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European Bank
for Reconstruction and Development

Corporate Governance in Transition Economies

Croatia Country Report

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The report is based on information available at the end of April 2015.

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.

Ratings:

“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 Croatia are the Company Act, the Audit Act, the Accountancy Act and the Credit Institutions Act. A [Corporate Governance Code](#) was adopted by the Croatian Financial Services Supervisory Agency (HANFA) and the Zagreb Stock Exchange in 2007 and revised in 2010. In line with EU legislation, the Code is to be implemented on a "comply or explain" basis.

Structure and Functioning of the Board

Companies can decide to be organised under a one-tier or two-tier system. All ten largest listed companies are organised under two-tier system. The average size of a board is seven members, which is a manageable size. Evidence has shown that smaller board tend to perform better (provided that they have the right mix of skills and support). Legal entities cannot serve as board members. Boards of the largest companies show relatively high gender diversity, well above the average of EU countries in the EBRD region.

In companies, the law misses to assign all key functions to the board but the banking framework is clearer. There are limited qualification requirements for board members (only for one member of the audit committee, e.g., corporate secretary), which does not seem to be always the case in Croatia. Only a few companies disclose the qualification of their board members, hence it is not possible to understand if boards possess the right mix of skills.

Only in banks, the law requires boards to have at least one independent director and only one company (a bank) out of the ten largest listed companies discloses having one – and only one - independent director on the board. Public interest entities are required to have an audit committee and all ten largest listed companies disclose having created one, but these are not "board committees", as "outsiders" (i.e., non-board members) always represent a majority on the audit committee. Further, there is no requirement that the audit committee should be composed of independent board members.

Only a few companies disclose performing regular board evaluation or having a corporate secretary. Disclosure on board activities and frequency of meetings is limited and does not allow to have a clear view as to whether they play a strategic role.

Transparency and Disclosure

Companies are required to publish their annual reports and the largest listed companies appear to comply well with this requirement.

Quality of non-financial information seems to be generally good, however some key information is not available (e.g., qualification of board members, activities and frequency of meetings of board and committees, and committees' composition). Reporting to the markets and shareholders is regulated by law and appears to be well implemented.

The law requires financial statements to be prepared in line with IFRS and made public and all ten largest listed companies comply with these requirements. Large companies are required to have their financial statements audited by independent auditors, and all large companies appear to comply with this requirement. The provision of non-auditing services to companies by the external auditor does not seem to be restricted. Disclosure on this point is very limited. Provision of non-auditing services by the external auditors can mine the auditors independence and they should be disclosed and carefully monitored.

Internal Control

Only credit institutions are required to create an internal audit function. They are also required to have a compliance function in place.

Public interest entities are required to establish an audit committee, however it does not appear to be necessarily a board committee as "outsiders" (i.e., non-board members) are allowed to be members of the committee. In practice, it appears that the audit committees of the ten largest listed companies are always made by a majority of "outsiders". This practice should be carefully considered. First, we believe it is important that the audit committee 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. The key question here is what could a person that it is not a board member add to the debate? The discussion is open. Our opinion is that the structure might be more effective if the board is composed of some independent non-executive members, who should also sit on committees, instead of "outsiders".

There are no independence requirements for audit committee's members. Only very few companies disclose the number of audit committee's meetings. The audit committee is in charge of monitoring the robustness of the internal audit function. External auditors do not express opinion on the effectiveness of the internal control system.

The provision of non-auditing services to companies by the external auditor does not seem to be restricted, but it subject to the audit committee scrutiny. Only banks are required to rotate their external auditors. There is no comprehensive whistleblowing legislation in Croatia.

Related party transactions and conflict of interest appear to be well regulated for banks; less so for companies.

