two board members with finance expertise and one independent member. In both cases, audit committees may comprise outsiders, which seems to be a common practice. It seems that executives are allowed to sit in committee. Disclosure on committee's meetings and activities is insufficient to assess if they are playing a strategic role in the company.* *Medium, large, listed companies and banks are required to have an independent external audit. Banks are further required to notify the National Bank upon the appointment of their external auditors, which can only be chosen among those considered "eligible auditors" by the National Bank. The audit committee is expressly in charge of overseeing external auditor's independence. The provision of non-auditing services by the external auditor is restricted, but there is no evidence of enforcement of this rule. External auditors are required to rotate on a regular basis.* *Regulation on related party transactions and conflict of interest appears to be comprehensive; however, disclosure on related party transactions is not always complete.* *There is no requirement to have a code of ethics.* *Whistleblowing protection is limited but a new law entered into force in June 2015.*
3.1. Quality of the Internal Control Framework *Fair*	***Strengths:*** • *Companies and banks are required to establish an internal control system and have an internal audit function. Banks must additionally organise compliance and risk management functions as part of the internal control system. Seven out of the ten largest listed companies disclose having internal audit in place.* • *Listed companies and banks are required to set up an audit committee. All companies in our sample disclose having one in place.* • *The CCI Code includes a section on internal control and recommends large companies to have an internal audit function in place. It also recommends that these companies establish separate risk management and compliance functions in the later stages of their development, while smaller companies are recommended to regularly reassess the need for those functions and to maintain an internal control framework that will facilitate their introduction, when deemed necessary.* • *The Serbian Chamber of Authorised Auditors maintains a registry of audit companies and certified auditors and controls their activities.* • *Whistleblowing has been recently regulated.* ***Weaknesses:*** • *A recent IMF Report (2015) highlighted the need for strengthening bank's corporate governance and risk control framework and Serbian authorities have committed to improve the framework. However, by the cut-off date of this report, we have not been informed of any substantial amendments being implemented.* • *Audit committees both of listed companies and banks may comprise "outsiders", which is a common practice among the companies of our sample. Audit committees of listed companies may also comprise a minority of executive directors. We have strong reservations about both practices (see above).* • *There is no requirement that companies should have a code of ethics in place, and the CCI recommends the adoption of such a code only for companies in which the state has an ownership. Only three companies disclose having one.*
3.2. Quality of Internal and External Audit *Moderately strong*	***Strengths:*** • *Companies and banks are required to establish an internal control system and most of the companies of our sample seem to comply with this requirement.* • *In public companies and banks, at least one person in charge of the internal audit must be a certified auditor.* • *Medium, large and listed companies and banks are required to have independent external audit appointed by the general shareholders' meeting and to disclose their names. Companies seem to comply with these requirements.* • *Auditors are required to confirm, in writing, their independence from the companies and reveal to the audit committee any non-auditing services performed in the past as well as any circumstances that might affect their independence.* • *Securities Commission provides the list of auditing firms that are allowed to audit the financial statements of public companies, and the National Bank provides such a list for banks. Banks are required to notify the National Bank of the appointment of their auditing firms.* • *External auditors of listed companies and banks are required to rotate every 5 years and it seems that all ten largest listed companies comply with this requirement. The law provides for penalties applicable to audit firms and*

Key Areas and Rating	Strengths and Weaknesses
	auditors who breach their obligations. • *External audit of financial statements of the ten largest listed companies is generally performed by a big four or other international firms.* • *Oversight of internal audit service and of external auditors is regulated by law and expressly assigned to the audit committee of listed companies and banks. External auditors are required to provide the audited entity a written confirmation of their independence and to inform the audit committee of that entity on any additional services to this company, as well as to discuss possible threats to its independence and safeguards against these threats.* ***Weaknesses:*** • *The external auditors are prohibited from providing non-audit and audit services simultaneously to a company; however, it seems that this requirement is not strongly enforced in practice.* • *Audit committees are not necessarily independent bodies and may comprise outsiders. Further, the law does not seem to prohibit executives from sitting in the audit committee. This might weaken the independent oversight over external and internal auditors.*
