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European Bank
for Reconstruction and Development

Corporate Governance in Transition Economies

Lithuania Country Report

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

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

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

Foreword

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

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

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

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

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

Methodology

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

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

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

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

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

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

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

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

Key areas were then rated according to the same criteria.

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

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 Lithuania are the Civil Code; the Law on Companies; the Law on Banks; the Law on Audit; and the Law on Securities. The Bank of Lithuania has also issued a number of secondary legislation relevant to corporate governance.

The Corporate Governance Code for the Companies Listed on NASDAQ OMX Vilnius was introduced in 2006 and reviewed in 2009. The law and the Listing Rules require listed companies to include an annual statement of how they have applied the main principles of the Code. A special template is to be answered by listed companies, where they are required to explain their practices even when they declare to comply with the principles (so-called "*comply and explain*" approach).

Structure and functioning of the board

The law allows a large amount of flexibility for companies to decide about their organisational structure. In this respect, companies can operate under one-tier or two-tier system. If the company does not have a supervisory board, then the general shareholders meeting (GSM) is in charge of appointing the board of directors. In turn the board or the supervisory board (if the board of directors is not formed) or the GSM (if neither the board of directors nor the supervisory board is formed) is in charge of appointing the manager of the company. Within this flexible approach, it is not always entirely clear from the disclosure offered by the ten largest listed companies how companies are organised in practice.

Board size is generally small (average 4.6 members) but with a diversified mix of skills. Legal entities can be supervisory board members. However, none of the companies in our sample has any corporation in its supervisory board. Gender diversity at the board is low.

The Corporate Governance Code recommends listed companies to have a sufficient number of independent directors. Half of the ten largest listed companies disclose having independent directors on their board with an average of approximately 1/3 of the board. A Resolution of the Bank of Lithuania includes a general definition of independence, related to audit committee members. The Corporate Governance Code provides for a more detailed definition. Both definitions concentrate on negative "*non-affiliation*" criteria only, without spelling out which positive requirements (i.e., objectivity of character and mind) are required from independent directors. In practice, it appears that disclosure on this point by companies is quite vague.

Listed companies and banks are required to set up audit committees which must be composed of at least one independent member. In banks, the independent member of the audit committee cannot be a board member. We have doubts about the soundness of this solution. A large majority of the ten largest listed companies disclose having an audit committee in place. However, it is not necessarily a "board" committee, as it is very often made up of "*outsiders*" and does not necessarily report to the board.

The Law on Banks also requires banks to have standing credit, internal audit and risk management committees. The Corporate Governance Code recommends establishing an audit, nomination and remuneration committees. Only one company in our sample disclosed having a nomination committee in place and no company disclosed having a remuneration committee.

The law assigns to the board the authority to approve strategy, but it is silent on other key functions (e.g., budget, risk).

It appears that there is no established practice of board evaluation and none of the ten largest listed companies disclosed having a corporate secretary in place. In general, disclosure is not sufficient to express a view on whether the board and the committees are playing a strategic role in the company.
Fiduciary duties, liability of board members and conflict of interest are regulated by the Civil Code. Case law on these matters exists.

Transparency and Disclosure

Companies are required to disclose a fair amount of non-financial information, and the ten largest listed companies in the country appear to comply well with this requirement. The only negative note relates to disclosure on board and committees meetings and activities.

Listed companies are required to disclose their compliance with the Corporate Governance Code under the so-called "comply or explain" approach. All companies provide this information, but the quality of explanations has room for improvement.

All ten largest listed companies disclose their financial information, in line with IFRS.

All ten companies publish their annual reports on their websites and on the stock exchange website.

Large companies are required to have their financial statements audited and to disclose the name of the auditor and the auditor's opinion. The provision of non-audit services by external auditors is allowed and there is extensive disclosure on this matter.

In general, disclosure requirements to the market and shareholders are extensive and appear to be well implemented by the ten largest listed companies.

Internal Control

Companies and banks are required to have an internal audit function, but only for banks regulation provides details of such function. We could not find any specific provisions requiring banks to have a separate compliance function.

Listed companies and banks are required to create audit committees. The Corporate Governance Code recommends the audit committee to ensure the efficiency of the internal audit function. It appears that the audit committee is not necessarily a "board" committee, as it can include non-board members. This is the case in at least six of the ten largest listed companies. We have doubts about this body's ability to ensure fit for purpose internal control systems and external auditing services. Disclosures on audit committee's meetings and activities are very limited, and reports do not unveil whether they are playing a key control role in the company.

Large companies and banks are required to have their financial statements audited by an independent external auditor. The provision of non-auditing services is allowed, but restricted under the audit committee's scrutiny. The law requires auditors to rotate, but it does not appear that this requirement is well implemented.

None of the ten largest listed companies discloses having a code of ethics in place. Currently, there is no comprehensive standalone whistleblowing legislation.

Related party transactions appear to be regulated, but not in detail. Conflicts of interest are mainly regulated by the Civil Code.