Rights of Shareholders

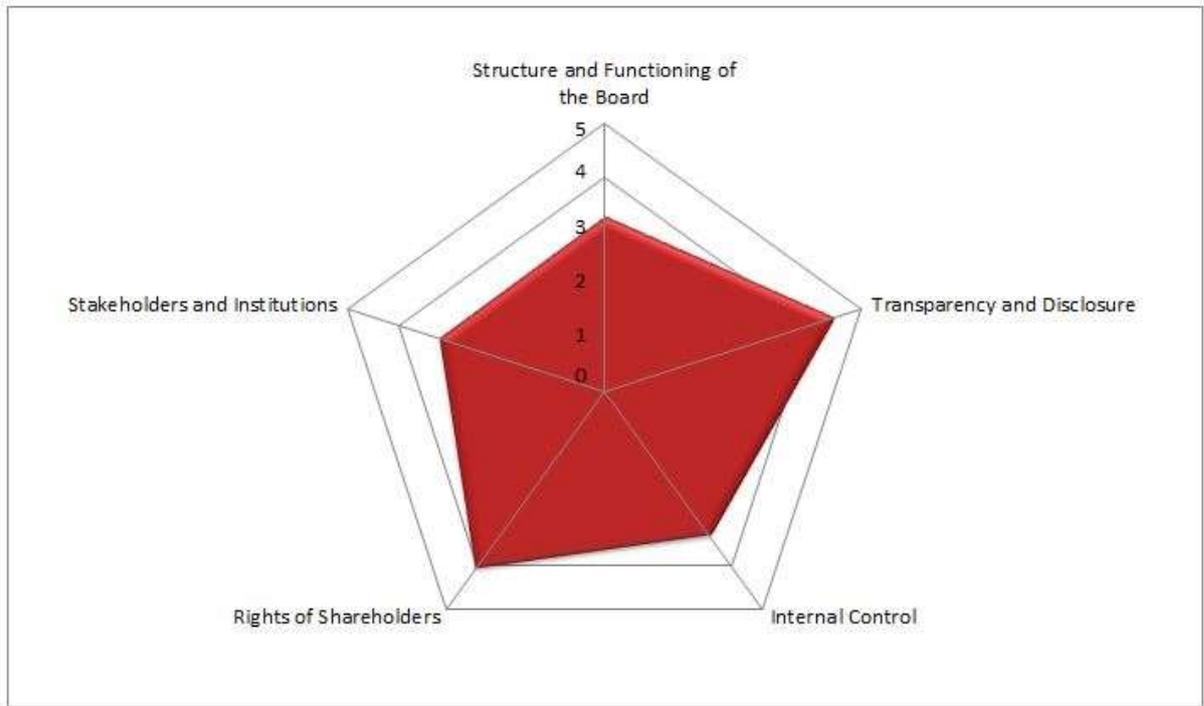
Basic shareholders rights are granted by law.

Insider trading is regulated by law and seems to be well enforced. The quality of regulation on self-dealing is not entirely clear. Disclosure on this issue appears limited. Shareholders' agreements are not regulated, and it is not clear if they are enforceable against third parties. Share register of issuers should be maintained by an independent registry institution.

Stakeholders and Institutions

The market capitalisation of the Zagreb Stock Exchange is quite high but liquidity appears limited. In general, it appears that the institutional framework supporting good corporate governance is relatively sound. This is also confirmed by indicators by International Organisations. The Corporate Governance Code is an excellent complement to the law. All ten largest listed companies have published a compliance statement, however explanations provided by the companies are not always meaningful and appropriate. The regulator and the exchange have prepared very interesting statistical reports offering general overview of the corporate governance and securities market situation in the country. However, they do not monitor the quality of explanations provided by the companies, which is essential in a "comply or explain" framework.

