EUROPEAN BANK
FOR RECONSTRUCTION AND DEVELOPMENT

CORPORATE GOVERNANCE
SECTOR ASSESSMENT PROJECT

REPORT ON
THE 2003 ASSESSMENT RESULTS

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BY

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ANNEX COUNTRY RATING MAP 2003
I. Overview

For the twenty-seven countries assessed under the EBRD's Corporate Governance Sector Assessment Project (the "CG Assessment Project"), 2003 was a year marked by important changes in terms of corporate governance legislative reform. For the eight EBRD countries of operations that are scheduled to join the European Union ("EU") in May 2004, 2003 was the last pre-accession year to step up efforts in harmonising national legislation with the EU acquis, including laws and regulations having implications on corporate governance issues and practices. While the ink on those legislative changes is not yet dry and many policy issues are still being debated at the national level, in May 2003 the European Commission announced an Action Plan (the "EU Action Plan"), outlining the EU's intention to overhaul its relevant norms in order to "modernise" the European regulatory framework for company law and corporate governance. Coincidentally, the Organisation for Economic Co-operation and Development ("OECD") was also actively undergoing a review and consultation process in 2003 with the aim of revising its Principles of Corporate Governance published in 1999. The work of both the European Commission and the OECD will be elaborated on in more detail in Section III of this Report. As for other EBRD countries of operations where EU accession is a remote or non-existent prospect, in 2003 improvements on corporate governance related legislation continued to take place, more often than not being the result of the technical assistance provided by donor countries or multilateral agencies.

The relevant country reports and ratings derived from the 2003 assessment of the CG Assessment Project are dealt with in Section II below. In Section III, this Report will offer some general observations and comments on corporate governance development and on the 2003 assessment results. The Report will conclude in Section IV, where some prospects for the EBRD's future legal reform work in the area of corporate governance will be discussed.

II. 2003 Assessment Results

II.1 Individual Country Reports for 2003

The country-specific assessment reports for 2003 can be accessed from the EBRD's website. The individual firm or consultant responsible for completing the respective country assessment is acknowledged on the cover page of the relevant report. As in 2002, the assessment work in 2003 was funded by the Government of the United Kingdom.

The assessment work for 2003 was mainly carried out during the second half of the year and the majority of the results were finalised in November. The scope of the review and assessment carried out was on those legislative changes that were promulgated or effective

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1 The Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, the Slovak Republic and Slovenia.
2 The relevant information can be accessed through http://www.ebrd.com/country/sector/law.
after the main assessment work in 2002 was completed\(^3\) and up to the end of the third quarter of 2003. Accordingly, the 2003 assessment results should be understood in the context of this timeframe.

II.2 Country Ratings of 2003

The rating methodology that was used in connection with the 2002 results was also followed in 2003\(^4\) and the final scores of countries are again categorised as A, B, C, D or E, as follows:

- **"A"** represents a "Very High Compliance" level of corporate governance systems when measured against OECD Principles of Corporate Governance by using the revised Checklist;
- **"B"** represents a "High Compliance" level of corporate governance systems;
- **"C"** represents a "Medium Compliance" level of corporate governance systems;
- **"D"** represents a "Low Compliance" level of corporate governance systems; and
- **"E"** represents a "Very Low Compliance" level of corporate governance systems.

The country ratings of 2003 are set forth in the table below. Countries which obtained an improved rating compared to 2002 have been highlighted. A country rating map for 2003 is attached as an Annex to this Report.

<table>
<thead>
<tr>
<th>A (VERY HIGH COMPLIANCE)</th>
<th>B (HIGH COMPLIANCE)</th>
<th>C (MEDIUM COMPLIANCE)</th>
<th>D (LOW COMPLIANCE)</th>
<th>E (VERY LOW COMPLIANCE)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Armenia</td>
<td>Albania</td>
<td>Bosnia &amp; Herzegovina</td>
<td>Georgia</td>
<td>Azerbaijan</td>
</tr>
<tr>
<td>Hungary</td>
<td>Bulgaria</td>
<td>Romania</td>
<td>Belarus</td>
<td>Bulgaria</td>
</tr>
<tr>
<td>Kazakhstan</td>
<td>Croatia</td>
<td>Turkmenistan</td>
<td>Tajikistan</td>
<td>Russia</td>
</tr>
<tr>
<td>Latvia</td>
<td>Czech Republic</td>
<td></td>
<td></td>
<td>Uzbekistan</td>
</tr>
<tr>
<td>Lithuania</td>
<td>Estonia</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

\(^3\) As mentioned in the Report on the 2002 Assessment Results, while the 2002 results were finalised in November 2002 the majority of the relevant assessment work was carried out during the first half of 2002.