Rights of Shareholders

Basic shareholder rights seem to be adequately regulated by law and major corporate changes require supermajority at the general shareholders' meeting.

Shareholders representing 10% of the capital may call a general shareholders' meeting (GSM). Shareholders have the right to ask questions at the meeting and to add items to the GSM agenda.

Furthermore, shareholders are endowed with general inspection rights and with pre-emptive rights in case of capital increase.

The Law on Companies and the Civil Code grant shareholders the right to start a claim on behalf of the company (i.e., derivative suit). It appears there were several derivative suits in the last 5 years.

Cumulative voting is the ordinary procedure provided by the Law on Companies for appointment of supervisory board members.

Insider trading is prohibited by the Law on markets in Financial Instruments, which transposes the EU Directive 2003/6/EC on insider dealing and market manipulation. It appears that in the last five years several cases on insider trading were investigated.

All ten companies publish their annual reports on their websites and on the stock exchange website. Access to annual reports of other companies is available via database managed by the Register of Legal Entities of Lithuania.

Share register of public limited liability companies must be maintained by the independent registry institution. Significant shareholding variations must be disclosed. The law only indirectly suggests that shareholder agreements are permitted. However, there are statutory provisions regarding certain types of shareholders' agreements.

Stakeholders and Institutions

The institutional framework supporting good corporate governance in Lithuania is relatively advanced. Nevertheless, important regulatory reforms would improve the transparency of its monitoring processes. Together with the Helsinki Stock Exchange and the Stockholm Stock Exchange, the Vilnius NASDAQ OMX Stock Exchange (VSE) is part of the OMX Baltic market division. This arrangement facilitates cross-border trading and attracts capital investment to the region. Nevertheless, companies listed in the Main Market do not need to hold higher corporate governance standards than companies in other tiers.

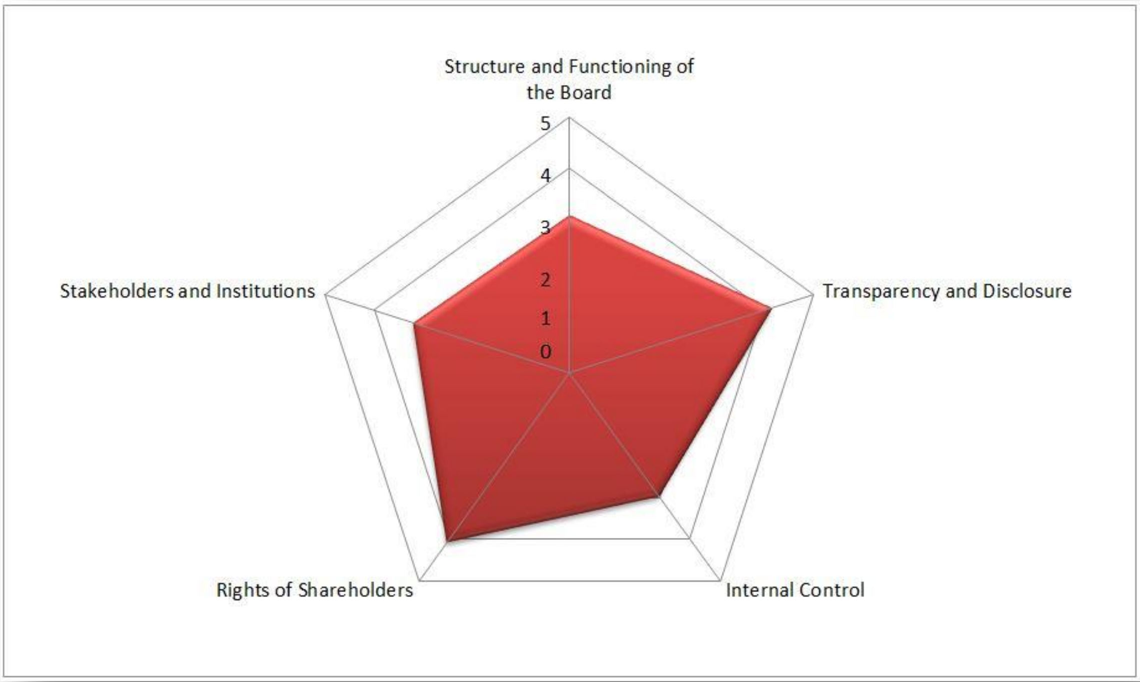
The Corporate Governance Code for the Companies Listed on NASDAQ OMX Vilnius was issued in 2006 and revised in 2009. The law and the Listing Rules require listed companies to disclose their compliance with the Code under the so-called "*comply or explain*" approach. All ten largest listed companies provided the required reporting but explanations provided are often not that meaningful. We could not locate any monitoring report disclosing how companies comply with the Code.

International audit and law firms seem to have material presence in the region, but international rating agencies seem to have only a limited presence.

Rulings from regulatory agencies are documented and publicly available.