Corporate Governance Legislation and Practices in Croatia



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
<p>1. Structure and Functioning of the Board Weak/Fair</p>	<p>Companies can decide to be organised under a one-tier or two-tier system. All ten largest listed companies are organised under two-tier system.</p> <p>The average size of a board is seven members, which is a “manageable size”. Evidence has shown that smaller board tend to perform better (provided that they have the right mix of skills and support, e.g., corporate secretary). However, this does not seem to be necessarily the case in Croatia.</p> <p>Legal entities cannot serve as board members.</p> <p>There are limited qualification requirements for board members (only for one member of the audit committee). Only a few companies disclose the qualification of their board members, hence it is not possible to understand if boards possess the right mix of skills.</p> <p>Only in banks, the law requires boards to have at least one independent director and only one company (a bank) out of the ten largest listed companies discloses having one – and only one - independent director on the board.</p> <p>Public interest entities are required to have an audit committee and all ten largest listed companies disclose having created one, but these are not “board committees”, as “outsiders” (i.e., non-board members) always represent a majority on the audit committee. Further, there is no requirement that the audit committee should be composed of independent board members.</p> <p>Boards of the largest companies show relatively high gender diversity, well above the average of EU countries in the EBRD region.</p> <p>Only a few companies disclose performing regular board evaluation or having a corporate secretary.</p> <p>Disclosure on board activities and frequency of meetings is limited and does not allow to have a clear view as to whether they play a strategic role.</p> <p>In companies, the law misses to assign all key functions to the board, but the banking framework is clearer.</p>
<p>1.1. Board Composition Weak/Fair</p>	<p>Strengths:</p> <ul style="list-style-type: none"> Companies can choose between one or two tier system. All ten largest listed companies are organised under two-tier system. Boards of the ten largest listed companies are generally well-sized to allow good cohesiveness, with an average of 7 members. Evidence has shown that smaller board tend to perform better (provided that they have the right mix of skills and support, e.g., corporate secretary). However, this does not seem to be necessarily the case in Croatia. Legal entities cannot serve as board members. The law requires credit institutions to include at least one independent member on the supervisory board. The banking regulation also includes a definition of independence, which includes only “non-affiliation” criteria (see below). The law requires all public interest entities to establish an audit committee composed of supervisory board members and “members appointed by the supervisory board”. There are no requirements in the law about committee’s independence, but the Corporate Governance Code recommends that the audit committee members are selected from the group of independent members of the supervisory board. <p>Weaknesses:</p> <ul style="list-style-type: none"> There are limited qualification requirements for (supervisory) board members in companies and banks but only a few companies disclose the qualifications of board members. It appears that only the Audit Act requires that at least one member of the audit committee is competent in the area of accountancy and/or audit, however, it does not specify whether this requirement necessarily applies to the supervisory board member (as “outsiders” can be members of the audit committee). All ten largest listed companies have created audit committees, but these are not “board” committees as they are made by a majority of non-board members. We have doubts about this solution (see below).
<p>1.2. Gender Diversity at the Board (18.2%) Fair</p>	<ul style="list-style-type: none"> The National Policy on Gender Equality was adopted by the Croatian Parliament in 2011. This policy aims to create a gender balance of supervisory and management board members in the public and private sectors by ensuring that the share of the under-represented gender, pursuant to the Act on Gender Equality, does not fall below 40 %. This Policy does not appear to be properly implemented in practice. All ten largest listed companies disclose the composition of their boards. Nine companies appear to have women on boards: one in each board (average in these boards: 20.3%). In total, there are 13 women among 74 board members in the ten companies disclosing this information, with an average of 18.2 %.

Key Areas and Rating	Strengths and Weaknesses
<p>1.3. Independent Directors Weak</p>	<p>Strengths:</p> <ul style="list-style-type: none"> The banking law requires banks to have at least one independent director on the board. The Corporate Governance Code recommends that the supervisory board is composed of “mainly independent members”. <p>Weaknesses:</p> <ul style="list-style-type: none"> The banking regulation and the Corporate Governance Code provide for two different definitions of “independence”; however, they are only made up of a long list of negative criteria defining “non-affiliation, 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. Only one out of the ten largest listed companies discloses having independent directors on the board. The other companies do not disclose whether they have independent members.
<p>1.4. Board Effectiveness Weak</p>	<p>Strengths:</p> <ul style="list-style-type: none"> The Credit Institution Act clearly assigns all key functions to the boards of banks. <p>Weaknesses:</p> <ul style="list-style-type: none"> Differently from banks, the Company Act does not seem to clearly authorise the board to approve the strategy, budget and risk profile of the company. Only three among the ten largest listed companies disclosed performing regular board evaluation. Only two companies among the ten largest listed companies disclose appointing a corporate secretary. Disclosure regarding board activities and meetings is limited and does not allow to have a clear view as to whether the board and the committees perform their strategic roles.
<p>1.5. Responsibilities of the Board Fair</p>	<p>Strengths:</p> <ul style="list-style-type: none"> Fiduciary duties and liability of board members are regulated by the law. It appears that there is clear and consistent case law and judicial practice related to this issue. <p>Weaknesses:</p> <ul style="list-style-type: none"> The Company Act restrict shareholders to vote in conflict of interest situations, however it is not clear if the same restriction applies to board members.

