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European Bank
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Corporate Governance in Transition Economies

Montenegro 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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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 Montenegro are the Law on Business Organizations; the Law on Banks; the Law on Accounting and Auditing; and the Law on Securities. In 2009, a Corporate Governance Code was adopted aiming at improving corporate governance practices of listed companies. The Code is divided into two chapters, dedicated to "*Key Stakeholders of the Corporate Governance*" and "*Transparency and Disclosure of Business Operations*". The Code is to be implemented according to the so-called "*comply or explain*" approach. The Rulebook of the Montenegro Stock Exchange requires companies listed on "A" and "B" listing segments to apply the Code. In 2011, a scorecard was introduced to measure the extent of compliance with the Code. The Stock Exchange claims that five companies adopted the Code.

Structure and functioning of the board

Both joint stock companies and banks are required to have a "board of directors", but there are substantial differences between the two systems: in companies all board members must be non-executives, while in banks up to 1/3 of the board can be composed of executives. Further, in banks the law is quite detailed on board's powers and responsibilities, while in companies the law requires the board to delegate the management of the company to the executive director and management, while retaining oversight over them. We therefore tend to conclude that joint stock companies are organised under a two-tier system while banks under a one-tier system. Boards are generally small, with relatively higher gender diversity than in most of other EBRD countries of operations. It seems that legal entities can serve as board members.

Listed companies are not required to appoint independent directors, and the Corporate Governance Code contains a rather vague recommendation on this matter. In the case of banks, boards are required to be composed of at least two persons who are "independent from the bank", but the criteria which determine their independence could be more comprehensive. None among the ten largest listed companies discloses having independent board members. The company law does not appropriately define the boards' functions. The banking law is more specific and includes all key responsibilities. Companies are not required to establish an audit or any other board committees but only "auditing boards", which do not fulfil the same function. In the case of banks, the law requires them to set up audit committees. In both cases these committees can be composed of "outsiders (i.e., non board members) and thus cannot be accurately classified as board committees. In practice, audit committees are either partially or fully composed of outsiders. The law establishes very few qualification requirements for banks' board and audit committee members.

Disclosure on committees' and boards' activities and meetings is extremely limited and does not allow us to ascertain whether they are playing a strategic role in the company. It appears that there is no consolidated practice of board evaluation. The law requires companies to appoint a "secretary", however its functions are only generally defined. The Corporate Governance Code provides some additional guidance on this. Fiduciary duties, liability of board members and conflicts of interests are regulated by law. Only limited case law on these issues exists.

Transparency and Disclosure

The law does not establish comprehensive requirements for the disclosure of companies' non-financial information. In practice, non-financial disclosures are generally poor. Joint stock companies must disclose information and submit all documents to the Central Registry of the Commercial Court (CRC), which in turn makes this material public. However, most disclosures are only published in the country's Official Gazette; neither the CRC nor listed companies are obliged to make information available through their websites. The website of the Central Registry provides the basic information of each company, including the names of non-executive directors, executive directors, secretaries and auditing firms, as well as their respective share capital ownerships.

The Rulebook of the Montenegro Stock Exchange requires listed companies included in the "A" and "B" listing tiers to adopt the recommendations provided by the Corporate Governance Code on a 'comply or explain' basis. Unfortunately, we could not find any documents disclosing compliance with the Code. Information on the board and audit committee members' qualifications, independence and activities is very limited. The legal framework requires medium and large entities, listed companies and banks to prepare their financial statements in line with the IFRS. Joint stock companies, listed companies and banks must disclose these documents to regulators, which must make them available to general public. Companies seem to comply with these requirements and all ten largest listed companies publish their financial statements with their external auditors' reports, which are available in either the regulator's or the exchange's website.

Internal Control

Companies are not required to establish an audit committee; instead, they are required to have an "auditing board", which is appointed by the general shareholders' meeting and may be comprised of "outsiders" (i.e., non-board members). Thus, this body cannot be accurately classified as an audit committee. We have reservations about this body's ability to support the functions of the board, which include the transparent and accurate presentation of information in financial reports and robustness of the internal control system.

In banks, boards are required to establish an audit committee; however - also in this case - it may be comprised of 'outsiders', which is not in line with best practices. There are no independence requirements for audit committees or auditing board members. Disclosures on meetings and activities are extremely limited, and reports do not unveil whether audit committees and boards are playing a strategic role on a company's performance. Large legal entities and banks are required to have an internal auditor who must meet certain qualifications. Banks are additionally required to establish a compliance function. Only a small minority of the surveyed companies —all banks— disclose having an internal audit in place, and compliance functions do not seem to be dealing with 'compliance risk'.

