Comments are welcome: please provide comments to cignag@ebrd.com

European Bank
for Reconstruction and Development

Corporate Governance in Transition Economies

Estonia 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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Finally, the Legal Transition team would like to express its thanks and appreciation to Gabrielle Cordeiro and David Risser from Nestor Advisors Ltd for the assistance provided in relation to the analysis of countries and the drafting of the reports.

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 Estonia are the Commercial Code; the Law on Auditors Activities; the Law on Securities Market and the Credit Institutions Act. The Financial Supervision Authority has also issued a number of secondary legislation, also relevant to corporate governance.

The Estonian Corporate Governance Recommendations are the Estonian Corporate Governance Code. The Recommendations were prepared in cooperation between the Estonian Financial Supervision Authority and the Tallinn Stock Exchange and adopted in September 2005. They apply to companies whose shares are admitted to trading on a regulated market operating in Estonia. They are endorsed by the Stock Exchange and implemented on the "*comply or explain*" basis. This means that listed companies must produce a corporate governance statement – Corporate Governance Recommendations Report - as a part of their annual report - to be published on the listed company's website. It appears that the Recommendations are well implemented and their implementation actively monitored.

Structure and functioning of the board

Companies can choose to organise their boards under a two-tier or under a one-tier system. However, entities whose share capital amounts to at least EEK 400,000 (approximately EUR 25,500) are required to adopt a two-tier board structure.

Supervisory boards (hereinafter also referred as "board") are generally small (the average of the ten largest listed companies is 5 members). Evidence shows that smaller boards tend to perform better, provided they have the necessary mix of skills and support (e.g. corporate secretary), but this does not seem to be necessarily the case in Estonia.

Legal entities cannot serve as board members. Gender diversity at the board is very limited.

Only board members of banks are subject to qualification requirements. The Corporate Governance Recommendations recommend supervisory board members to be elected from *persons having sufficient knowledge and experience*.

The Corporate Governance Recommendations recommend boards of listed companies to have at least half of their members made up of independent members. Seven among the ten largest listed companies disclosed having independent board members; however, only in two cases the number of independent directors amounts to half of the board.

Public interest entities - including listed companies and banks - are required to establish audit committees. Nine of the ten largest listed companies disclosed having an audit committee in place. While the law does not require audit committee to comprise any independent directors, five companies in our sample disclosed having at least one independent director on their audit committees. Banks, depending on its nature and level of complexity, are also required to set up risk committees and nomination committees. Nomination and remuneration committees are not common in Estonia. Only one company disclosed having a combined committee in place.

The law requires boards to meet when necessary but not less frequently than quarterly. Six of the ten largest companies clearly disclosed that they comply with this requirement.

The law vests the board with the authority to discuss and approve the strategy and to oversee management. Pursuant to the law, the board has the authority to approve the annual budget of the company, unless the articles of association place this responsibility within the competence of the general shareholders meeting (GSM). We do not think that it is appropriate for the GSM to approve the budget, as this is closely connected with the strategy and should stay under the remit of the board. The law does not make any direct reference to risk oversight function of the board.

There is no established practice of board evaluation and company secretary function.

Fiduciary duties, liability of board members and conflicts of interests are regulated by law.

Transparency and Disclosure

The law requires companies to prepare and disclose their annual reports, which should include both financial and non-financial information. All ten largest listed companies comply with this requirement and the quality of disclosure is generally sound. Annual reports are accessible online at the Estonian Commercial Register and on the companies' websites. Companies' websites are generally complete and well updated.

The listing rules require listed companies to report their compliance with the Corporate Governance Recommendations or to explain deviations. All ten largest listed companies comply with this requirement. The level of compliance appears quite high and therefore there are not many explanations; the majority of explanations provided are quite meaningful. However, it should be noted that the Corporate Governance Recommendations do not deal with a number of key issues such as formation and composition of the board committees, board evaluation, code of ethics, directors' qualifications, internal control, etc. This might explain the high level of compliance.

Companies are required to disclose financial information in line with IFRS and all companies in our sample comply with this requirement.

Reporting to the market and shareholders is regulated by law and appears to be well implemented.

Annual reports contain external auditors' opinions and all ten largest listed companies declare their auditors to be independent. The provision of non-audit services by the external auditor is allowed, subject to the scrutiny of the audit committee. The Auditors Activities Act requires audit firms to disclose their fees for audit and non-audit services, however disclosure on this matter is limited.

Internal Control

Companies and banks are required to have internal audit functions. Banks are also required to establish compliance functions and our respondents believe that banks generally comply with this requirement.

Public interest entities are required to establish audit committees. The law allows "*outsiders*" (i.e., non-board members) to sit in the audit committee. We have doubts whether this option can ensure fit-for-purpose internal control and external auditing services. In practice, nine companies declared having audit committee in place, where three of them are partially formed of outsiders. There are no independence requirements for audit committee members. Disclosure on the number and activities of the audit committee is limited and does not allow to assess if they are playing a key control role.