\(^4\) Please refer to the Report on the 2002 Assessment Results for more information about the rating methodology.
III. Comments and Observations

III.1 Corporate Governance Development in General

- EU Action Plan

In the aftermath of the scandalous collapse of Enron, in April 2002 the EU asked a "High Level Group of Company Law Experts" to look into corporate governance issues in the European context. The scope of this review specifically included the role of non-executive directors and of supervisory boards, management remuneration, the responsibility of management for the preparation of financial information, auditing practices, etc.\(^5\) The High Level Group presented its Final Report to the European Commission in November 2002, in which, in addition to dealing with the afore-mentioned and other corporate governance issues, a number of company law subjects were also discussed. These included capital formation and maintenance rules, group and pyramid structures, corporate restructuring and mobility, the European private company and other European legal forms of enterprise as well as certain general themes for future development of company law in Europe. In addition, the High Level Group recommended certain priorities for the EU in dealing with corporate governance issues in the short, medium and longer term. The European Commission was also advised to formulate an EU company law action plan.\(^6\)

In response, on 21 May 2003 the European Commission issued a Communication\(^7\) outlining its Action Plan. In a related press release the European Commission recognised that new initiatives\(^8\) "are needed for the following reasons: the damaging impact of recent financial scandals, the growing trend of European companies to operate cross-border [within the EU], the continuing integration of European capital markets, the rapid development of new information and communication technologies" and the forthcoming EU enlargement in May 2004.\(^9\) In this Communication the European Commission highlights two key policy objectives which should be worked towards through future interventions at the EU level in the area of company law. These two objectives are: (1) to strengthen shareholder rights and third party protection, with a proper distinction between categories of companies, and (2) to foster efficiency and competitiveness of business, with special attention to some specific cross-border issues. In the EU Action Plan, the various interventions which appear necessary to achieve a modern European company law regulatory framework are prioritised over the short, medium and long term. In connection with each intervention proposed, the EU Action Plan indicates which type of regulatory instrument should be used and approximate timetable.

Two comments can be made in relation to recent EU developments as described above. First, the previous Report on the 2002 Assessment Results of this Project (the "2002 Report") noted that, while EU accession countries might be performing better in terms of economic transition, they do not always have better "laws on the books" than other non-accession countries whose

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\(^8\) Which will be aimed either at modernising existing EU company law instruments or at completing the EU framework with a limited number of new, tailored instruments.

relevant legislation was also assessed under this Project. This observation can clearly be repeated on the basis of the 2003 country ratings shown in Section II.2 above. One explanation put forward in the 2002 Report was that the EU accession process itself focuses on the harmonisation of national laws with the EU acquis and accordingly better corporate governance regimes can be considered as a side effect of harmonisation (but not as a goal for EU accession purposes). The fact that the European Commission has decided to take a more direct and organised approach in tackling corporate governance issues within the EU further supports this explanation.

The second comment is on the seemingly endless harmonisation process for EU accession. Over the years, a dilemma constantly facing accession countries is that while they are endeavouring to establish a so-called "EU compatible" regulatory framework at the national level, the relevant EU norms themselves are not standing still and the global economic environment in which the countries are trying to thrive is also changing very fast. Take capital markets as an example. Since EU capital markets are evolving rapidly thanks to technological advancement and the introduction of the Euro, by the time the candidate accession countries adopt relevant EU standards the landscape in the European capital markets may have altered substantially. Therefore, throughout the accession process it is not uncommon to see a country amending a piece of legislation adopted only in the previous year. For the countries who are set to join the EU in 2004 the level of the harmonisation anxiety arising from the announcement of the EU Action Plan may not be so high. However, for Bulgaria and Romania, who also aspire to EU membership but for whom a firm entry date has yet to be determined, the Action Plan could mean that the Parliaments of these two countries would be required to put in more efforts in the legislative process than the other ten before being permitted to join the EU.