3.3. Functioning and Independence of the Audit Committee *Weak/Fair*	***Strengths:*** • *Public interest entities (including larger companies, listed companies and financial institutions) are required to establish an audit committee. Public interest entities that are required by other regulations to have bodies with similar competences as the audit committee, and subsidiaries of groups in which tasks of the audit committee are performed on a group level are exempt from this requirement. This is fine in principle, but some doubts arise in state-owned enterprises.* • *Banks' audit committees are required to meet monthly and at least quarterly in person at the bank's head office.* • *The CCI Code recommends the key functions and responsibilities of the audit committee. It also recommends the audit committee to be made of qualified non-executive members of the board of directors/members of the supervisory board, where at least one should be independent. The CCI Code recommends non-board members on the audit committee only when it is deemed to be in the best interest of the company and in that case, "outsiders" should not make the majority of the audit committee. Given the provisions of the law, this is the best possible recommendation.* ***Weaknesses:*** • *Audit committees of listed companies must be made up of a majority of non-executive directors, chaired by an independent director and comprised of at least one member who is knowledgeable in accounting or audit. However, the law seems to allow this committee to be comprised by a minority of executive directors – who are excluded from the decision on the committee formation – and "outsiders" (i.e., non-board members).* • *Banks' audit committee members cannot be "persons related to the bank", at least two must be board members and one must be independent, but it seems that the independent member as well as other additional members may be "outsiders".* • *None of the companies in our sample have executive directors as members of the board committees. However, the presence of outsiders seems to be commonplace (the ten largest listed companies have outsiders in their audit committees). This solution raises some doubts (see comments above).* • *Disclosure of committee members' qualifications and activities is limited and it is not clear that audit committees are playing a meaningful role in companies or that companies fulfil the legal requirement that audit committees have members with audit or accounting expertise.*
3.4. Control over Related Party Transactions and Conflict of Interest *Moderately strong*	***Strengths:*** • *Related party transactions and conflicts of interests are regulated by law and legislation seems to be comprehensive. Related party transactions must be disclosed in the annual report – which companies seem to comply with; however it appears that disclosure is not always comprehensive.* ***Weaknesses:*** • *It is not clear how the law is enforced in practice as there is no case law covering these subjects.*

Key Areas and Rating	Strengths and Weaknesses
4. Rights of Shareholders *Fair/Moderately strong*	*The law grants shareholders all basic rights related to the general shareholders meeting (GSM) as well as other general protections and access to corporate documents. Shareholders representing 5% of the shares are entitled to call a GSM, to propose items to be added to the GSM agenda, to nominate board member candidates and to bring a derivative claim. Cumulative voting is available only if provided by the Articles.* *Major corporate changes require qualified majority (of shares present at the meeting) but it appears that the capital can be increased by simple majority (of shares present at the meeting). Articles can also be amended by simple majority, but this majority is calculated on all issued shares with voting rights.* *Shareholders agreements are not comprehensively regulated by law and do not seem to be enforceable against third parties.* *Free transferability of shares cannot be restricted. Share registration must be kept by an external independent registrar.* *Significant shareholding variations must be disclosed; however, penalty for breach of this obligation seems to be insufficient to discourage it.* *Related party transactions and conflicts of interests are regulated by law. Insider trading can result in criminal penalties, but there is little evidence of enforcement.*
4.1. General Shareholders' Meeting (GSM) *Moderately strong*	***Strengths:*** • *Shareholders representing 5% of the shares are entitled to call a general shareholders' meeting (GSM), to propose to the board items to be added to the GSM agenda and to nominate board member candidates.* • *Any shareholder can submit questions in advance and ask them during the GSM.* • *Shares carry proportionate voting rights (i.e. follow the one share on vote principle).* • *Companies seem comply with the requirement of publishing GSM notifications and supporting materials.* ***Weaknesses:*** • *The law provides for cumulative voting and electronic voting at the GSM but only if established by the Articles.*