Key Areas and Rating	Strengths and Weaknesses
<p>2. Transparency and Disclosure Moderately strong</p>	<p>Companies are required to publish their annual reports and the largest listed companies appear to comply well with this requirement.</p> <p>Quality of non-financial information seems to be generally good, however some key information is not available (e.g., qualification of board members, activities and frequency of meetings of board and committees, and committees' composition).</p> <p>The law requires financial statements to be prepared in line with IFRS and made public and all ten largest listed companies comply with these requirements.</p> <p>Reporting to the markets and shareholders is regulated by law and appears to be well implemented.</p> <p>Large companies are required to have their financial statements audited by independent auditors, and all large companies appear to comply with this requirement.</p> <p>The provision of non-auditing services to companies by the external auditor does not seem to be restricted. Disclosure on this point is very limited.</p>
<p>2.1. Non-Financial Information Disclosure Moderately strong</p>	<p>Strengths:</p> <ul style="list-style-type: none"> • Companies are required to prepare and disclose annual reports including financial and non-financial information and companies appear to comply with this requirement. The Corporate Governance Code also recommends that annual reports are published in English. • The large majority of the largest listed companies include some indication on their strategy in their annual reports. • All ten largest listed companies post the minutes of their general shareholders meeting online. • All ten largest listed companies disclose the names of their directors; five of them also posted their bios on their websites among the documentation for the GSM. However, often this information is not for all board members and in Croatian only. • Listed companies are required to disclose their compliance with the Code and all largest listed companies appear to comply. • All ten largest listed companies have reasonably informative websites and disclosure of non-financial information is generally good. <p>Weaknesses:</p> <ul style="list-style-type: none"> • Disclosure on beneficial ownership and qualification of board members is limited. • Disclosure of the company's articles and committees' composition, qualification of members, number of meetings and activities is limited. • All ten largest listed companies disclose information on their shareholders; but only two of them go into some details revealing also beneficial owners.
<p>2.2. Financial Information Disclosure Strong</p>	<p>Strengths:</p> <ul style="list-style-type: none"> • The law requires large companies and banks to prepare and disclose their financial statements. Listed companies are also required to prepare and make public their quarterly financial report. • By law, financial statements must be in line with IFRS. • All ten largest listed companies comply with this requirement.
<p>2.3. Reporting to the Market and to Shareholders Moderately strong</p>	<p>Strengths:</p> <ul style="list-style-type: none"> • Annual reports and minutes of the GSM appear to be well disclosed. • The law requires disclosure of price sensitive information. • The stock exchange and regulator appear active in monitoring disclosure by companies. <p>Weaknesses:</p> <ul style="list-style-type: none"> • All largest listed companies disclose their compliance with the Code, but explanations in case of non-compliance are not always meaningful and/or appropriate.
<p>2.4. Disclosure on the External Audit Moderately strong</p>	<p>Strengths:</p> <ul style="list-style-type: none"> • The law requires companies and banks to have an independent external auditor and to disclose its name and auditor's report. All ten largest listed companies appear to comply with this requirement. • The audit committee is in charge of undertaking the auditor's "independence test". • The right to appoint the external auditor is reserved to the GSM, upon recommendation from the audit committee. • The provision of non-auditing services by the auditor is prohibited, but only for credit institutions. <p>Weaknesses:</p> <ul style="list-style-type: none"> • In companies, provision of non-auditing services by the external auditor is allowed, subject to the monitoring of the audit committee. This is fine in principle, however, it appears that only a minority of companies have the audit committee made of a majority of independent members. This might undermine the objectivity of the monitoring process.