There appears to be no major inconsistencies in the law. Nonetheless, some key corporate governance issues deserve some reflection. In general, however it seems that the institutional framework is generally sound. This is also confirmed by international organisations' competitiveness, investor protection and corruption indicators.

Corporate Governance Legislation and Practices in Lithuania



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*	*The law allows a large amount of flexibility for companies to decide about their organisational structure. In this respect, companies can operate under one-tier or two-tier system. If the company does not have the supervisory board, then the general shareholders meeting (GSM) is in charge of appointing the board of directors. In turn the board or the supervisory board (if the board of directors is not formed) or the GSM (if neither the board of directors nor the supervisory board is formed) is in charge of appointing the manager of the company. Within this flexible approach, it is not always entirely clear from the disclosure offered by the ten largest listed companies how companies are organised in practice.* *Board size is generally small (average 4.6 members) but with a diversified mix of skills. Legal entities can be supervisory board members. However, none of the companies in our sample has any corporation in its supervisory board. Gender diversity at the board is low.* *The Corporate Governance Code recommends listed companies to have a sufficient number of independent directors. Half of the ten largest listed companies disclose having independent directors on their board with an average of approximately 1/3 of the board. A Resolution of the Bank of Lithuania includes a general definition of independence, related to audit committee members. The Corporate Governance Code provides for a more detailed definition. Both definitions concentrate on negative "non-affiliation" criteria only, without spelling out which positive requirements (i.e., objectivity of character and mind) are required from independent directors. In practice, it appears that disclosure on this point by companies is quite vague.* *Listed companies and banks are required to set up audit committees which must be composed of at least one independent member. In banks, the independent member of the audit committee cannot be a board member. We have doubts about the soundness of this solution. A large majority of the ten largest listed companies disclose having an audit committee in place. However, it is not necessarily a "board" committee, as it is very often made up of "outsiders" and does not necessarily report to the board.* *The Law on Banks also requires banks to have standing credit, internal audit and risk management committees. The Corporate Governance Code recommends establishing an audit, nomination and remuneration committees. Only one company in our sample disclosed having a nomination committee in place and no company disclosed having a remuneration committee.* *The law assigns to the board the authority to approve strategy, but it is silent on other key functions (e.g., budget, risk).* *It appears that there is no established practice of board evaluation and none of the ten largest listed companies disclosed having a corporate secretary in place. In general, disclosure is not sufficient to express a view on whether the board and the committees are playing a strategic role in the company.* *Fiduciary duties, liability of board members and conflict of interest are regulated by the Civil Code. Case law on these matters exists.*
1.1. Board Composition *Fair*	***Strengths:*** • *Companies can operate under one-tier or two-tier system. If the company does not have the supervisory board, then the general shareholders meeting (GSM) is in charge of appointing the board of directors. In turn the board of directors or the supervisory board (if the board of directors is not formed) or the GSM (if neither the board of directors nor the supervisory board is formed) is in charge of appointing the manager of the company.* • *The general director and board of directors' members cannot sit on the supervisory board.* • *Supervisory boards have to comprise between 3 and 15 members, whilst board of directors must be composed of at least 3 members. On average, with 4.6 members, the board size of the ten largest listed companies is close to the minimal size. Evidence shows that smaller boards tend to perform better, provided that they have the necessary mix of skill and support. Despite the small size, Lithuanian boards seem to present a certain mix of skills: seven companies disclosed the qualifications of their board members. In all seven companies there is at least one board member with specific industry expertise.* • *The Law on Audit has transposed the Directive 2006/43/EC on statutory auditors and requires listed companies and banks to establish audit committees. Banks are also required to have credit, internal audit and risk management committees. The Corporate Governance Code recommends the creation of a nomination and a remuneration committee. Nine companies in our list disclosed having an audit committee in place (however, in most cases this is not a "board" committee). Only one company disclose having the nomination committee in place and no company discloses having a remuneration committee.* • *In listed companies and banks, at least one member of the audit committee should be independent. The Corporate Governance Code recommends the boards to have a "sufficient" number of independent board*