4.2. Protection against Insider Trading and Self-dealing *Fair*	***Strengths:*** • *Insider trading is regulated by law and can result in criminal penalties, including imprisonment.* • *Related party transactions and conflicts of interests are regulated by law. Related party transactions must be disclosed in the annual report – which companies seem to comply with.* ***Weaknesses:*** • *There is no evidence that insider trading regulation is well enforced in practice, as there is no evidence of cases or convictions related to insider trading.* • *None of the companies in our sample disclose on their websites share transactions by directors.*
4.3. Minority Shareholders Protection and Shareholders' Access to Information *Fair/Moderately Strong*	***Strengths:*** • *Shareholders are granted pre-emptive rights.* • *Shares carry voting rights in proportion to their value.* • *Shareholders representing 5% of the shares are entitled to call a GSM, to propose to the board items to be added to the GSM agenda and to nominate board member candidates.* • *Shareholders representing 5% of the shares may bring a derivative claim on behalf of the company on the situations stipulated by law.* • *A qualified majority (various majority requirements apply in different cases – in most cases the blocking minority is 25%+1 of the shares) is required for major corporate changes (but not for increase of capital and amendments to the Articles – see below).* • *Shareholders have a general right to inspect the corporate documents.* ***Weaknesses:*** • *Decisions on changes to the Articles can be approved by a simple majority vote, unless the Articles provide for a higher majority. This major weakness is to a certain extent mitigated by the fact that the majority is calculated on all issued voting shares.* • *It appears that the decision for reduction of capital must be adopted by a ¾ majority of all shares, but the increase of capital can be approved by simple majority. The risk of dilution is somehow offset by the fact that pre-emptive rights exist - which can be waived only by ¾ majority of present shares - however considering the concentrated ownership in Serbia and the fact that the increase of the capital can be delegated to the board, this provision raises some doubts.* • *The law provides for cumulative voting only if provided by the Articles.*

Key Areas and Rating	Strengths and Weaknesses
4.4. Registration of Shareholdings *Fair*	***Strengths:*** • *The share register of joint stock companies should be maintained by an external independent registrar and the free transferability of shares cannot be restricted.* • *A person that, directly or indirectly, reaches, exceeds or falls under certain thresholds of the voting rights in a listed company must notify the regulator, the company and the market. Further, prior to acquiring certain thresholds of ownership in a bank (5%-20%, more than 20%-33%, more than 33%-50% and over 50%), the proposed acquirer must obtain consent of the National Bank. If this is not adhered to, the National Bank can order the acquirer to dispose of such ownership and prohibit such person from direct or indirect exercising of the voting rights in the bank and from influencing its management or business policy.* ***Weaknesses:*** • *Shareholder agreements are not comprehensively regulated by law and not subject to any formalities, being as a rule, only binding among the contracting parties.* • *Failure to inform the regulator about a substantial acquisition of securities may result in fines. However, it seems that the fine levels are not sufficient to discourage violations of this rule.*

<table>
<tr><th>Key Areas and Rating</th><th>Strengths and Weaknesses</th></tr>
<tr><td>5. Stakeholders and Institutions
Weak</td><td>Market capitalisation over GDP has significantly shrunk since 2007, with a very low level of liquidity of the Belgrade Stock Exchange. The stock exchange provides limited corporate governance information on issuers.
There are two corporate governance codes in Serbia, one issued by the Belgrade Stock Exchange and one by the Chamber of Commerce and Industry of Serbia. Three among the ten largest listed companies appear to refer to the latter one.
The Code of the Belgrade Stock Exchange was issued in 2008 and it has never been reviewed since then, being now out-dated. The Code is applied on a “comply-or-explain” basis, and the law requires listed companies to declare their compliance with the Code or any other corporate governance code. Companies listed on the Prime and the Standard Markets of the Belgrade Stock Exchange are required by the Listing Rules to fill in and submit to the stock exchange a Corporate Governance Questionnaire. Companies appear to formally comply with this requirement but explanations provided are generally not meaningful. The Code issued by the Chamber of Commerce and Industry of Serbia in 2012 appears better aligned to best practices.