Revision of OECD's Principles of Corporate Governance

Also against the backdrop of several huge corporate scandals (including Enron) in the US, the OECD Council Meeting at Ministerial Level in 2002 agreed to survey developments in OECD countries and to re-assess the Principles of Corporate Governance in light of developments in this field. Since then, and throughout 2003, the OECD Steering Group on Corporate Governance entrusted with this review has "undertaken very comprehensive consultations. These consultations have included experts from a large number of the [OECD Corporate Governance] Roundtable countries and other non-OECD countries as well as a wide range of interested parties such as the business sector, professional groups at national and international level, trade unions, civil society organisations and international standard setting bodies". The end result of these consultations was the issue of a draft text of the revised Principles of Corporate Governance in January 2004 calling for public comments. According to the OECD, a final revised version of the Principles of Corporate Governance is

10 The Steering Group on Corporate Governance comprises representatives not only from OECD countries but also from the World Bank, the Bank for International Settlements and the International Monetary Fund as observers to the Group. Representatives from the Financial Stability Forum, the Basel Committee on Banking Supervision and the International Organization of Securities Commissions are also invited as ad hoc observers. Please see OECD, "Draft Revised OECD Principles of Corporate Governance" (12 January 2004), available at http://www.oecd.org/dataoecd/19/29/23888981.pdf.
11 See OECD, "OECD Invites Comment on Draft Revision of its Corporate Governance Principles" (13 January 2004), available at OECD's website.
expected to be presented at the annual meeting of the OECD Council at Ministerial Level scheduled for 13-14 May 2004.

Among the important revisions introduced to the new draft *Principles of Corporate Governance*, four areas are worth noting. First, the responsibilities that institutional investors should have in fostering good corporate governance are elaborated upon. According to the OECD's draft, "institutional investors acting in a fiduciary duty should disclose their overall corporate governance and voting policies with respect to their investments." In addition, institutional investors "should also disclose how they manage material conflict of interest that may affect the exercise of key ownership rights regarding their investments." Second, the need for an effective and efficient framework dealing with corporate insolvency and for adequate enforcement of creditor rights is emphasised. Third, recommendations concerning auditing and financial disclosure issues and the responsibilities of relevant participants are clarified in more detail. Fourth, for the first time the obligations of external market professionals (e.g., brokers, rating agencies and analysts, etc.) who play an important part in decisions made by investors are discussed. According to the OECD's draft, those who provide analysis or advice which has implications on investors' decisions should "disclose any material conflict of interest that might compromise the integrity of their analysis or advice. They should also establish and disclose procedures for managing such conflicts."

### Development of national corporate governance codes

Over the last decade, along with the various countries’ growing concern about regulating corporate governance issues, a number of states have adopted a voluntary corporate governance code at the national level with the aim of better protecting the interests of investors. As recognised by the European Commission in the EU Action Plan, "Forty or so corporate governance codes relevant to the [EU] have been adopted over the last decade, at national or international level, …" Indeed, in 2001 the EU commissioned a comparative study to "further the understanding of commonalities and differences in corporate governance practices among EU Member States through an analysis of corporate governance codes and -- to a limited extent -- relevant elements of the underlying legal framework." While in line with the conclusions of the High Level Group of Company Law Experts the European Commission is of the view that there is no need for an EU corporate governance code, interest in developing a code by individual countries at the national level either within or outside the EU is not abating.

The two tables below show which of EBRD’s countries of operation have, as of the end of 2003, adopted or are considering adopting a voluntary code of corporate governance. In this connection, two trends can be observed: one is that listed companies are the focus of the codes adopted; another is that in the case where the application of a relevant code has been

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13 See *id.*, at Section I. F.
14 *Id.*
15 *Id.*
16 See *id*, at Section III. F.
17 See *id*, at Section IV. F.
18 See footnote 7 above, Page 10.
20 See *id.*, Page 14.
made "mandatory" (for listed companies, for example), a "comply-or-explain" mechanism\(^{21}\) is usually utilised as the enforcement method.