Large companies are required to have their financial statements audited by an independent external auditor. The auditors of all ten largest listed companies are all international audit firms and declared to be independent. The provision of non-auditing services by the external auditor is allowed, subject to the scrutiny of the audit committee. This should be carefully monitored, as it might undermine the auditor's independence. Unfortunately, disclosure on this matter is limited. The law requires rotation of external auditors in public interest entities after no more than seven years. The Corporate Governance Recommendations recommend rotation every five years. Three companies out of the ten largest listed in the country appear to have exceeded this period and last time rotated their auditors 8-9 years ago.

There is no requirement for companies to have a code of ethics and none of them disclosed having one in place. Estonian legal regulations on whistle-blowers focus mostly on public sector. When it comes to private sector, regulation is almost non-existent.

Regulation and practices on related party transactions and conflicts of interest is regulated by law, but we found no evidence of its enforcement.

Rights of Shareholders

Shareholders representing 10% of the company can call a general shareholders' meeting (GSM) and propose new items to the GSM agenda. All ten largest listed companies published notifications and documentation related to the GSM on their websites or stock exchange website.

Furthermore, shareholders are endowed with general inspection rights and with pre-emptive rights in case of capital increase. They may ask questions at the GSM or submit them in advance even if these questions are not related to the items on the agenda. Supermajority is required to approve major corporate changes.

Cumulative voting and proportional representation are not foreseen for companies and our respondents believe that similar devises are not used in practice. Voting rights are proportional to the value of shares.

Estonian law does not provide the possibility for shareholders' derivative suits; therefore, shareholders are not entitled to present a claim against company's directors in the name of the company.

Insider trading is prohibited by law and can be punished with fines or imprisonment. There is some evidence that this prohibition is enforced in practice.

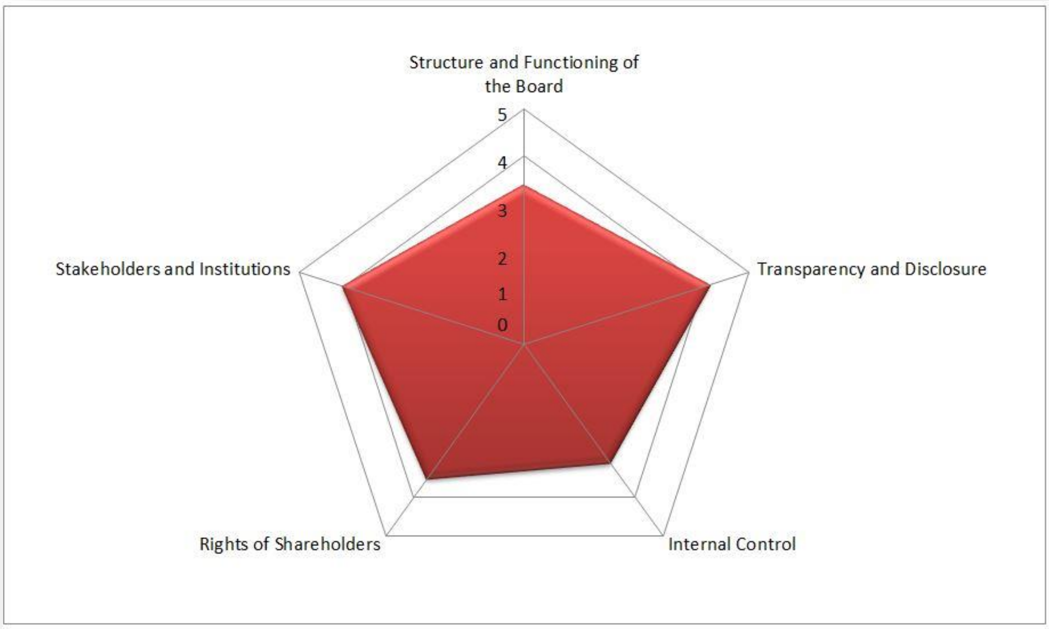
Significant shareholding variations must be disclosed to the market regulator and the issuer. Fines for non-notification can be applied.

Public companies are required to have share registration maintained by an independent registry institution, the Estonian Central Securities Depository. Shareholders agreements are considered enforceable among the parties, but there is not much case law on this matter. As a general rule, free transferability of shares cannot be restricted. However, some limitations may be foreseen in shareholders' agreement.

Stakeholders and Institutions

The Estonia's related market is the Tallinn NASDAQ OMX stock exchange (TSE), established in 2008. Although the TSE appears to have a limited capitalization and liquidity, it is active in promoting high quality disclosures by listed companies. Further, it promotes compliance with the Corporate Governance Recommendations by disclosing an annual ranking of the top 20 listed companies in the Baltic region. Nevertheless, the stock exchange has no listing segments requiring companies to have higher corporate governance standards.
International rating agencies do not seem to be active in the country; international audit and law firms, in turn, have material presence in the country.
The Estonian Corporate Governance Recommendations are relatively comprehensive and well implemented, but have not been updated in a decade. Listed companies are required to report their compliance with the Recommendations on a "*comply or explain*" basis. Many explanations for lack of compliance are adequately justified, and refer to companies' practices. The monitoring efforts undertaken by the Financial Supervision Authority (FSA) have been generally successful in ensuring compliance with the Recommendations. All ten largest listed companies disclose their corporate governance practices on their websites and annual reports. Additionally, the FSA regularly publishes detailed reports dedicated to assessing and supporting listed companies' practices and disclosures. Disclosures suggest that most listed companies do not comply with the Recommendations on electronic voting, and disclosures of board members' remunerations.
International organisations' indicators confirm that the institutional framework supporting good corporate governance is sound.