Key Areas and Rating	Strengths and Weaknesses
	members, but it leaves to companies' discretion to decide what does "sufficient" means. Five of the companies in our list disclosed having independent directors. However, they do not go in details to explain the ground upon which they are considered independent. • *The Corporate Governance Code recommends that the members of the audit committee, collectively, should have a recent knowledge and relevant experience in the fields of finance, accounting and/or audit. In practice, in three– out of the seven companies that disclosed the qualification of their board members - the audit committee includes some expertise on auditing or accounting.* • *There are additional qualification requirements for members of the board of banks stemming from the prudential regulations and bank internal documents. These requirements include: higher education of all board members; at least two board members must have higher education in law, management, business administration or economy; all members must have at least 3 consecutive years of experience in a managerial post.* ***Weaknesses:*** • *Companies can operate without a management board and a supervisory board at all, i.e., having only general director. Even listed companies are only recommended and not required to have a management board or/and a supervisory board.* • *Legal entities cannot serve as board members. However, this prohibition does not seem to apply to supervisory boards. This solution raises some concerns, since it weakens supervisory board members' fiduciary duties and does not ensure that these members are fit for purpose.* • *The audit committee is not necessarily a "board" committee.*
1.2. Gender Diversity at the Board (11.67%) *Weak*	• *All ten largest listed companies disclose the names of their directors: four companies disclosed having some gender diversity: three companies have one woman each on their boards and one company has two women on its board. Among these companies, female representation averages 29.17%.* • *In total, there are 5 women out of 46 board members.* • *When counting all the ten companies in our sample, the average of female directors per board falls to 11.67%.*
1.3. Independent Directors *Fair*	***Strengths:*** • *The Corporate Governance Code recommends boards to have a "sufficient" number of independent board members, but it leaves to companies' discretion to decide what does "sufficient" means.* • *It appears that five of the ten largest listed companies have independent board members with an average of approximately 1/3 of the board.* ***Weaknesses:*** • *The definition of independence for board members is included in the Corporate Governance Code; however, it is only made up of a long list of negative criteria defining "non-affiliation". 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. Similar considerations apply to the definition applicable to members of the audit committee in banks, included in a Resolution of the Bank of Lithuania.* • *Companies generally report on their compliance with the requirements of the Corporate Governance Code and, when they fail to comply with the independence requirements, they simply mention in their statements that they do not have independent board members on the board, without any explanations.*
1.4. Board Effectiveness *Weak*	***Strengths:*** • *The Law on Banks requires banks to have standing credit, internal audit and risk management committees. Listed companies are required to set an audit committee. The Corporate Governance Code also recommends establishing a nomination and a remuneration committee. The Code recommends that these committees should be composed of at least three members. In cases where the company chooses not to set up a supervisory board, both the remuneration and the audit committees should be entirely composed of non-executive directors. The majority of the members of each committee should be constituted by independent directors.* • *The Corporate Governance Code recommends that the calendar of meetings of the board should be approved yearly in advance. The Code also recommends that the supervisory board meets once per quarter and the board of directors once per month. The number of meetings should be disclosed, however this does not seem to be a well implemented practice.* ***Weaknesses:*** • *It appears that there is no established practice of board evaluation, despite the Corporate Governance Code recommendation to conduct one annually. None of the ten largest listed companies disclosed that they perform regular board evaluations.* • *There is no requirement for companies to have a corporate secretary. None of the ten largest listed companies disclosed having such a function in place.* • *Nine companies in our list disclosed having an audit committee in place, but six of them are partially or completely composed of "outsiders" (i.e., non-board members) appointed by the general shareholders' meeting (GSM). It follows that the audit committee under Lithuanian law is not a "board" committee (see further below).* • *Only one company disclosed having a nomination committee in place and no company disclosed having a remuneration committee.* • *The Law on Companies is silent on the number of meetings by the board. In banks, the audit committee should meet at least twice a year (best practices would suggest meeting every quarter). The Corporate Governance Code recommends the same for companies. The Code also recommends companies to disclose the committees'*

Key Areas and Rating	Strengths and Weaknesses
	composition, number of meetings and attendance over the year, and their main activities. Only three companies disclosed the number of board meetings per year; being 4, 5 and 12. Only three companies disclosed some limited information on the board activities undertaken in the past 12 months. Only one company disclosed that its audit committee met 8 times in person last year, which is a sign that the audit committee is quite overburdened. No company disclosed the activities of the audit committee. • *In general, disclosure is not sufficient to express a view on whether the board and the committees are playing a strategic role in the company.*
1.5. Responsibilities of the Board *Fair*	***Strengths:*** • *The law assigns to the board the authority to approve strategy.* • *Directors must compensate the company for all damages suffered due to breaches of the directors' duties.* • *Fiduciary duties, liability and conflicts of interest are addressed by the law, and case law on these matters exists (for further information, see the EC Commission's Study on Directors' Duties and Liability - http://ec.europa.eu/internal_market/company/docs/board/2013-study-reports_en.pdf).* ***Weaknesses:*** • *The Law on Companies is silent on key strategic functions, such as budget, risk profile/appetite or risk management. The law allows shareholders to define the board's powers through the companies' articles of association or terms of reference. We are not convinced that this is the right approach. Instead, we believe that the key strategic functions of the board (e.g. strategy, budget, risk management and appointment, removal and oversight of management) should be clearly set by law and should not be left to shareholders' decision, as this might undermine check and balances between corporate bodies. The Law on Banks also establishes that the articles of association shall define the board responsibilities.*