All joint stock companies must have their financial statements audited by an independent external auditor. Provision of non-auditing services is restricted, but there is no requirement to rotate the external auditor. In banks, external auditors are appointed by the board. We have reservations about this practice, since it may weaken the reliability of financial statements produced by them. Further, the external auditor's accountability line is to shareholders, not to the board.

Only a minority of companies appear to have a code of ethics in place. Whistleblowing protection is addressed by law, but it is not comprehensive. Regulation on related party transactions and conflicts of interests are regulated.

Rights of Shareholders

Shareholders in Montenegro enjoy a relatively high level of protection "on paper", but it seems that there is a lack of shareholder culture and judicial practice on the matter. This suggests a strong need to increase public awareness, and to improve the judicial infrastructure dealing with corporate governance issues.

Basic shareholder rights seem to be adequately regulated by law. Shareholders representing 5% of the share capital of a joint stock company are entitled to call a general shareholders' meeting (GSM), to add items to the agenda, and to nominate board members and the company's auditor. Shareholders are provided with timely notifications and materials for the GSM online. Furthermore, shareholders are endowed with general inspection rights, pre-emptive rights and cumulative voting rights. Shareholders are entitled to file a suit against board members for breach of their duties or obligations. Supermajority is required to approve major corporate changes, but not to amend the articles of association. Disclosure of non-financial information is generally poor and companies' websites are not very informative. Self-dealing is regulated, insider trading is prohibited, and several insider trading cases have been investigated in the past five years. However, sanctions do not apply to individuals, but only to legal entity, and do not include imprisonment.

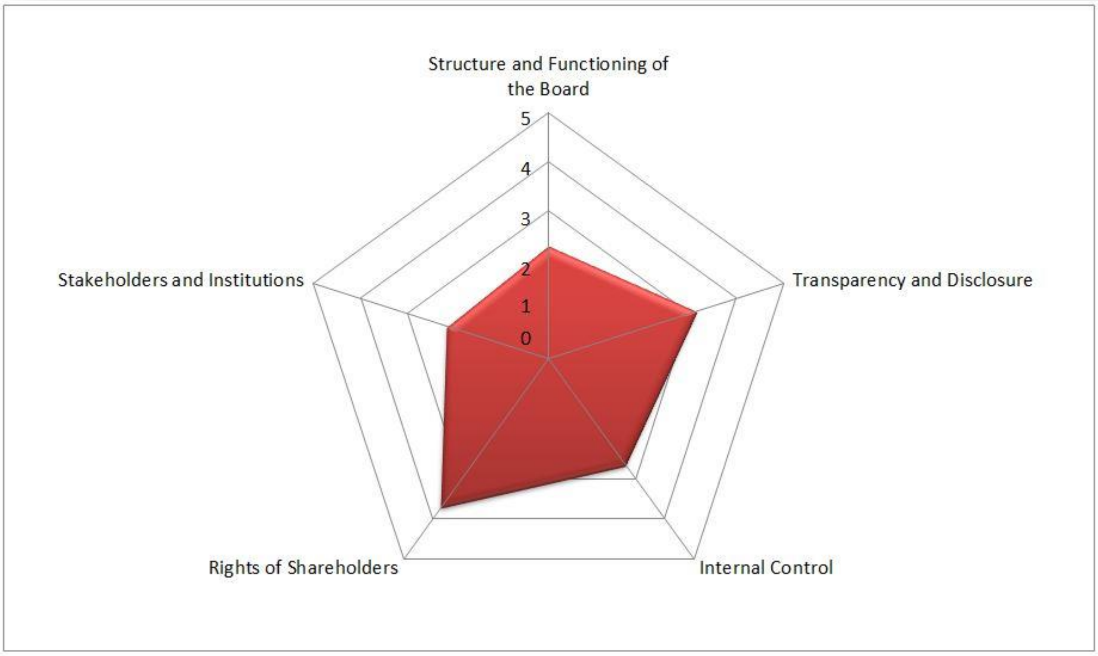
Shareholders agreements, related party transactions and conflicts of interests are regulated by law. Registration of shares is maintained by the Central Depository Agency. The free transferability of shares cannot be limited.