Corporate Governance Legislation and Practices in Estonia



Source: EBRD, Corporate Governance Assessment 2016

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

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

Key Areas and Rating	Strengths and Weaknesses
1. Structure and Functioning of the Board Fair	Companies can choose to organise their boards under a two-tier or under a one-tier system. However, entities whose share capital amount to at least EEK 400,000 (approximately EUR 25,500) are required to adopt a two-tier board structure. Supervisory boards (hereinafter also referred as "board") are generally small (the average of the ten largest listed companies is 5 members). Evidence shows that smaller boards tend to perform better, provided they have the necessary mix of skills and support (e.g. corporate secretary), but this does not seem to be necessarily the case in Estonia. Legal entities cannot serve as board members. Gender diversity at the board is very limited. Only board members of banks are subject to qualification requirements. The Corporate Governance Recommendations (the Estonian Corporate Governance Code) recommend supervisory board members to be elected from persons having sufficient knowledge and experience. The Corporate Governance Recommendations recommend boards of listed companies to have at least half of their members made up of independent members. Seven among the ten largest listed companies disclosed having independent board members; however, only in two cases the number of independent directors amounts to half of the board. Public interest entities, including listed companies and banks, are required to establish audit committees. While the law does not require audit committee to comprise any independent directors, five companies in our sample disclosed having at least one independent director on their audit committees. Banks, depending on its nature and level of complexity, are also required to set up risk committees and nomination committees. Nomination and remuneration committees are not common in Estonia. Only one company disclosed having a combined committee in place. The law requires boards to meet when necessary but not less frequently than quarterly. Six of the ten largest companies clearly disclosed that they comply with this requirement. The law vests the board with the authority to discuss and approve the strategy and to oversee management. Pursuant to the law, the board has the authority to approve the annual budget of the company, unless the articles of association place this responsibility within the competence of the general shareholders meeting (GSM). We do not think that it is appropriate for the GSM to approve the budget, as this is closely connected with the strategy and should stay under the remit of the board. The law does not make any direct reference to risk oversight function of the board. There is no established practice of board evaluation and company secretary function. Fiduciary duties, liability of board members and conflicts of interests are regulated by law.
1.1. Board Composition Moderately strong	**Strengths:** • Companies can choose to organize their boards under a one or two-tier system. However, it is obligatory for an entity to adopt a two-tier structure, if its share capital amounts to at least EEK 400,000 (approximately EUR 25,500). The boards of all ten largest listed companies are all organised under a two-tier system. • Legal entities cannot serve as board members. • The Commercial Code requires boards to be made up of at least 3 members (there is no upper limit). The Credit Institutions Act requires boards of banks to have at least 5 members. The boards of the ten largest listed companies have between 3 and 9 members, with an average of 5 members. While evidence has shown that smaller boards tend to perform better, an average of 5 members is on the edge, as it might not allow the board to have a diversified mix of skills. • Only board members of banks are subject to qualification requirements. The Credit Institution Act provides that "Only persons who have the necessary expertise, skills, experience, education, professional qualifications and an impeccable business reputation may be elected or appointed managers". The Corporate Governance Recommendations recommend board members to be elected from persons having sufficient knowledge and experience for participation in the work of the board. • The Auditors Activities Act requires public interest entities to create audit committees, appointed by the board and made up of at least two members. At least two of the audit committee's members must be experts in accounting, finance or law. Nine among the ten largest listed companies declared having an audit committee in place. However, two of them are partially formed of "outsiders" (i.e., non-board members). We have doubts about the effectiveness of outsiders on board committees. **Weaknesses:** • There are no qualification requirements by law for board members in companies. However the Corporate Governance Recommendations provides some (limited) guidance in this respect. • In practice, it appears that board members mostly have industry experience, but very rarely education or experience in the field of accountancy, audit, risk management or other financial expertise. • The law is vague on the composition of the audit committee, while the Corporate Governance Recommendations