Key Areas and Rating	Strengths and Weaknesses
<p>3. Internal Control Fair</p>	<p>Only credit institutions are required to create an internal audit function. They are also required to have a compliance function in place.</p> <p>Public interest entities are required to establish an audit committee, however it does not appear to be necessarily a board committee, as “outsiders” (i.e., non-board members) are allowed to be members of the committee. In practice, it appears that the audit committees of the ten largest listed companies are always made by a majority of “outsiders”. This practice should be carefully considered.¹ First, we believe it is important that the audit committee 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 – and “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. The key question here is what could a person that it is not a board member add to the debate? The discussion is open. Our opinion is that the structure might be more effective if the board is composed of some independent non-executive members, who should also sit on committees, instead of outsiders.</p> <p>There are no independence requirements for audit committee’s members. Only very few companies disclose the number of audit committee’s meetings. The audit committee is in charge of monitoring the efficiency of the internal audit function. External auditors do not express opinion on the effectiveness of the internal control system. The provision of non-auditing services to companies by the external auditor does not seem to be restricted, but it subject to the audit committee scrutiny. Only banks are required to rotate their external auditors.</p> <p>There is no comprehensive whistleblowing legislation in Croatia.</p> <p>Related party transactions and conflict of interest appear to be well regulated for banks; less so for companies.</p>
<p>3.1. Quality of the Internal Control Framework Fair</p>	<p>Strengths:</p> <ul style="list-style-type: none"> • Credit institutions are required to create an internal audit function and a standalone compliance function. • The internal audit is to report to the audit committee. • Listed companies are recommended by the Corporate Governance Code to establish an internal audit function. The large majority of the ten largest listed companies disclose having an audit committee in place. • Public interest entities are required to establish audit committees, however we have doubts that the composition and independence of the audit committee is in line with best practices. <p>Weaknesses:</p> <ul style="list-style-type: none"> • Audit committee can include “outsiders” (i.e., non-board members). Hence, audit committees are not necessarily board committees. In practice, it appears that all largest listed companies have set up audit committees; “outsiders” always represent a majority on the audit committee. • It is not clear if audit committees are made of independent and qualified members. • Only a minority of the ten largest listed companies disclose having a code of ethics in place. • There is no comprehensive whistleblowing legislation in Croatia.

¹ The arguments in favour of this approach are that non-board members would allow the audit committee to draw from a larger pool of industry and accounting expertise and that it might give the audit committee greater independence.

Key Areas and Rating	Strengths and Weaknesses
<p>3.2. Quality of Internal and External Audit Moderately strong</p>	<p>Strengths:</p> <ul style="list-style-type: none"> The audit committee is in charge of monitoring the effectiveness of the internal audit function. Large companies and public interest entities are required to have their financial statements audited by an independent external auditor. The audit committee is in charge of undertaking the external auditor's "independence test". In banks, the provision of non-auditing services by the external auditor is prohibited. <p>Weaknesses:</p> <ul style="list-style-type: none"> In companies, the provision of non-auditing services by the external auditor is allowed, subject to the scrutiny of the audit committee. This is fine in principle, however, it appears that only a minority of companies have the audit committee made of a majority of independent members. This might undermine the objectivity of the monitoring process. In companies, there is no rotation requirement for external auditors.
<p>3.3. Functioning and Independence of the Audit Committee Weak</p>	<p>Strengths:</p> <ul style="list-style-type: none"> Public interest entities are required to have an audit committee. All ten largest listed companies have set up audit committees. The law requires that at least one member of the audit committee is competent in the area of accountancy and/or audit, however, it does not specify whether this requirement necessarily applies to the supervisory members or to the "outsider". <p>Weaknesses:</p> <ul style="list-style-type: none"> There are no requirements in the law about the audit committee's independence. Only the Corporate Governance Code recommends that the audit committee members should be selected from the group of independent members of the supervisory board, however we have doubt that this recommendation is well implemented. In the ten largest listed companies, "outsiders" (i.e., non-board members) always represent the majority of the audit committee. None of the ten largest listed companies have the audit committees made of a majority of independent board members. Disclosure on the audit committee's meetings and activities is very limited.
<p>3.4. Control over Related Party Transactions and Conflict of Interest Fair</p>	<p>Strengths:</p> <ul style="list-style-type: none"> The regulation on related party transaction and conflict of interest appear to be comprehensive, but only for banks. The Corporate Governance Code recommends that all transactions involving board members or management should be based on the current market situation, be confirmed by an independent expert and clearly presented in the annual report. When looking at the websites of the ten largest listed companies, we found that all of them disclosed related party transactions within the notes to the financial statements; however, sometimes they disclose only aggregated amounts of transactions with no details of number or parties to these transactions. The Corporate Governance Code recommends companies to create an independent committee to oversee all significant related party transactions. All ten largest listed companies have created an audit committee but there is no clear evidence that it is an independent committee. <p>Weaknesses:</p> <ul style="list-style-type: none"> In companies, the regulation on related party transaction and conflict of interest is limited.