Stakeholders and Institutions

The Montenegro Stock Exchange (MNSE) is the main local stock exchange in Montenegro. MNSE's market capitalisation is high at around 90% of the GDP, but it seems that the volume of trades is very low. A Corporate Governance Code was developed in 2009 to be implemented under a 'comply or explain' basis. The Code was supplemented with a scorecard in 2011, but we have reservations about its use as corporate governance cannot be accurately measured through a simple quantitative assessment. Rather companies should be encouraged to provide meaningful narratives. The Code does not address certain key corporate governance issues.

There are two main listing tiers at the MNSE: Tier A and Tier B. Companies listed in these two tiers are required to comply with the Corporate Governance Code under a 'comply or explain' basis. Nevertheless, none of the ten largest listed companies discloses a 'comply or explain' section in its annual report. The Stock Exchange declares to be monitoring compliance with the Code, but monitoring reports mostly focus on companies' financial information, and there appears to be no mention of companies' corporate governance practices. There are a few inconsistencies in corporate governance legislation, and some corporate governance matters are not regulated. Indicators provided by international organisations rank Montenegro poorly with regard to corruption and competitiveness.

Corporate Governance Legislation and Practices in Montenegro



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 *Weak/Fair*	*Both joint stock companies and banks are required to have a "board of directors", but there are substantial differences between the two systems: in companies all board members must be non-executives, while in banks up to 1/3 of the board can be composed of executives. Further, in banks the law is quite detailed on board's powers and responsibilities, while in companies the law requires the board to delegate the management of the company to the executive director and management, while retaining oversight over them. We therefore tend to conclude that joint stock companies are organised under a two-tier system while banks under a one-tier system.* *Boards are generally small, with relatively higher gender diversity than in most of other EBRD countries of operations. It seems that legal entities can serve as board members.* *Listed companies are not required to appoint independent directors, and the Corporate Governance Code contains a rather vague recommendation on this matter. In the case of banks, boards are required to be composed of at least two persons who are "independent from the bank", but the criteria which determine their independence could be more comprehensive.* *None among the ten largest listed companies discloses having independent board members.* *The company law does not appropriately define the boards' functions. The banking law is more specific and includes all key responsibilities.* *Companies are not required to establish an audit or any other board committees but only "auditing boards", which do not fulfil the same function. In the case of banks, the law requires them to set up audit committees. In both cases these committees can be composed of "outsiders (i.e., non board members) and thus cannot be accurately classified as board committees. In practice, audit committees are either partially or fully composed of outsiders.* *The law establishes very few qualification requirements for banks' board and audit committee members.* *Disclosure on committees' and boards' activities and meetings is extremely limited and does not allow us to ascertain whether they are playing a strategic role in the company.* *It appears that there is no consolidated practice of board evaluation. The law requires companies to appoint a "secretary", however its functions are only generally defined. The Corporate Governance Code provides some additional guidance on this.* *Fiduciary duties, liability of board members and conflicts of interests are regulated by law. Only limited case law on these issues exists.*
1.1. Board Composition *Weak*	***Strengths:*** • *In the case of banks, the law expressly prohibits executive directors from being appointed chair of the board. This requirement seems to be well implemented and none of the surveyed companies combines the roles of the CEO and chair.* • *Banks are required to have at least two independent board members. In companies, the Corporate Governance Code only vaguely recommends independent directors to serve on the board.* • *In banks, board members are required to have certain qualifications, including a university degree and experience in the banking sector. In addition, appointments must be approved by the Central Bank. The Corporate Governance Code recommends that board members should have a combination of different knowledge, professional and practical experiences. However, there is little evidence that the Code is well implemented in practice.* ***Weaknesses:*** • *It seems that legal entities can serve as board members. However, no company among the ten largest in the country appear to have any corporation in their boards.* • *Boards are generally small, with an average of seven members. Smaller boards tend to be more cohesive and perform better, provided that they have the necessary mix of skills, diversified experience and appropriate support, such as a corporate secretary. However, this does not seem to be necessarily the case in Montenegro.* • *None of the ten largest listed companies discloses having independent board members.* • *Large legal entities are required to establish an auditing board where at least one member must be an*