Key Areas and Rating	Strengths and Weaknesses
	are silent on this matter.
1.2. Gender Diversity at the Board (9.78%) Very Weak	• All ten largest listed companies disclose the names of their directors; five companies count one female director each. Among these companies, female representation averages 19.56%. • In total, there are 5 women among 53 board members. • When counting all the ten companies in our sample, the average of female directors per board falls to 9.78%.
1.3. Independent Directors Fair	**Strengths:** • The Corporate Governance Recommendations provide that at least half of the board of a listed company should be made up of 'independent' members. Seven among the ten largest listed companies disclosed having independent board members; however, only in two companies the number of independent directors amounts to half of the board. The average of independent directors in the boards of the seven companies is 38.9%. **Weaknesses:** • The definition of independence is provided in the Annex of the Corporate Governance Recommendations. Albeit quite comprehensive, it includes only negative, i.e. "non-affiliation" criteria. There are no positive requirements on what independent members should do in practice to exercise their independence. It should be pointed out that the concepts of "non-affiliation" and "independence" are different. While non-affiliation can be established by negative criteria only, independence necessarily needs objectivity of mind and character, which is a positive characteristic that should be demonstrated and explained in positive terms. • The law does not provide for specific requirements to have independent directors on boards. • The law and the Corporate Governance Recommendations do not clearly provide that committees should be made only (or at least by a majority) of independent board members. In practice, in five companies the audit committee includes at least one independent board member (in one case the audit committee is made entirely of independent board members and in one case they are the majority). In other three cases, non-board members sit in the audit committees. • Even the seven companies that disclosed having independent directors do not explain the ground upon which such directors are considered independent. We think this is essential. Being "independent" is a status of mind that needs to be explained. It is not just a matter of "non-affiliation".
1.4. Board Effectiveness Fair	**Strengths:** • Boards are required to meet whenever necessary but not less frequently than once every three months. The Corporate Governance Recommendations provide that if a member of the board has attended less than half of the meetings of the board, this must be indicated separately in the Corporate Governance Report. This is an interesting solution to ensure good attendance. • Six companies out of the ten largest listed in the country disclosed the number of board meetings per year, which ranges from 3 to 11 meetings. • Public interest entities, including listed companies and banks, are required to establish audit committees. Banks, depending on its nature and level of complexity, are also required to set up risk committees and nomination committees. **Weaknesses:** • There is no established practice of board evaluation. The Corporate Governance Recommendations are also silent on this issue. Only one company disclosed in its corporate governance statement that it performs regular evaluation, but no information related to this evaluation or follow-up actions were disclosed. Another company states that it performs evaluation, but not on a regular basis. • There are no requirements or recommendations to have a corporate secretary and none of the ten largest listed companies disclosed having one in place. • Nomination and remuneration committees are not common in Estonia. Only one company disclosed having a combined committee in place. • Only one company disclosed the number of meetings of its audit committee. It met 10 times in person last year, which is quite high and possible indication of the fact that the audit committee is overstretched with its functions. • The law does not require audit committees to comprise only independent directors.
1.5. Responsibilities of the Board Moderately strong	**Strengths:** • The law vests the authority to discuss and approve strategy to the board. The board plans the activities of the company, organises its management and supervises the activities of the management board. However, the law does not make any direct reference to risk oversight function of the board. The Corporate Governance Recommendations provide that boards should determine and regularly review strategy, general plan of action, principles of risk management and annual budget of the company. • As far as banks are concerned, all key responsibilities are duly assigned to the board. • Fiduciary duties and liability of board members are regulated by law. There is case law and judicial practice on these matters. For a detailed analysis see: http://ec.europa.eu/internal_market/company/docs/board/2013-study-reports_en.pdf • Conflicts of interest are regulated by law and by the Corporate Governance Recommendations, though there is no evidence of its enforcement (see below). **Weaknesses:** • The law assigns to the board the authority to approve the annual budget of the company, unless the articles of association place this responsibility within the competence of the general shareholders' meeting. We do not think that this is appropriate, as the budget is closely connected with the strategy and should stay under the remit of the board.

<table>
<tr><th>Key Areas and Rating</th><th>Strengths and Weaknesses</th></tr>
<tr><td>2. Transparency and Disclosure
Moderately strong</td><td>The law requires companies to prepare and disclose their annual reports, which should include both financial and non-financial information. All ten largest listed companies comply with this requirement and the quality of disclosure is generally sound. Annual reports are accessible online at the Estonian Commercial Register and on the companies' websites.
Companies' websites are generally complete and well updated.
The listing rules require listed companies to report their compliance with the Corporate Governance Recommendations or to explain deviations. All ten largest listed companies comply with this requirement. The level of compliance appears quite high and therefore there are not many explanations; the majority of explanations provided are quite meaningful. However, it should be noted that the Corporate Governance Recommendations do not deal with a number of key issues such as formation and composition of the board committees, board evaluation, code of ethics, directors' qualifications, internal control, etc. This might explain the high level of compliance.
Companies are required to disclose financial information in line with IFRS and all companies in our sample comply with this requirement.
Reporting to the market and shareholders is regulated by law and appears to be well implemented.
Annual reports contain external auditors' opinion and all ten largest listed companies declare their auditors to be independent. The provision of non-audit services by the external auditor is allowed, subject to the scrutiny of the audit committee. The Auditors Activities Act requires audit firms to disclose their fees for audit and non-audit services, however in practice disclosure on this matter is very limited.</td></tr>
<tr><td>2.1. Non-Financial Information Disclosure
Moderately strong</td><td>Strengths:
• Companies and banks are required by law to prepare and publish annual reports, which include a section called management report, with an overview of the activities of the company, circumstances which are material to the assessment of the financial position and business activities of the company, significant events which have occurred during the financial year and the likely future developments in the following financial year.
• Annual reports are accessible on companies' websites and at the Estonian Central Register of Securities: http://statistics.e-register.ee/en/summary
• The websites of the ten largest listed companies are generally informative and well updated. Corporate governance information is relatively easy to find. All ten largest listed companies disclose the minutes of the general shareholders meeting and provide up to date information on their shares and capital on their websites.
• Listed companies are required to include a Corporate Governance Report in their annual reports with some key corporate governance information (e.g., information on organisation and administration, general shareholders' meeting, supervisory board and committee, management board etc.).
• The Listing Rules of the Tallinn Stock Exchange require listed companies to report their compliance with the Corporate Governance Recommendations under the so-called "comply or explain" approach. All ten largest listed companies comply with this requirement.
• Companies are required to disclose their articles of association on the Estonian Central Register of Securities website (see link above). It appears that the articles of all ten largest listed companies are available online.
• Large companies are required to disclose the names of their directors and all companies in our sample comply with this requirement.
• Eight companies disclosed the activities of the board in their annual reports and six the number of board meetings. Nine companies declared having an audit committee in place, but only one disclosed the number of its meetings.
• The majority of the ten largest listed companies disclose the transactions involving company's shares carried out by supervisory and management board members.
Weaknesses:
• Sometimes, it is not easy to immediately find the issues of non-compliance with the Corporate Governance Recommendations, as this information is not provided in a table.
• In most cases the report on the board and committees' activities is merely a "copy and paste" from the corporate documentation and not a report on what they have done in practice in the previous year.
• There is no legal requirement to disclose beneficial owners. All ten largest companies disclosed information on their major shareholders, but only two of them disclose information on their main beneficial owners as well.
• The Corporate Governance Recommendations do not call for the adoption of a code of ethics and none of the ten largest listed companies disclosed having one in place.</td></tr>
<tr><td>2.2. Financial Information Disclosure
Strong</td><td>Strengths:
• The law requires listed companies and banks to file financial accounts in accordance with IFRS. All ten companies in our sample comply with requirement.
• Companies are required to include in their annual reports the auditor's opinion and companies seem to comply with this obligation.</td></tr>
</table>