Key Areas and Rating	Strengths and Weaknesses
<p>4. Rights of Shareholders Moderately strong</p>	<p>Basic shareholders rights are granted by law.</p> <p>Insider trading is regulated by law and seems to be well enforced. The quality of regulation on self-dealing is not entirely clear. Disclosure on this issue appears limited.</p> <p>Shareholders' agreements are not regulated, and it is not clear if they are enforceable against third parties.</p> <p>Share register of issuers should be maintained by an independent registry institution.</p>
<p>4.1. General Shareholders' Meeting (GSM) Moderately strong</p>	<p>Strengths:</p> <ul style="list-style-type: none"> • Shareholders owning more than 5 % of the company's shares can call a GSM. • Notification with agenda of the GSM should be sent to the shareholders at least 21 calendar days before the meeting and published on the ZSE website. • Shareholders can ask questions during the GSM or submit them in advance. • The "one share – one vote" rule is foreseen by law. • The GSM is the exclusive body authorised to approve the distribution of dividends. <p>Weaknesses:</p> <ul style="list-style-type: none"> • It is not clear whether all shareholders have the right to nominate directors. • Cumulative voting is not expressly regulated by law, but the Companies Act provides that the Articles may provide the right of certain shareholder to appoint no more than 1/3 of the supervisory board.
<p>4.2. Protection against Insider Trading and Self-dealing Fair</p>	<p>Strengths:</p> <ul style="list-style-type: none"> • Insider trading is regulated and prohibited by law and appears to be well enforced in practice. • Related party transactions appear to be well regulated for banks; less so for companies. • All ten largest listed companies disclose related party transactions within the notes to the financial statements, however, sometimes they disclose only aggregate amounts of transactions with no details of number or parties to these transactions. <p>Weaknesses:</p> <ul style="list-style-type: none"> • The regulation on self-dealing does not provide for an appraisal by an independent evaluator to establish if the price paid is fair or equal to market value (this is only recommended by the Corporate Governance Code). The audit committee is not required by law to be involved in the analysis and approval of related party transactions (again, this is only recommended by the Corporate Governance Code).
<p>4.3. Minority Shareholders Protection and Shareholders' Access to Information Moderately strong</p>	<p>Strengths:</p> <ul style="list-style-type: none"> • All ten largest listed companies appear to publish their financial reports on the ZSE website and their Annual Reports on their websites. Non-financial information is sometimes incomplete. • Major corporate changes require ¾ majority vote at the GSM (the blocking minority shareholding for major corporate changes is 25%+1). • Pre-emptive rights in all cases of capital increase and can only be waived by 3/4 majority vote of all present shares at the GSM. • Pursuant to the Companies Act, shareholders owning 10 % or more of company's stock can bring a derivative claim in the name of the company. Nonetheless, it does not seem to be widely used in practice. <p>Weaknesses:</p> <ul style="list-style-type: none"> • Cumulative voting is not expressly regulated by law, but the Companies Act provides that the Articles may provide the right of certain shareholder to appoint no more than 1/3 of the supervisory board.
<p>4.4. Registration of Shareholdings Moderately strong</p>	<p>Strengths:</p> <ul style="list-style-type: none"> • Shareholders agreements are considered enforceable but only among the parties. They should be made in front of a notary public to be enforceable. Shareholders' agreements only have contractual effect and are only enforceable vis-à-vis the shareholders that have concluded the shareholders' agreement. Therefore a shareholders' agreement generally cannot be enforced against third parties (aside shareholders' successors and assignees and third parties having knowledge), nor can it be enforced against the company itself. • As a general rule, free transferability of shares cannot be restricted. • Share register of issuers should be maintained by the independent registry institutions – Central Depository & Clearing Company, which, in accordance with the law, publishes a list of the ten largest shareholders on its internet page. • Significant shareholding variations must be disclosed.