Key Areas and Rating	Strengths and Weaknesses
	expert in accounting or audit. However, there is no requirement that this member is a board member. • *Only two among the ten largest listed companies disclose their directors' qualifications online, and in these cases directors seem to lack experience or education in the fields of accountancy, audit and other financial expertise.* • *Banks' audit committees must be comprised in their majority by persons "not connected to the bank", and these may include "outsiders" (i.e., non-board members). The same applies to "auditing boards". Both solutions raise some doubts. 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 follow up on such recommendations and vote on the committee's recommendations at the board meeting, 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 audit 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.* • *In practice, four among the ten largest listed companies— three of which are banks— disclosed having audit committees, and only three disclosed their compositions. In one case, audit committees are partially composed of outsiders and, in two cases, committees are completely constituted by them.*
1.2. Gender Diversity at the Board (16.52%) *Fair*	• *All ten largest listed companies disclose the names of their directors; eight have women sitting on their boards. Among these companies, female representation averages 20.65%.* • *In total, there are 11 women out of 60 board members. Overall, when counting all the ten companies in our sample, the average of female directors per board falls to 16.52%.*
1.3. Independent Directors *Very weak*	***Strengths:*** • *Banks are required to have at least two board members who are "independent from the bank".* ***Weaknesses:*** • *In companies, the Corporate Governance Code recommends companies to have some independent directors, however the recommendation and definition of independence provided by the Code are vague. Companies are further recommended to adopt their own definition of independence, which does not help clarity.* • *In their majority, bank audit committees must be comprised by persons "not connected to the bank". This condition may be met by appointing "outsiders" members (see above).* • *There are two definitions of independence: one is found in the Law on Banks and the other one in the Corporate Governance Code. Neither definition is comprehensive, nor includes any positive criteria informing companies of the conditions which make directors independent in practice. 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 characteristic that should be demonstrated, disclosed and explained in practice.* • *In practice, none of the ten largest listed companies discloses having independent board members.*
1.4. Board Effectiveness *Weak*	***Strengths:*** • *The boards of banks are responsible for appointing audit committees. In turn, committees must periodically report their duties to the board.* • *The law requires companies to appoint a corporate secretary and five of the ten largest listed companies disclose having a corporate secretary function in place; however, no additional information of their responsibilities is available.* ***Weaknesses:*** • *The Law on Accounting and Auditing requires large legal entities to establish "auditing boards" with members appointed by the general shareholders' meeting. Auditing board's members do not need to be board members. We have doubts about the effectiveness of this body (see above).* • *None of the top ten listed companies discloses having a nomination and/or remuneration committee.* • *Only three companies in our sample disclose their boards' and committees' activities and meetings; hence, it is not possible to assess whether these play a strategic role in the companies' performance.* • *The Corporate Governance Code recommends boards to analyse and evaluate the quality and efficiency of their work. They are similarly suggested to implement and disclose measures or activities which will improve their performance. However, none of the ten largest listed companies reports undertaking any of these measures.*
1.5. Responsibilities of the Board *Fair*	***Strengths:*** • *By law, the board is responsible for appointing and dismissing executives.* • *The Law on Banks is clear in assigning to the board key strategic functions and defining the board's responsibilities.*

Key Areas and Rating	***Strengths and Weaknesses***
	• *Fiduciary duties, liability and conflicts of interest are addressed by the law. However, enforcement in these matters is very limited, and access to case law is subpar.* ***Weaknesses:*** • *In companies, the law does not clearly assign to the board its key strategic functions; rather, it allows shareholders to define the board's powers through the companies' Articles of Association.*