Key Areas and Rating	Strengths and Weaknesses
2.3. Reporting to the Market and to Shareholders *Moderately strong*	***Strengths:*** • *Companies are required to publish their annual reports which consist of financial statements and some non-financial information.* • *All ten largest companies posted their annual reports on their websites and stock exchange website.* • *Failure to comply with disclosure rules can be penalised with fines.* • *All ten largest listed companies disclose the minutes of their general shareholders' meetings on their own websites or on the NASDAQ OMX Tallinn Stock Exchange website.* • *Listed companies are required to disclose price sensitive information.* ***Weaknesses:*** • *There is no evidence of companies sanctioned over the last 5 years for breach of reporting rules. This can be read as either a sign of perfect implementation of the rules or lack of monitoring by authorities.*
2.4. Disclosure on the External Audit *Moderately Strong*	***Strengths:*** • *External auditors are required to be independent and the auditors of all ten largest listed companies declared to be independent.* • *All the companies in our sample comply with the requirement to disclose the name and opinion of their external auditor.* ***Weaknesses:*** • *Provision of non-audit services by the external auditor is allowed and it seems to be a common practice in Estonia. The Auditors Activities Act requires audit firms to disclose the fees for audit and non-audit services. In practice, however, it appears that only one company among the ten largest listed confirmed receiving non-audit services from its external auditor. The company in question does not seem to have a policy on non-audit services.*