Key Areas and Rating	Strengths and Weaknesses
2. Transparency and Disclosure *Moderately strong*	*Companies are required to disclose a fair amount of non-financial information, and the ten largest listed companies in the country appear to comply well with this requirement. The only negative note relates to disclosure on board and committees meetings and activities.* *Listed companies are required to disclose their compliance with the Corporate Governance Code under the so-called "comply or explain" approach. All companies provide this information, but the quality of explanations has room for improvement.* *All ten largest listed companies disclose their financial information, in line with IFRS.* *All ten companies publish their annual reports on their websites and on the stock exchange website.* *Large companies are required to have their financial statements audited and to disclose the name of the auditor and the auditor's opinion. The provision of non-audit services by external auditors is allowed and there is extensive disclosure on this matter.* *In general, disclosure requirements to the market and shareholders are extensive and appear to be well implemented by the ten largest listed companies.*
2.1. Non-Financial Information Disclosure *Fair/Moderately strong*	***Strengths:*** • *Companies are required to prepare and publish their annual reports, which include a considerable amount of non-financial information, including competences of the general shareholders' meeting; powers of the board; restrictions of voting rights; shares directly or indirectly held by the company; shareholders exercising specific control rights; management of existing risks and relevant internal controls; reference to the applicable Corporate Governance Code or information about corporate governance practice of a company; non-compliance with the provisions of the Corporate Governance Code (if any) and reasons for such non-compliance. All ten largest listed companies publish their annual reports on their websites and on the stock exchange website (http://www.nasdaqomxbaltic.com/market/?lang=en)* • *The law and the Listing Rules require listed companies to comply with the Corporate Governance Code or explain the reason for non-compliance, which is an EU law requirement (see Accounting Directive 2013/34). A special template for this purpose exists. All ten largest listed companies disclosed this information.* • *Companies are required to publish their articles of association in the Register of Legal Entities. The majority of the ten companies also publish them on their websites.* • *All ten largest listed companies disclose the names of their directors; seven of them disclose their qualifications as well.* • *All ten largest listed companies disclose information on their shareholders; seven of those companies seem to go in detail and disclose their main beneficial owners as well.* • *All ten largest listed companies disclose the number of shares and capital, and the minutes of their general shareholders' meeting on their websites.* • *It appears that the ten largest listed companies have reasonably informative websites with information that is complete and easy to find.* ***Weaknesses:*** • *Companies generally disclose their compliance with the Corporate Governance Code, but the quality of explanation is poor.* • *Only three out of the ten largest listed companies disclose the number of board meetings per year and the boards' activities in their annual reports.* • *No company discloses having a code of ethics in place.*
2.2. Financial Information Disclosure *Strong*	***Strengths:*** • *Companies are required to publish their annual financial reports and the annual reports together with an auditor's report in the Legal Entities Register.* • *Publicly traded companies must prepare separate financial statements in line with IFRS. All ten largest listed companies comply with this requirement.* • *All ten companies publish their annual reports on their websites and on the stock exchange website (http://www.nasdaqomxbaltic.com/market/?lang=en).*
2.3. Reporting to the Market and to Shareholders *Strong*	***Strengths:*** • *The quality of financial information appears robust and all ten largest listed companies submit their annual reports on the national disclosure platforms and stock exchange website.* • *Companies are required to disclose the minutes of their general shareholders' meeting and all ten largest companies comply with this requirement.* • *Listed companies are required to make timely disclosure of price sensitive information. The Corporate Governance Code recommends that companies to disclose such information on their websites.* ***Weaknesses:*** • *According to the Administrative Code the CEO and the executive responsible for financial statements may be fined with an amount between LTL 100 (approx. EUR 30) and LTL 5,000 (approx. EUR 1,450) if the annual report is not submitted on time to the Register of Legal Entities. These fines seem low to prevent breaches.*

Key Areas and Rating	Strengths and Weaknesses
2.4. Disclosure on the External Audit *Strong*	***Strengths:*** • *Large companies are required to have their financial statements audited and to disclose their auditors' name and opinion. The right to appoint external auditors is reserved for the general shareholders' meeting.* • *The law requires external auditors to be independent and the Corporate Governance Code recommends the audit committee to run the "independence test". The auditors of ten largest listed companies declared to be independent.* • *The provision of non-audit services by external auditors (while providing auditing services) is allowed, but restricted. By law, the provision of certain non-auditing services will make the auditor non-independent. The Corporate Governance Code recommends the audit committee to monitor the independence and impartiality of the external auditor and to monitor the nature and extent of the non-audit services. Seven companies among the ten largest listed disclosed receiving other non-audit services (e.g. training services). This a good indication that the process is monitored and well disclosed.*