Key Areas and Rating	Strengths and Weaknesses
2. Transparency and Disclosure *Fair*	*The law does not establish comprehensive requirements for the disclosure of companies' non-financial information. In practice, non-financial disclosures are generally poor.* *Joint stock companies must disclose information and submit all documents to the Central Registry of the Commercial Court (CRC), which in turn makes this material public. However, most disclosures are only published in the country's Official Gazette; neither the CRC nor listed companies are obliged to make information available through their websites.* *The website of the Central Registry provides the basic information of each company, including the names of non-executive directors, executive directors, secretaries and auditing firms, as well as their respective share capital ownerships.* *The Rulebook of the Montenegro Stock Exchange requires listed companies included in the "A" and "B" listing tiers to adopt the recommendations provided by the Corporate Governance Code on a 'comply or explain' basis. Unfortunately, we could not find any documents disclosing compliance with the Code.* *Information on the board and audit committee members' qualifications, independence and activities is very limited.* *The legal framework requires medium and large entities, listed companies and banks to prepare their financial statements in line with the IFRS. Joint stock companies, listed companies and banks must disclose these documents to regulators, which must make them available to general public. Companies seem to comply with these requirements and all ten largest listed companies publish their financial statements with their external auditors' reports, which are available in either the regulator's or the exchange's website.*
2.1. Non-Financial Information Disclosure *Weak*	***Strengths:*** • *Banks are required to disclose information on their risk management strategies, credit risks and other types of risk online. The banks in our sample seem to comply with this requirement.* • *All ten largest listed companies disclose the names of their directors and provide updated information on share ownership and major shareholders.* • *Companies listed in the 'A' and 'B' listing tiers are required to report their compliance with the Corporate Governance Code on a 'comply or explain' basis. A "scorecard" was also developed by the stock exchange to report their levels of compliance.* ***Weaknesses:*** • *According to the exchange's website, five companies have committed to implement the Corporate Governance Code; however, we could not assess the extent to which this "commitment" is implemented in practice as none of them seems to publicly disclose information on their compliance with the Code.* • *Companies are only required to include financial information in their Annual Reports. Only a small minority of the ten largest listed companies disclose their articles of association, minutes of the general shareholders' meeting, main beneficial shareholders, board members' qualifications, audit committee compositions (other committees seem to be non-existent), and the boards' and audit committees' activities on their websites or in their Annual Reports. None of the ten largest listed companies discloses transactions in company's shares.*
2.2. Financial Information Disclosure *Strong*	***Strengths:*** • *Joint stock companies are required to submit their annual and quarterly financial statements to the Securities Commission (http://www.scmn.me//index.php). Conversely, banks are required to submit them to the Central Bank (http://www.cb-cg.org/eng/). Both the Securities Commission and the Central Bank publish these documents on their websites. Listed companies must additionally submit their financial reports to the Stock Exchange (http://www.montenegroberza.com). All ten largest listed companies comply with these obligations.* • *Banks are expressly required to publish all their financial information on their websites.* • *The financial reports of all ten largest listed companies are prepared in line with the IFRS.*
2.3. Reporting to the Market and to Shareholders *Fair*	***Strengths:*** • *The quality of financial information is generally robust and all ten largest listed companies submit their financial statements to the Securities Commission and the Stock Exchange.* • *The Securities Commission has the authority to issue sanctions when companies fail to submit financial statements or disclose misleading or false information. According to the regulator, a number of companies have been sanctioned over the last five years. Additionally, the regulator publishes the list of companies which failed to submit their financial reports on time.*

Key Areas and Rating	***Strengths and Weaknesses***
	• *Listed companies are required to make timely disclosure of price sensitive events.* ***Weaknesses:*** • *Disclosure of non-financial information is generally poor.* • *The website of the Central Registry stores information of all business entities and provides basic corporate information, including the names of non-executive directors, executive directors, secretaries and auditing firms, as well as their respective share capital ownerships. However, other important documents are published via the national Official Gazette, rather than online.* • *The websites of the ten largest listed companies are not very informative; information is often incomplete, scattered and difficult to find.* • *There is no requirement to disclose the minutes of the general shareholders' meeting and only one among the ten largest listed companies posted the minutes on its website.*
2.4. Disclosure on the External Audit *Moderately strong*	***Strengths:*** • *All ten largest listed companies disclose their auditors' names and opinions on their financial statements, and declare that their auditors are independent.* ***Weaknesses:*** • *As disclosure on the board and audit committee activities is very limited, we could not ascertain whether these bodies effectively monitor the auditors' independence.*