<table>
<tr><th>Key Areas and Rating</th><th>Strengths and Weaknesses</th></tr>
<tr><td>3. Internal Control
Fair</td><td>Companies and banks are required to have internal audit functions. Banks are also required to establish compliance functions and our respondents believe that banks generally comply with this requirement.
Public interest entities are required to establish audit committees. The law allows “outsiders” (i.e., non-board members) to sit in the audit committee. We have doubts whether this option can ensure fit-for-purpose internal control and external auditing services. In practice, nine companies declared having audit committee in place, where three of them are partially formed of outsiders. There are no independence requirements for audit committee members. Disclosure on the number and activities of the audit committee is limited and does not allow to assess if they are playing a key control role.
Large companies are required to have their financial statements audited by an independent external auditor. The auditors of all ten largest listed companies are all international audit firms and declared to be independent. The provision of non-auditing services by the external auditor is allowed, subject to the scrutiny of the audit committee. It seems that the provision of non-auditing services by the external auditor is a common practice in Estonia. This should be carefully monitored, as it might undermine the auditor’s independence. Unfortunately, disclosure on this matter is limited.
The law requires rotation of auditors in public interest entities after no more than seven years. The Corporate Governance Recommendations recommend rotation every five years. Three companies out of the ten largest listed in the country appear to have exceeded this period and last time rotated their auditors 8-9 years ago.
There is no requirement for companies to have a code of ethics and none of them disclosed having one in place. Estonian legal regulations on whistle-blowers focus mostly on public sector. When it comes to private sector, regulation is almost non-existent.
Regulation and practices on related party transactions and conflicts of interest is regulated by law, but we found no evidence of its enforcement.</td></tr>
<tr><td>3.1. Quality of the Internal Control Framework
Fair</td><td>Strengths:
Companies and banks are required to have an internal audit function in place. The requirements for the internal audit functions are well detailed in the law. Five among the ten largest listed companies disclose having an internal audit department in place.
Banks are required to establish compliance function and our respondents believe banks generally comply with this requirement.
Public interest entities and banks are required to have audit committee appointed by the board. The law details the functions of the audit committee. Nine among the ten largest listed companies declared having an audit committee in place.
The Institute of Internal Auditors operates in the country.
Weaknesses:
In at least three cases, the audit committee is partially formed of outsiders. We have reservations about this approach (see below).
There are no requirements for companies to have a code of ethics and none of the companies in our sample disclosed having one in place.
Estonian legal regulations on whistle-blowers focus mostly on the public sector. There is no standalone legal act on whistleblowing. The main legal act referring to it is the Anti-Corruption Act (ACA); however, there are other minor regulations as well (e.g. Public Service Act, Equal Treatment Act, Penal Code etc). When it comes to the private sector, regulations are almost non-existent, being limited to two paragraphs in the Criminal Code.</td></tr>
<tr><td>3.2. Quality of Internal and External Audit
Fair</td><td>Strengths:
Companies and banks are required to have an internal audit function in place; half of the companies in our sample clearly disclosed they have it in place.
The appointment and removal of the internal auditor is subject to the recommendation of the audit committee.
The appointment of an external auditor is required for large companies. Auditors are appointed by the general shareholders’ meeting. In case of public interest entities, auditors are appointed on the basis of a recommendation of the audit committee.
The law requires external auditors to declare their independence. The Corporate Governance Recommendations recommend boards to run the “independence test”. The auditors of all ten largest listed companies are all international audit firms and declared to be independent.
Weaknesses:
The provision of non-auditing services by the external auditor is allowed and it is common practice in the country. The Auditors Activities Act requires the audit committee to ensure the independence of the external auditors and audit firms to disclose the fees for audit and non-audit services. In practice, however, only one company among the ten largest listed provided some information in this respect.
The law requires rotation of auditors in public interest entities after no more than seven years. The Corporate</td></tr>
</table>

Key Areas and Rating	***Strengths and Weaknesses***
	Governance Recommendations recommend rotation every five years. Three companies out of the ten largest listed in the country appear to have exceeded this period and last time rotated their auditors 8-9 years ago and none of these companies disclose this as non-compliance with the Corporate Governance Recommendations.
3.3. Functioning and Independence of the Audit Committee *Fair*	***Strengths:*** • *Public interest entities are required to establish audit committees, and nine among the ten largest listed companies disclosed having it in place. According to the Auditors Activities Act, "the members of an audit committee shall be elected or removed by the supervisory board or, in the absence thereof, by the highest management body". Furthermore, audit committees shall have at least two members who are experts in accounting, finance or law.* • *Banks are required to have audit committees "formed of members of the supervisory board. The competence, rights and principles of activity of the committee shall be determined by the supervisory board of the credit institution".* • *The law expressly prohibits the internal auditor and members of the management body to be members of the audit committee. In state owned enterprises, the same prohibition applies to assistant ministers and secretary general of a ministry.* ***Weaknesses:*** • *The Credit Institutions Act specifies that "other persons appointed by the supervisory board may be members of the audit committee instead of the members of the supervisory board, except the members of the management board and staff members of the credit institution". Hence, this provision allows "outsiders" to be members of audit committees. In three of the companies which declared having audit committees, they are partially formed of outsiders appointed by board. We believe it is important that audit committees include only board members if the functions delegated to the committee are typical board functions. Secondly, it is essential that those members sitting in the committee and recommending specific actions to the board 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.* • *There are no independence requirements for audit committee members. Despite the lack of legal requirement, five companies disclose having independent directors on their audit committees. Only in two among the ten largest listed companies the audit committee is made up of a majority of independent board members. In at least three companies, the audit committee does not include any independent board members.* • *Only one out of the nine companies that declared having the audit committee in place disclosed the committee's number of meetings (10 meetings).*
3.4. Control over Related Party Transactions and Conflict of Interest *Moderately strong*	***Strengths:*** • *As the financial statements are due to be in line with IFRS, we assume that IAS 24 on related party transactions – applies.* • *The Estonian Commercial Code requires that boards should approve (a) transactions between the company and the management board members and (b) all transactions which are beyond the scope of everyday economic activities. In case of listed companies, the general shareholders' meeting should review and approve all significant related party transactions. Further, the Commercial Code provides that "A transaction concluded between a public limited company and a member of the supervisory board is void if a general meeting does not agree to the transaction. The above does not apply to transactions concluded in the course of the everyday economic activities of the public limited company or based on the market price of a service".* • *All ten largest listed companies disclose related party transactions within the notes to their financial statements or annual reports. Nevertheless, some of our respondents believe that this disclosure is not always complete.* • *The law stipulates that board members should avoid any conflicts of interest that might affect their judgement. Furthermore, board members and shareholders can be legally prevented from voting at the meetings where the deal-related conflicts of interest issues are to be discussed.* ***Weaknesses:*** • *We have found no evidence of case law, enforcement or sanctions being imposed with reference to breaches of regulation on related party transactions or conflicts of interest. It is not entirely clear whether these issues are monitored.*