Key Areas and Rating	Strengths and Weaknesses
<p>5. Stakeholders and Institutions Moderately strong</p>	<p>The market capitalisation of the Zagreb Stock Exchange is quite high but liquidity appears limited. The market is divided in segments according to the transparency of companies, with the Prime Market being the most demanding segment, especially in relation to transparency. However, very few companies (if any) appear to be listed on the Prime Market.</p> <p>The decisions issued by the Croatian Financial Services Supervisory Agency (HANFA) are published on HANFA website.</p> <p>Rating of companies and availability of training courses appear to be limited.</p> <p>The Corporate Governance Code is an excellent complement to the law. All ten largest listed companies have published a compliance statement, however explanations provided by the companies are not always meaningful and appropriate. The regulator and the exchange have prepared very interesting statistical reports offering general overview of the corporate governance and securities market situation in the country. However, they do not seem to monitor the quality of companies' explanations in case of non-compliance with the Code.</p> <p>In general, it appears that the institutional framework supporting good corporate governance is sound. This is also confirmed by indicators by International Organisations.</p> <p>The only negative note appearing from the assessment – common to a number of countries – is the limited attention by listed companies to queries by potential investors and stakeholders, which might be a sign of the need to develop better the investor relation department of issuers.</p>
<p>5.1. Corporate Governance Structure and Institutions Fair</p>	<p>Strengths:</p> <ul style="list-style-type: none"> The Regulated Market of the Zagreb Stock Exchange is divided into the following segments: Prime Market; Official Market; and Regular Market. Prime Market is the most demanding market segment, especially in relation to transparency. The stock exchange and the regulator provide for website pages with all regulatory submissions by listed companies. Such websites are www.zse.hr and www.hanfa.hr. International audit firms have material presence in the country. The ZSE Training Academy and the Croatian institute of Directors organise training course for directors. <p>Weaknesses:</p> <ul style="list-style-type: none"> The Zagreb Stock Exchange has a considerable capitalisation in terms of GDP but limited liquidity. The number of international law firms is limited. International rating agencies are not active in Croatia. We could not find ratings on any of the ten largest listed companies.
<p>5.2. Corporate Governance Code Moderately strong</p>	<p>Strengths:</p> <ul style="list-style-type: none"> The Corporate Governance Code was adopted in 2007 and reviewed in 2010. The Code recommends higher standards of corporate governance compared to those required by the law. It appears to be an excellent complement to the law. The Code is implemented on a "comply or explain" basis for all listed companies on the regulated market. All listed companies are required to complete an Annual Questionnaire (attached to the Code) to disclose their compliance with the Code where they must explain negative answers and submit it annually to the stock exchange, which discloses them online. All ten largest listed companies have published a compliance statement, however explanations provided by the companies are not always meaningful and appropriate. The Croatian Financial Services Supervisory Agency (HANFA) is publishing Reports on Corporate Governance since 2010 (http://www.hanfa.hr/EN/nav/111/giku---englsih.html). They are interesting statistical reports offering general overview of the corporate governance and securities market situation in the country. The analysis covers ownership structures, origins of capital, managing bodies, gender diversity, remuneration, and other corporate governance issues. We strongly support the regulator in its monitoring procedures and would recommend to make deeper analysis, including all explanation provided by companies in their Questionnaire. The Stock Exchange seems to be actively monitoring disclosure by companies. The Stock Exchange has published a number of reports on the quality of disclosure by companies. Unfortunately the reports are only available in Croatian (http://zse.hr/default.aspx?id=144). <p>Weaknesses:</p> <ul style="list-style-type: none"> The Corporate Governance Code has been lastly reviewed in 2010 and it would benefit from another review. The ZSE and HANFA monitoring reports do not appear to look at the quality of explanations provided by companies in case of non-compliance with the Code, which is essential in a "comply or explain"

Key Areas and Rating	Strengths and Weaknesses
	<p>environment.</p> <ul style="list-style-type: none"> It appears that there is no case law specifically referring to the Code.
<p>5.3. Institutional Environment Moderately strong</p>	<p>Strengths:</p> <ul style="list-style-type: none"> No major inconsistencies between laws and regulations in matters regarding corporate governance have been reported, however a few key issues (e.g., composition and independence of the audit committee should be better regulated). The regulator seems active in the promotion of good corporate governance. The monitoring report on the Code is an interesting example to follow. HANFA decisions are published on HANFA website (http://www.hanfa.hr/categorynews.html?categoryid=10). Indicators by international organisations show a sound framework, at the top half of countries reviewed. <p>Weaknesses:</p> <ul style="list-style-type: none"> Case law does not seem to be aggregated and is not easily accessible by lawyers in the country. The 2015 EBRD Assessment on Accessibility of Court Decisions noted suboptimal level of general public access to commercial courts decisions, the major obstacle to court decisions publication being lack of prompt publication of cases. It seems that there is limited attention by listed companies to corporate governance queries by stakeholders. This might be a sign of the need to develop better investor relation departments of issuers.