Key Areas and Rating	**Strengths and Weaknesses**
3. Internal Control *Fair*	*Companies are not required to establish an audit committee; instead, they are required to have an "auditing board", which is appointed by the general shareholders' meeting and may be comprised of "outsiders" (i.e., non-board members). Thus, this body cannot be accurately classified as an audit committee. We have reservations about this body's ability to support the functions of the board, which include the transparent and accurate presentation of information in financial reports and robustness of the internal control system.* *In banks, boards are required to establish an audit committee; however - also in this case - it may be comprised of 'outsiders', which is not in line with best practices. There are no independence requirements for audit committees or auditing board members. Disclosures on meetings and activities are extremely limited, and reports do not unveil whether audit committees and boards are playing a strategic role on a company's performance.* *Large legal entities and banks are required to have an internal auditor who must meet certain qualifications. Banks are additionally required to establish a compliance function. Only a small minority of the surveyed companies —all banks— disclose having an internal audit in place, and compliance functions do not seem to be dealing with 'compliance risk'.* *All joint stock companies must have their financial statements audited by an independent external auditor. Provision of non-auditing services is restricted, but there is no requirement to rotate the external auditor. In banks, external auditors are appointed by the board. We have reservations about this practice, since it may weaken the reliability of financial statements produced by them. Further, the external auditor's accountability line is to shareholders, not to the board.* *Only a minority of companies appear to have a code of ethics in place.* *Whistleblowing protection is addressed by law, but it is not comprehensive.* *Regulation on related party transactions and conflicts of interests are regulated.*
3.1. Quality of the Internal Control Framework *Fair*	***Strengths:*** • *Large legal entities and banks are required to have an internal auditor.* • *Banks are required to establish a compliance function; however, it appears that this function is mostly tackling money laundering matters and not necessarily 'compliance risk'.* • *Banks are required to have an audit committee composed of members reporting to and appointed by the board.* ***Weaknesses:*** • *Large companies are required to have an "auditing board". This is not a board committee and should not be confused with it: members of the auditing board are appointed by the general shareholders meeting — not the board — and do not need to be board members. Similarly, in banks audit committees are not required to be composed of board members only. There is not a clear independence requirement for these members, only a vague requirement in the banking law.* • *Only four out of the ten largest listed companies —three of which are banks— disclose having an audit committee. Three of them disclosed their committees' compositions; they are either partially or entirely composed of outsiders.* • *Companies are not recommended to have a code of ethics, and only two out of the ten largest listed companies disclose having one.* • *There is no comprehensive whistle-blowing legislation.*
3.2. Quality of Internal and External Audit *Fair*	***Strengths:*** • *Large legal entities and banks are required to have an internal auditor, and the law details its qualification requirements.* • *Joint stock companies, large entities and financial institutions are required to have their financial statements reviewed by an independent external auditor.* • *Both the "audit committee" and the "auditing board" are in charge of monitoring the independence of the external auditors.* • *The auditors of all ten largest listed companies declare to be independent. All of the latter are international audit firms.* • *External auditors are forbidden from extending non-auditing services.* ***Weaknesses:*** • *Only in the case of banks, the law requires internal auditors to file a report to the audit committee.*

Key Areas and Rating	***Strengths and Weaknesses***
	• *Only three of the ten largest companies —all banks— disclose having an internal audit function on their websites.* • *In the case of companies, external auditors are appointed by the general shareholders' meeting. However, in the case of banks, auditors are appointed by the board and we have reservations about this practice. External auditors are an important mechanism to assure shareholders that financial statements produced by the management present a fair view of the company's financial results. By allocating the power to appoint them with the board, the accountability lines get blurred and external auditors are likely to feel accountable to the board, rather than to shareholders.* • *The Corporate Governance Code recommends that external auditors should rotate every 5 years. However, there is no legal requirement to do so. In practice, the Code's recommendation does not seem to be followed.*
3.3. Functioning and Independence of the Audit Committee *Weak*	***Strengths:*** • *Financial institutions are required to have an audit committee composed of members appointed by the board. The majority of these members must have experience in the finance industry. Executive directors cannot serve on the audit committee. The Corporate Governance Code recommends companies to form an audit committee, composed of members with adequate knowledge and experience.* • *Both the "audit committee" and the "auditing board" are in charge of monitoring the independence of the external auditors.* ***Weaknesses:*** • *The majority of members in banks' audit committees must be persons "not connected to the bank" who can be outsiders and therefore, this committee cannot be considered to be a board committee (see "Board Composition" above for our concerns about having "outsiders" in the audit committee).* • *Large entities are required to establish an "auditing board". In practice, this is a "revision commission" and not an "audit committee" with members appointed by and reporting to the general shareholders' meeting. We have doubts about this body's ability to ensure fit-for-purpose internal control systems and external auditing services.* • *The Corporate Governance Code backs the law and suggests that outsiders may serve as audit committee's members, which is not in line with best practices.* • *There is no comprehensive independence requirement both for audit committee members and for auditing board members.* • *Only four among the ten largest listed companies—three of which are banks— disclosed having an audit committee online. Three of them disclosed their composition: in two cases they are entirely composed of outsiders. Only one of them discloses the number of meetings held per year, and their activities.*
3.4. Control over Related Party Transactions and Conflict of Interest *Fair/Moderately strong*	***Strengths:*** • *In companies, any kind of transactions with directors are prohibited. Directors have the duties to inform the general shareholders' meeting of their compensation fees and any other benefits granted to them and to avoid actual and potential conflicts of interest between their personal interests and those of the company. Additionally, if shareholders hold direct interests on a particular issue, they may not exert their votes on such matter at the general shareholders' meeting.* • *In the case of banks, related party transactions (RPTs) are allowed only if they are undertaken under fair terms, and within certain value limits. The procedures to approve them must be further established through internal documentation.* • *All ten largest listed companies disclose RPTs as sections within their financial statements. It appears that such disclosure is sometimes incomplete.* ***Weaknesses:*** • *We could not find evidence of RPT regulations being enforced; there seems to be no case law on the matter.*