<table>
<tr><th>Key Areas and Rating</th><th>Strengths and Weaknesses</th></tr>
<tr><td>4. Rights of Shareholders
Moderately Strong</td><td>Shareholders representing 10% of the company can call a general shareholders’ meeting (GSM) and propose new items to the GSM agenda. All ten largest listed companies published notifications and documentations related to the GSM on their websites or stock exchange website.
Furthermore, shareholders are endowed with general inspection rights and with pre-emptive rights in case of capital increase. They may ask questions at the GSM or submit them in advance even if these questions are not related to the items on the agenda. Supermajority is required to approve major corporate changes.
Cumulative voting and proportional representation are not foreseen for companies and our respondents believe that similar devises are not used in practice. Voting rights are proportional to the value of shares.
Estonian law does not provide the possibility for shareholders' derivative suits; therefore, shareholders are not entitled to present a claim against company's directors in the name of the company.
Insider trading is prohibited by law and can be sanctioned with fines or imprisonment. There is some evidence that this prohibition is enforced in practice.
Significant shareholding variations must be disclosed to the market regulator and the issuer. Fines for non-notification can be applied.
Public companies are required to have share registration maintained by an independent registry institution, the Estonian Central Securities Depository. Shareholders agreements are considered enforceable among the parties, but there is not much case law on this matter. As a general rule, free transferability of shares cannot be restricted. However, some limitations may be foreseen in shareholders’ agreement.</td></tr>
<tr><td>4.1. General Shareholders’ Meeting (GSM)
Moderately Strong</td><td>Strengths:
Shareholders representing 10% of the company’s shares (or 5% in case of listed companies) can call a GSM and propose new items to the GSM agenda.
The law requires that notifications with the GSM agenda should be sent to shareholders at least 21 calendar days before the meeting. All ten largest listed companies published notifications and documentations related to the GSM on their websites or stock exchange website.
The law allows shareholders to participate at the GSM not only in person, but also on the basis of a power of attorney, and by post. Electronic voting is regulated by law, but - based on what companies reported in their corporate governance reports – in most cases, it was not possible in practice.
Shareholders may ask questions at the GSM or submit them in advance even if these questions are not related to the items on the agenda.
Eight of the ten largest listed companies provide information about voting rights and their exercise by shareholders on their websites.
Weaknesses:
It is not clear whether shareholders have the right to nominate members of the supervisory board.
Cumulative voting and proportional representation are not foreseen for companies and our respondents believe that similar devises are not used in practice. The Corporate Governance Recommendations are also silent on this issue.</td></tr>
<tr><td>4.2. Protection against Insider Trading and Self-dealing
Strong</td><td>Strengths:
Insider trading is prohibited by law and punishable with fines or imprisonment of up to three years.
It appears that in the last five years several cases on insider trading have been investigated.
Related party transactions are regulated by law. Six of the ten largest companies disclose such transactions on their website.
Six out of the ten largest listed companies routinely disclose transactions involving the company’s shares carried out by supervisory and management board members.</td></tr>
<tr><td>4.3. Minority Shareholders Protection and Shareholders’ Access to Information
Fair</td><td>Strengths:
All ten companies publish their annual reports on their websites. Annual reports are also accessible at the Estonian Commercial Register website at: http://statistics.e-register.ee/en/summary
Pre-emptive rights are assigned to shareholders and in all cases of capital increase can be waived by three-fourth majority vote at the GSM.
Two-third qualified majority vote of all present shares is required to make changes to the articles of association, the capital of the company; and to decide issues regarding merger, take-over, reorganisation, and winding up or voluntary liquidation of the company. Minority shareholders may block major corporate changes with a 33%+1 vote.
Voting rights are proportional to the value of shares. Eight largest listed companies provide information about voting rights and their exercise by shareholders on their websites.
Shareholders have general inspection rights. The law provides for specific liability and sanctions in case of breach of the rules on failure to allow inspection of books and records.</td></tr>
</table>

Key Areas and Rating	***Strengths and Weaknesses***
	Weaknesses: • *Cumulative voting and proportional representation are not foreseen for companies and our respondents believe that similar devises are not used in practice. The Corporate Governance Recommendations are also silent on this issue.* • *Estonian law does not provide a possibility for shareholders' derivative suit therefore the shareholders are not entitled to present a claim against company's directors in the name of the company.*
4.4. Registration of Shareholdings *Moderately Strong*	***Strengths:*** • *Public limited companies are required to have share registration maintained by an independent registry institution, the Estonian Central Securities Depository.* • *Shareholders agreements are considered enforceable among the parties, but there is not much case law on this matter.* • *Significant shareholding variations must be disclosed to the market regulator and the issuer. The pecuniary fine for non-notification can be applied.* ***Weaknesses:*** • *As a general rule, free transferability of shares cannot be restricted. However, some limitations may be foreseen in shareholders' agreement. An agreement between shareholders restricting the transfer of shares in a public company does not violate the legal mandate of free transferability of shares.*