<table>
<thead>
<tr>
<th>Country</th>
<th>Title</th>
<th>Promulgation Institution(s)</th>
<th>Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Czech Republic</td>
<td>Corporate Governance Code(^{22})</td>
<td>Czech Securities Commission</td>
<td>February 2001</td>
</tr>
<tr>
<td>Kazakhstan</td>
<td>Corporate Governance Code(^{23})</td>
<td>University of International Business (Almaty), Center of International Private Enterprise</td>
<td>October 2001</td>
</tr>
<tr>
<td>Poland</td>
<td>Corporate Governance Code for Polish Listed Companies(^{24})</td>
<td>Gdańsk Institute for Market Economics</td>
<td>June 2002</td>
</tr>
<tr>
<td>Romania</td>
<td>Corporate Governance Code(^{25})</td>
<td>(business associations)</td>
<td>March 2000</td>
</tr>
<tr>
<td>Russia</td>
<td>Code of Corporate Conduct(^{26})</td>
<td>Federal Commission for the Securities Market</td>
<td>April 2002</td>
</tr>
<tr>
<td>Slovak Republic</td>
<td>Corporate Governance Code(^{27})</td>
<td>Financial Market Authority, etc.</td>
<td>September 2003</td>
</tr>
<tr>
<td>Ukraine</td>
<td>Ukrainian Corporate Governance Principles(^{28})</td>
<td>Securities and Stock Market State Commission</td>
<td>December 2003</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Country</th>
<th>Institution(s) Involved</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lithuania</td>
<td>National Stock Exchange of Lithuania</td>
</tr>
<tr>
<td>FYR Macedonia</td>
<td>USAID Deloitte Touche Tohmatsu</td>
</tr>
<tr>
<td>Slovenia</td>
<td>Association of Supervisory Board's Members Slovenian Managers Association, and Ljubljana Stock-Exchange</td>
</tr>
</tbody>
</table>

\(^{21}\) That is, either follow the rules or explain (usually in the annual report) why the relevant rules have not been complied with.

\(^{22}\) Available at http://www.sec.cz/download/Next/CG_CODE.doc.

\(^{23}\) Available at http://www.uib.kz/corpgov/eng/kky_e.html.


\(^{25}\) Available at http://www.ecgi.org/codes/country_documents/romania/romania.pdf.


\(^{27}\) Available at http://www.ecgi.de/codes/country_documents/slovakia/corp_gov_code.pdf.

\(^{28}\) Available at http://www2.ifc.org/ukraine/ucdp/materials/CGPrinciples%202003_final_e.pdf.
During 2003, it was clearly observed that a common effort by the countries assessed to improve legal and regulatory framework concerning financial reporting was being made. At least four countries\(^{29}\) enacted new accounting and/or auditing laws and two\(^{30}\) amended their existing legislation, all aimed at bringing national legislation in line with International Financial Reporting Standards\(^{31}\). One explanation could be that this area of reform was considered the last step in completing the establishment of a sound regulatory environment for the financial sector. Another explanation could again be linked to the collapse of Enron and others in 2001 and 2002, where accounting practices have been identified as a key factor contributing to those events.

### III.2 Some Country-specific Notes

#### Countries Rated as High Compliance

According to the 2003 assessment results, Armenia, Hungary, Kazakhstan, Latvia, Lithuania, FYR Macedonia, Moldova, Poland and Russia were rated as "High Compliance". Some country-specific comments about Lithuania and Kazakhstan are noted below.

#### Lithuania

Lithuania obtained a better rating in 2003. This can be attributed to the improvements made to the country's company and securities market laws, adopted to bring the Lithuanian regulatory framework closer to the EU acquis. Revisions to the company law were also made to remove any inconsistency between the company law and the civil code of Lithuania. Additionally, in order to address issues arising from the application of certain provisions of the company law, changes were introduced to clarify the rights (in particular, voting rights) and obligations of shareholders. It is worth noting that the requirement that a public limited liability company should have at least a supervisory board or management board has been abolished. The scope of the company law now also covers the restructuring of companies.