Key Areas and Rating	**Strengths and Weaknesses**
4. Rights of Shareholders *Fair/Moderately strong*	*Shareholders in Montenegro enjoy a relatively high level of protection "on paper", but it seems that there is a lack of shareholder culture and judicial practice on the matter. This suggests a strong need to increase public awareness, and to improve the judicial infrastructure dealing with corporate governance issues.* *Basic shareholder rights seem to be adequately regulated by law. Shareholders representing 5% of the share capital of a joint stock company are entitled to call a general shareholders' meeting (GSM), to add items to the agenda, and to nominate board members and the company's auditor. Shareholders are provided with timely notifications and materials for the GSM online. Furthermore, shareholders are endowed with general inspection rights, pre-emptive rights and cumulative voting rights. Shareholders are entitled to file a suit against board members for breach of their duties or obligations. Supermajority is required to approve major corporate changes, but not to amend the articles of association.* *Disclosure of non-financial information is generally poor and companies' websites are not very informative.* *Self-dealing is regulated, insider trading is prohibited, and several insider trading cases have been investigated in the past five years. However, sanctions do not apply to individuals, but only to legal entity, and do not include imprisonment.* *Shareholders agreements, related party transactions and conflicts of interests are regulated by law.* *Registration of shares is maintained by the Central Depository Agency. The free transferability of shares cannot be limited.*
4.1. General Shareholders' Meeting (GSM) *Moderately strong*	***Strengths:*** • *Shareholders representing 5% of the capital can call a GSM, propose new items to the GSM agenda, and nominate directors and the company's auditor.* • *The GSM announcement and agenda are required to be sent to shareholders at least 30 days before the meeting.* • *All ten largest listed companies publish the GSM notifications in the stock exchange's website; three of them also posted GSM materials on their own websites.* • *Shareholders may ask questions at the GSM or submit them in advance. The board members and CEO must attend the GSM. The law also requires the external auditor to attend the GSM.* • *Cumulative voting is mandatory when electing board members.* • *Shares carry proportional voting rights.* • *The law allows shareholders to vote electronically, by proxy, or by post.* ***Weaknesses:*** • *Only one of the ten largest listed companies provides information about voting rights, and their exercise, on its website.*
4.2. Protection against Insider Trading and Self-dealing *Fair*	***Strengths:*** • *Insider trading is prohibited by law. Several insider trading cases have been investigated in the past five years.* ***Weaknesses:*** • *Insider trading sanctions do not apply to individuals, but only to legal entities. Therefore, imprisonment cannot be imposed for these offences.* • *The limited presence of independent directors does not ensure that related party transactions (RPTs) and conflicts of interest are objectively dealt with. This is somehow mitigated by the fact that all RPTs are prohibited in companies.* • *None of the ten largest listed companies discloses transactions in company's shares.*
4.3. Minority Shareholders Protection and Shareholders' Access to Information *Fair*	***Strengths:*** • *All ten largest listed companies submit their financial statements to the Securities Commission and the Stock Exchange.* • *Shareholders have general inspection rights. Additionally, shareholders have the right to call a GSM, add items to the agenda, and nominate board members.* • *Pre-emptive rights are assigned to shareholders in all cases of capital increases in cash, and can only be waived by a two thirds majority vote of all affected shares at the GSM.* • *Increase of capital can be decided by the majority vote of shareholders representing 2/3 of the capital.*

Key Areas and Rating	***Strengths and Weaknesses***
	However, the charter or a 2/3 majority decision of the general shareholders' meeting can authorize the board to increase the capital. • *Cumulative voting is mandatory for the election of the board members.* • *Any shareholder can present a claim against the company, its board members or its controlling shareholders for wrongdoings or unfair prejudice. The Securities Commission may also penalize listed companies engaging in unfair prejudice actions, and may order the issuer to pay damages to the wronged member. Case law on this matter is, however, limited.* ***Weaknesses:*** • *Supermajority is required for major corporate decisions, however it seems that the articles of association can be changed by simple majority at the GSM.* • *Disclosure of non-financial information is poor.* • *Companies' websites are not very informative; information is often incomplete and difficult to find. Likewise, the Securities Commission's website does not seem to be well updated.*
4.4. Registration of Shareholdings *Moderately strong*	***Strengths:*** • *Share register of all joint stock companies is maintained by the Central Depository Agency.* • *If a person's shareholding exceeds or falls below 10%, 20%, 33%, or 50% of the company's share capital or voting rights, he must inform the Securities Commission and the issuer of his new position within 7 days.* • *In the case of banks, significant acquisitions of shares and shareholder agreements can only be executed after obtaining the Central Bank's prior approval.* • *Shareholder agreements are regulated by law. They are binding only upon the contractual parties and must be disclosed.*