<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 an internal audit function, but only for banks regulation provides details of such function. We could not find any specific provisions requiring banks to have a separate compliance function.
Listed companies and banks are required to create audit committees. The Corporate Governance Code recommends the audit committee to ensure the efficiency of the internal audit function. It appears that the audit committee is not necessarily a “board” committee, as it can include non-board members. This is the case in at least six of the ten largest listed companies. We have doubts about this body’s ability to ensure fit for purpose internal control systems and external auditing services. Disclosures on audit committee’s meetings and activities are very limited, and reports do not unveil whether they are playing a key control role in the company.
Large companies and banks are required to have their financial statements audited by an independent external auditor. The provision of non-auditing services is allowed, but restricted under the audit committee’s scrutiny. The law requires auditors to rotate, but it does not appear that this requirement is well implemented.
None of the ten largest listed companies discloses having a code of ethics in place. Currently, there is no comprehensive standalone whistleblowing legislation.
Related party transactions appear to be regulated, but not in detail. Conflicts of interest are mainly regulated by the Civil Code.</td></tr>
<tr><td>3.1. Quality of the Internal Control Framework
Weak</td><td>Strengths:
• The internal control issues are regulated in detail in specific laws applicable to certain types of companies, i.e., Law on Financial Institutions, Law on Insurance, etc. These laws require these companies to establish internal audit departments. The Resolution of the Bank of Lithuania provides detailed requirements for internal audit in banks.
• Only four companies reported having an internal audit department in place. However, our respondents believe that the majority of the largest ten companies in the country have an internal audit function.
Weaknesses:
• We could not find any specific provisions requiring banks to have a separate compliance function.
• The law requires listed companies and banks to create audit committees, but this committee can be made of “outsiders” (i.e., non-board members) – a common practice in Lithuania – and cannot be accurately classified as a board committee (see below).
• There is no requirement or recommendation for companies to adopt a code of ethics. No company discloses having one in place.
• There is no comprehensive whistleblowing legislation. General legal provisions found in the Labour Code, Criminal Code and the Law on Civil Service offer minimum protection.</td></tr>
<tr><td>3.2. Quality of Internal and External Audit
Moderately strong</td><td>Strengths:
• Listed companies and banks are required to have internal audit departments.
• The Institute of Internal Auditors operates in the country. This body does not issue its own guidance on internal control matters and audit methodology, but it advocates the IPPF (International Professional Practices Framework) and the IIA Global methodology.
• Companies, which meet certain requirements, must have their financial statements audited by an external auditor, appointed by the general shareholders’ meeting. These requirements are: 1) net turnover during the reporting financial year – LTL 12 million; 2) the value of the assets specified in the balance sheet – LTL 6 million; 3) average annual number of pay-roll workers during the reporting financial year – 50 persons.
• The law requires external auditors to be independent and the Corporate Governance Code recommends the “audit committee to confirm that it is satisfied with the independence of the audit process and describe briefly the actions it has taken to reach this conclusion”. The auditors of the ten largest listed companies declared to be independent. They are all international audit firms.
• The Law on Audits does not allow auditors to provide audit services to the same company for a period exceeding 7 consecutive years and, if auditing a public interest entity, including but not limited to company whose securities are traded in the regulated market of the Republic of Lithuania and/or any other EU member state, for longer than 5 consecutive years, unless other laws establish otherwise.
• External auditors are allowed to perform non-auditing services, but the Law on Audit foresees that an external auditor cannot be considered independent if certain non-auditing services are provided. Disclosure provided on this matter evidences that companies tend to scrutinize non-auditing services provided by the external auditor.
Weaknesses:
• It appears that five among the ten largest listed companies have not rotated their external auditors for 7-11 years.</td></tr>
</table>

Key Areas and Rating	Strengths and Weaknesses
3.3. Functioning and Independence of the Audit Committee *Weak/Fair*	***Strengths:*** • *The Law on Audit has transposed the Directive 2006/43/EC on statutory auditors and requires (Art. 52) listed companies and banks to establish audit committees.* • *A Regulation of the Securities Commission requires audit committees to consist of at least three members, one of whom must be independent and have at least five years of experience in the field of auditing and accounting. If the supervisory board is not established or it consists of fewer members, then the audit committee may consist only of two members.* • *The Corporate Governance Code recommends that the members of the audit committee, collectively, should have a recent knowledge and relevant experience in the fields of finance, accounting and/or audit for the stock exchange listed companies. The Code dedicates a number of recommendations to the functions and responsibilities of the audit committee.* • *Nine among the ten largest listed companies declared having an audit committee in place.* ***Weaknesses:*** • *The law does not require the audit committee to be made only of independent board members. In six of the ten largest listed companies, the audit committee is partially or completely composed of outsiders appointed by and reporting to the general shareholders' meeting. We believe this is not a good practice. We believe it is important that the audit committee includes 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.* • *Only one company disclosed the number of meetings held by its audit committee, which met 8 times in person last year (which is a sign that the audit committee is overburdened). No company discloses the activities of the audit committee. In general, disclosure is not sufficient to assess whether audit committees are playing a key control role in the company.*
3.4. Control over Related Party Transactions and Conflict of Interest *Moderately strong*	***Strengths:*** • *IFRS applies and (IAS 24) regulates related party transactions. However, the law does not seem to regulate related party transactions in detail.* • *The Civil Code provides that a director, who wants to enter into contracts with the company must without delay notify shareholders of the company or other body about the contract (such information must be provided in writing or included into the minutes of the meeting of company's bodies), if incorporation documents of the company fail to provide explicitly for a different procedure of notification.* • *The Corporate Governance Code recommends that transactions (except insignificant ones due to their low value or concluded when carrying out routine operations under usual conditions) concluded between the company and its shareholders, members of the supervisory or managing bodies or other natural or legal persons that exert or may exert influence on the company's management should be subject to approval of the board. The decision concerning approval of such transactions should be deemed adopted only provided the majority of the independent members of the board voted for such a decision.* • *Related party transactions need to be disclosed in financial statements, pursuant to IAS 24. All ten largest listed companies disclose related party transactions within the notes to the financial statements.*