The stock exchange developed a corporate governance scorecard that provides little information on actual companies’ corporate governance practices.
No authority seems to be active in monitoring compliance by companies on the Corporate Governance Code.
There are inconsistencies in corporate governance legislation. International organisations indicators reveal that corruption is still perceived as a problem.</td></tr>
<tr><td>5.1. Corporate Governance Structure and Institutions
Weak/Fair</td><td>Strengths:
• Rulings of regulatory agencies are publicly available and easily accessible.
• Companies are required to have their financial statements in line with the IFRS and to prepare an annual report containing non-financial information.
• International audit and law firms have a significant presence in the country.
• Banks must inform and, in many cases request approval from the National Bank (authority in charge of supervising banks) on several governance matters.
Weaknesses:
• The Belgrade Stock Exchange has limited market capitalisation and a low liquidity. Its ‘Regulated Market’ provides for four listing categories for company’s shares. The majority of the companies are listed in the Open Market, which imposes lower governance standards. There are only eight companies listed on the Prime and Standard Markets, which require higher governance standards to be met. It seems that there is little (if any) monitoring of compliance with the Code.
• Information provided by the stock exchange’ website is limited and commonly unavailable in English.
• International rating firms do not have an active presence in the country.</td></tr>
<tr><td>5.2. Corporate Governance Code
Weak/Fair</td><td>Strengths:
• All listed companies are required by law to include in their annual report, a statement on their compliance with the corporate governance code they apply (which can also include the code adopted by the company – which is not appropriate) and any deviations from the rules provided by such code.
• The stock exchange requires that companies listed on the Prime and Standard segments submit a Corporate Governance Questionnaire reporting on their corporate governance practices. Nine out of the ten largest listed companies (including one which is not listed on these special segments) filled in the Corporate Governance Questionnaire and have their answers available on the stock exchange’s website.
• The Corporate Governance Code issued by the Chamber of Commerce and Industry of Serbia in 2012 (replacing its previous code from 2006) is quite comprehensive and generally aligned to best practices. Companies that are members of the Chamber of Commerce and Industry of Serbia are required (by the wording of the CCI Code) to notify the Chamber whether they apply the CCI Code or another code. Three companies in our sample disclose adopting the Code of the Chamber of Commerce and Industry of Serbia.
Weaknesses:
• The stock exchange adopted its own Corporate Governance Code in 2008, but it now needs to be reviewed as several parts seem to be out-dated and clashing with the law (see comments above).
• Information provided on the Corporate Governance Questionnaires is often relevant; however, explanations for deviations are not always meaningful and the Corporate Governance Questionnaire fails to cover some important issues (e.g. details on external audit and internal controls).
• The stock exchange developed a Corporate Governance Scorecard intended to evaluate companies’ corporate governance practices. However, we have strong reservations about the scorecard alone, as corporate governance cannot be simply measured by numerical values.
• There is no case law referring either to the stock exchange’s code or to the Chamber Commerce’s one.</td></tr>
</table>

Key Areas and Rating	Strengths and Weaknesses
5.3. Institutional Environment *Weak*	***Strengths:*** • *Rulings of regulatory agencies are publicly available and easily accessible.* ***Weaknesses:*** • *The Securities Commission has the authority to address corporate governance failures and compel appropriate remedial action. However, it is not clear if corporate governance issues are monitored.* • *According to the 2015 EBRD Assessment on Accessibility of Court Decisions, the ease of access to court decisions by parties in the proceedings was 10/10 while the ease of access by third parties overall score was 1/10.* • *When looking at the indicators provided by international organisations, Serbia is not well positioned in terms of competitiveness (World Economic Forum's Global Competitiveness Index), ease of doing business (Doing Business Index) and corruption (TI CPI).*