Key Areas and Rating	Strengths and Weaknesses
5. Stakeholders and Institutions *Weak*	*The Montenegro Stock Exchange (MNSE) is the main local stock exchange in Montenegro. MNSE's market capitalisation is high at around 90% of the GDP, but it seems that the volume of trades is very low.* *A Corporate Governance Code was developed in 2009 to be implemented under a 'comply or explain' basis. The Code was supplemented with a scorecard in 2011, but we have reservations about its use as corporate governance cannot be accurately measured through a simple quantitative assessment. Rather companies should be encouraged to provide meaningful narratives. The Code does not address certain key corporate governance issues.* *There are two main listing tiers at the MNSE: Tier A and Tier B. Companies listed in these two tiers are required to comply with the Corporate Governance Code under a 'comply or explain' basis. Nevertheless, none of the ten largest listed companies discloses a 'comply or explain' section in its annual report. The Stock Exchange declares to be monitoring compliance with the Code, but monitoring reports mostly focus on companies' financial information, and there appears to be no mention of companies' corporate governance practices.* *There are a few inconsistencies in corporate governance legislation, and some corporate governance matters are not regulated. Indicators provided by international organisations rank Montenegro poorly with regard to corruption and competitiveness.*
5.1. Corporate Governance Structure and Institutions *Fair*	**Strengths:** • *The Montenegro Stock Exchange (MNSE) is the main local stock exchange in Montenegro. The MNSE website contains a comprehensive summary of the company's financial and non-financial information, including the company's number of shares, GSM announcements, financial statements and indicators.* • *International audit firms have a significant presence in the country.* **Weaknesses:** • *MNSE's market capitalisation is high but it seems that the volume of trades is very low.* • *There are two main listing tiers at the MNSE: Tier A and Tier B. Companies listed in these two tiers are required to comply with the Corporate Governance Code under a 'comply or explain' basis. Nevertheless, none of the ten largest listed companies discloses a 'comply or explain' section in its annual report or its website.* • *The rulings of regulatory agencies are not always publicly available.* • *International law firms and rating agencies are not very active in the country; only one of the ten largest listed companies has been rated by international ratings agencies.*
5.2. Corporate Governance Code *Weak*	**Weaknesses:** • *A Corporate Governance Code was developed in 2009, and has not been reviewed since.* • *The Code is implemented under a 'comply or explain' basis. Some key corporate governance issues are not properly addressed by the Code, such as the independent status of board members and board committees.* • *The Code was supplemented with a scorecard in 2011. When completing this scorecard, companies are required to assess their own governance practices using a numerical score, and they cannot add any qualitative information to complement their answers. We have reservations about the use of scorecards, since we believe corporate governance is not a "science" and cannot be accurately measured only through a simple quantitative assessment.* • *Although the Stock Exchange claims that up to five companies have "fully adopted the Code", we could not find any published scorecards or 'comply or explain" reports to verify this information.* • *The Stock Exchange declares to be monitoring compliance with the Code, but monitoring reports mostly focus on companies' financial information, and there appears to be no mention of companies' governance practices.* • *There is no case law referring to the Corporate Governance Code.*
5.3. Institutional Environment *Weak/Fair*	**Strengths:** • *Montenegro performs relatively well on the investor protection category of the World Bank's Doing Business index.* • *According to the 2015 EBRD Assessment on Accessibility of Court Decisions, it seems that case law is fairly easily accessible to parties and the public, with Montenegro as one of the strongest performers in the assessment.* **Weaknesses:** • *Indicators provided by international organisations rank Montenegro poorly with regard to corruption and*

Key Areas and Rating	***Strengths and Weaknesses***
	/competitiveness. • *There are a few inconsistencies in corporate governance legislation, and some corporate governance issues are not regulated (e.g. independence of the board and audit committee).*