Key Areas and Rating	**Strengths and Weaknesses**
4. Rights of Shareholders *Moderately strong*	*Basic shareholder rights seem to be adequately regulated by law and major corporate changes require supermajority at the general shareholders' meeting.* *Shareholders representing 10% of the capital may call a general shareholders' meeting (GSM). Shareholders have the right to ask questions at the meeting and to add items to the GSM agenda.* *Furthermore, shareholders are endowed with general inspection rights and with pre-emptive rights in case of capital increase.* *The Law on Companies and the Civil Code grant shareholders the right to start a claim on behalf of the company (i.e., derivative suit). It appears there were several derivative suits in the last 5 years.* *Cumulative voting is the standard procedure provided by the Law on Companies for appointment of supervisory board members.* *Insider trading is prohibited by the Law on markets in Financial Instruments, which transposes the EU Directive 2003/6/EC on insider dealing and market manipulation. It appears that in the last five years several cases on insider trading were investigated.* *All ten companies publish their annual reports on their websites and on the stock exchange website. Access to annual reports of other companies is available via database managed by the Register of Legal Entities of Lithuania.* *Share register of public limited liability companies must be maintained by the independent registry institution. Significant shareholding variations must be disclosed. The law only indirectly suggests that shareholder agreements are permitted. However, there are statutory provisions regarding certain types of shareholders' agreements.*
4.1. General Shareholders' Meeting (GSM) *Moderately strong*	***Strengths:*** • *Shareholders representing 10% of the shares are entitled to call a GSM. The articles can provide for a lower threshold.* • *The GSM announcement and agenda are required to be sent to shareholders at least 21 calendar days before the meeting. All ten largest companies published notifications and materials on companies' websites or stock exchange website.* • *Shareholders can participate at the GSM in person, on the basis of power of attorney, by post and electronically. Shareholders can also ask questions at the GSM.* • *Shareholders who hold shares with not less than 1/20 of all votes attached to them can propose new items to the GSM agenda.*
4.2. Protection against Insider Trading and Self-dealing *Moderately strong*	***Strengths:*** • *Transactions between shareholders, directors, officers and other related parties must be based on fair terms; otherwise, they can be invalidated in court and action can be taken against the relevant parties.* • *Under the Law on Markets in Financial Instruments, insider trading is prohibited and punishable with fines.* • *It appears that in the last five years several cases on insider trading were investigated.* ***Weaknesses:*** • *The law does not restrict or impose disclosure on directors' dealings with the company's shares. None of the ten largest listed companies disclose this matter.*
4.3. Minority Shareholders Protection and Shareholders' Access to Information *Strong*	***Strengths:*** • *All ten companies publish their annual reports on their websites and on the stock exchange website (http://www.nasdaqomxbaltic.com/market/?lang=en). Access to annual reports is available via database managed by the Register of Legal Entities of Lithuania.* • *Pre-emptive rights are granted in all cases of capital increase and can only be blocked with a qualified majority vote that must not be less than ¾ of all votes carried by the shares of the shareholders present at the GSM and entitled to vote when deciding on the issue.* • *Cumulative voting is the standard procedure provided by the Law on Companies for appointment of supervisory board members.* • *The Law on Companies details the decisions to be taken with a qualified majority. Two thirds qualified majority vote of all present shares is required – inter alia - to make changes to the articles of association, the share capital (only when reduced); 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.* • *Shares carry voting rights in proportion to their value.* • *Shareholders have a general right to inspect the corporate documents.* • *The Law on Companies and the Civil Code grant shareholders the right to start derivative suits. It appears there were several derivative suits in the last 5 years.*

Key Areas and Rating	Strengths and Weaknesses
4.4. Registration of Shareholdings *Moderately strong*	***Strengths:*** • *Share register of public limited liability companies must be maintained by an independent registry institution.* • *Law on Companies requires shareholders to inform the market regulator and the issuer about the total amount of votes when they acquire 5, 10, 20, 30, 50, 75 or 95% of the share capital. Pecuniary fine for non-notification can be applied.* • *The free transferability of shares can be restricted by the court or by the supervision authority in specific cases (when the shares are seized or there are other agreements regarding the restrictions on the transfer of shares).* • *It seems that the Law on Companies only indirectly suggests that shareholder agreements are permitted to be concluded among shareholders. However, there are statutory provisions regarding certain types of shareholders' agreements.* ***Weaknesses:*** • *There is no requirement to disclose shareholders agreements. They are considered to be enforceable between the parties but no much case law exists.*