<table>
<tr><th>Key Areas and Rating</th><th>Strengths and Weaknesses</th></tr>
<tr><td>5. Stakeholders and Institutions
Moderately Strong</td><td>The Estonia's regulated market is the Tallinn NASDAQ OMX stock exchange (TSE), established in 2008. Although the TSE appears to have a limited capitalization and liquidity, it is active in promoting high quality disclosures by listed companies. Further, it promotes compliance with the Corporate Governance Recommendations by disclosing an annual ranking of the top 20 listed companies in the Baltic region. Nevertheless, the stock exchange has no listing segments requiring companies to have higher corporate governance standards.
International rating agencies do not seem to be active in the country; international audit and law firms, in turn, have material presence in the country.
The Estonian Corporate Governance Recommendations are relatively comprehensive and well implemented, but have not been updated in a decade. Listed companies are required to report their compliance with the Recommendations on a "comply or explain" basis. Many explanations for lack of compliance are adequately justified, and refer to companies' practices. The monitoring efforts undertaken by the Financial Supervision Authority (FSA) have been generally successful in ensuring compliance with the Recommendations. All ten largest listed companies disclose their corporate governance practices on their websites and annual reports. Additionally, the FSA regularly publishes detailed reports dedicated to assessing and supporting listed companies' practices and disclosures. Disclosures suggest that most listed companies do not comply with the Corporate Governance Recommendations on electronic voting, and disclosures of board members' remunerations.
International organisations' indicators confirm that the institutional framework supporting good corporate governance is sound.</td></tr>
<tr><td>5.1. Corporate Governance Structure and Institutions
Moderately Strong</td><td>Strengths:
Estonia's regulated market, the Tallinn NASDAQ OMX stock exchange (TSE), was established in 2008.
The market capitalisation of the local stock exchange is around 32% of the country's GDP. For the month of September 2015, it appears that in Estonia, the equities turnover was EUR 1,808.25 with a daily value of EUR 0.34m.
Together with the Riga Stock Exchange and the Vilnius Stock Exchange, the TSE is part of the OMX Baltic market division. This group facilitates cross-border trading and attracts capital investment to the Baltic region.
The NASDAQ Baltic website provides a comprehensive list of regulatory submissions by listed companies. It offers a section with comprehensive information on trading activities, financial statements, annual reports and corporate governance disclosures for each listed company.
International audit and law firms have material presence in the country.
It appears that there are institutions providing corporate governance courses for directors.
The State Gazette is available online and provides a comprehensive repository of legislation in English. It is available at: https://www.riigiteataja.ee/en/
Weaknesses:
There are two listing tiers at the NASDAQ OMX Tallinn Stock Exchange: the Main Market Segment and the Secondary Market Segment. The Main Market requires companies to have significantly higher financial standards, but there are no listing segments officially requiring companies to have higher corporate governance standards.
International rating agencies are not active in Estonia; we could not find ratings for any of the ten largest listed companies.</td></tr>
<tr><td>5.2. Corporate Governance Code
Moderately strong/Strong</td><td>Strengths:
In 2005, the Financial Supervision Authority of Estonia (FSA) and the TSE drafted and issued the Estonian Corporate Governance Recommendations.
As per the EU legislation, listed companies are required to report their compliance with the Corporate Governance Recommendations on a "comply or explain" basis. Many explanations for lack of compliance are adequately justified, and refer to companies' practices.
All ten largest listed companies disclose their corporate governance reports on their websites and annual reports. The level of compliance appear quite high and the majority of explanations provided by the largest companies are meaningful and do relate to their practices
The TSE promotes compliance with the Recommendations by disclosing annual rankings of the top 20 listed companies in the Baltic region. One of the criteria used to rank these companies is the quality of their annual reports. Companies seeking to rank at the top of this list must provide thorough descriptions of their practices.
The FSA regularly publishes detailed reports dedicated to assessing and supporting listed companies' practices and disclosures. The reports are available at: https://www.fi.ee/index.php?id=12510 . The most recent reports refer to 2010 and 2011.
Weaknesses:
The Corporate Governance Recommendations has not been updated since their adoption, but a review seems to be currently undergoing.
Disclosures in annual reports suggest that most listed companies do not comply with the Recommendations on electronic voting and disclosures of board members' remunerations.</td></tr>
</table>

Key Areas and Rating	Strengths and Weaknesses
	• *It should be noted that the Corporate Governance Recommendations do not deal with a number of key issues such as formation and composition of the board committees, board evaluation, code of ethics, directors' qualifications, internal control, etc. This might explain the high level of compliance.* • *Judicial practice on corporate governance issues seems to be limited. Supreme Court case law has previously referred to the Recommendations, but lower courts do not refer to it as a document establishing contractual obligations.*
5.3. Institutional Environment *Strong*	***Strengths:*** • *No major inconsistencies between laws and regulations in matters regarding corporate governance have been reported, however some key issues (e.g., audit committee composition) would deserve a more detailed regulation.* • *The regulator seems active in the promotion of good corporate governance. The FSA publishes reports assessing companies' compliance with the Corporate Governance Recommendations every two years.* • *Case law appears to be easily accessible by lawyers in the country.* • *Indicators by international organisations rank Estonia positively with regard to corruption, competitiveness and investor protection perceptions.*