Key Areas and Rating	**Strengths and Weaknesses**
5. Stakeholders and Institutions *Moderately strong*	*The institutional framework supporting good corporate governance in Lithuania is relatively advanced. Nevertheless, important regulatory reforms would improve the transparency of its monitoring processes. Together with the Helsinki Stock Exchange and the Stockholm Stock Exchange, the Vilnius NASDAQ OMX Stock Exchange (VSE) is part of the OMX Baltic market division. This arrangement facilitates cross-border trading and attracts capital investment to the region. Nevertheless, companies listed in the Main Market do not need to uphold higher corporate governance standards than companies in other tiers.* *The Corporate Governance Code for the Companies Listed on NASDAQ OMX Vilnius was issued in 2006 and revised in 2009. The law and the Listing Rules require listed companies to disclose their compliance with the Code under the so-called "comply or explain" approach. All ten largest listed companies provided the required reporting but explanations provided are often not that meaningful. We could not locate any monitoring report disclosing how companies comply with the Code.* *International audit and law firms seem to have material presence in the region, but international rating agencies seem to have only a limited presence.* *Rulings from regulatory agencies are documented and publicly available.* *There appears to be no major inconsistencies in the law. Nonetheless, some key corporate governance issues deserve some reflection. In general, however it seems that the institutional framework is generally sound. This is also confirmed by international organisations' competitiveness, investor protection and corruption indicators.*
5.1. Corporate Governance Structure and Institutions *Moderately strong*	***Strengths:*** • *Lithuania's regulated market is the Vilnius NASDAQ OMX Stock Exchange (VSE), which was established in 1993. Its market capitalisation seems to be around 42% of country's GDP.* • *Together with the Helsinki Stock Exchange and the Stockholm Stock Exchange, the VSE is part of the OMX Baltic market division. This group facilitates cross-border trading and attracts capital investment to the Baltic region.* • *There are two listing tiers at the NASDAQ OMX Baltic market. The Main Market is a segment for companies with significantly higher disclosure and management standards. Nevertheless, companies listed in the Main Market do not need to uphold higher corporate governance standards than companies in other tiers. Additionally, there is a First North (Alternative Market) segment where regulatory demands are not as extensive as those of the Main Market.* • *The Code is endorsed by the Stock Exchange and is to be implemented on a "comply and explain" basis. The law and the listing rules require corporate governance comply or explain report to be included in the annual report. A special template is filled in by listed companies, where they are required to explain their practices even in cases when they comply with the Code. All ten largest listed companies provide the required report but explanations provided are often not that meaningful.* • *International audit and law firms have a material presence in the country.* • *The NASDAQ Baltic website provides a comprehensive list of regulatory submissions by listed companies. It offers a section with comprehensive information on trading activities, and main shareholders. Management composition and governance disclosures are more limited, but existent.* • *The Baltic Institute of Corporate Governance (BICG) is a regional NGO which creates events, programs and publications to promote the development of corporate governance. The BICG has a prominent role in educating board members of companies and advancing specialized corporate governance research in the Baltic region.* • *Rulings of regulatory agencies are documented and easily accessible.* ***Weaknesses:*** • *International rating agencies have only a partial presence in the country. Only two of the ten largest listed companies have been rated according to international standards.*
5.2. Corporate Governance Code *Fair/Weak*	***Strengths:*** • *The Corporate Governance Code for Companies Listed on NASDAQ OMX Vilnius was introduced in 2006 and amended in 2009. The Code is based upon OECD Principles of Corporate Governance.* • *The Code's recommendations are implemented on a "comply or explain" basis. Listed companies are required to fill a special template describing their corporate governance practices, even in cases when they do comply with the Code.* ***Weaknesses:*** • *The last revision of the Code dates back to 2009.* • *Explanations provided by the companies in our sample when they do not comply with the Code do not seem to be that meaningful or informative.* • *Although both the Bank of Lithuania and NASDAQ OMX Vilnius claim to be monitoring compliance with the Code, we could not find any published reports evidencing these oversight activities.* • *There is no case law referring to the Corporate Governance Code or to the codes adopted by companies as a source of obligation.*

Key Areas and Rating	Strengths and Weaknesses
5.3. Institutional Environment *Moderately Strong*	***Strengths:*** • *Case law seems to be regularly updated and easily accessible to the public.* • *There appears to be no major inconsistencies in the law. Nonetheless, some key corporate governance issues would deserve some reflections (e.g., the composition of an audit committee and the definition of independence).* • *The Bank of Lithuania provides for a comprehensive repository of legislation in English on its website (https://www.lb.lt/legal_acts_institutions)* • *It appears that Lithuania is relatively well placed in the international rankings. The World Economic Forum's Global Competitiveness Index 2013-2014 places Lithuania on the 52nd place among 148 economies. The Doing Business Index 2014, which ranks economies on their ease of doing business, positions Lithuania on the 24th place among 189 economies on the strength of investor protection index. Finally, the Transparency International's Corruption Perceptions Index (CPI) ranks Lithuania at the 39th place among 176 countries.*