#### Kazakhstan

A major event in Kazakhstan in 2003 was that a new Joint Stock Companies Law came into force on the 13\(^{th}\) of May, replacing the one promulgated in 1998. A fundamental change is that the division between "open" and "closed" types of joint stock companies was eliminated. Joint stock companies are now either "regular" or "public", depending on the capitalisation of the company. Another major change concerns share registers, which can only be maintained by duly authorised independent registrars according to the new law. Other changes

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29 Armenia, Estonia, Serbia & Montenegro, and the Slovak Republic.

30 Latvia and Kazakhstan.

introduced by this 2003 law deal with new requirements concerning share placements and payment of dividends, etc. In addition to the company law, it is also worth noting that new rules concerning accounting and financial reporting came into force in Kazakhstan in 2003 which require compliance with International Financial Reporting Standards.

**Countries Rated as Medium Compliance**

Albania, Bulgaria, Croatia, the Czech Republic, Estonia, the Kyrgyz Republic, Serbia and Montenegro, the Slovak Republic, Slovenia and Uzbekistan were rated as "Medium Compliance" according to the 2003 assessment results. Both the Kyrgyz Republic and Serbia and Montenegro obtained improved ratings and some country-specific comments are noted below for reference.

**Kyrgyz Republic**

The improved rating of the Kyrgyz Republic was mainly attributed to the adoption of the new Joint Stock Company Law in April 2003. Compared to its predecessor, the new law can be considered as an important step forward in improving the country's corporate governance legal framework. Areas of improvement brought about by this new law include strengthening the powers of the general assembly of shareholders, expanding shareholders' rights (especially those concerning minority shareholders), clarifying the functions and powers of the board of directors, enhancing mechanisms in relation to the protection of shareholders and companies from interested-party transactions, introducing mandatory buy-out rules, etc. However, despite these improvements, it is recognised by the Kyrgyz Government that there remain ambiguities and insufficiencies under the new law. Accordingly, it is understood that the Government has been preparing a bill to amend this law already.

**Serbia and Montenegro**

In Serbia and Montenegro the promulgation of a new accounting and auditing law and a new securities market law improved the country's rating in 2003. Effective at the Federal level on 30 September 2003 (and a Serbian version on 29 October 2003), the new securities market law introduced changes which helped enhance the country's legal framework governing certain corporate governance issues. However, it should be noted that the implementation of this law in practice seemingly remains problematic. One reason is that a number of provisions of this new law are not consistent with the requirements of the existing company law. It is said that the Government of the Republic of Serbia has formed a group of legal experts to draft a new company law, which will hopefully be adopted in 2004.

**Countries Rated as Low Compliance**
Bosnia and Herzegovina, Georgia, Romania and Turkmenistan were rated as "Low Compliance" according to the 2003 assessment results. Some comments are noted below for Georgia, a country that obtained an improved rating in 2003.

**Georgia**

The improved rating of Georgia in 2003 was the result of amendments made to the Law on Enterprises and Law on Securities Market, which are the two key pieces of legislation concerning corporate governance in the country. A major change introduced by these amendments was to make all joint stock companies into so-called "reporting companies"\(^{32}\), thereby subjecting joint stock companies to stricter disclosure and reporting requirements. Another key change was to enhance the power of the National Securities Commission of Georgia ("NSCG") by enabling it to enforce provisions of the Law on Enterprises to the extent relevant to joint stock companies. In addition, the NSCG issued a new regulation\(^{33}\) in December 2002 which imposes on members of the supervisory board and directors of a "reporting company" a duty to protect the rights of securities owners of the company.

**Countries Rated as Very Low Compliance**

Similarly to the 2002 ratings, Azerbaijan, Belarus, Ukraine and Tajikistan remained being rated as "Very Low Compliance" according to the 2003 assessment results. However, some encouraging developments in Azerbaijan are noted below for reference.

**Azerbaijan**

On 8 May 2003 the International Finance Corporate ("IFC") and the State Secretariat for Economic Affairs of Switzerland ("SECO") announced a joint project to assist Azerbaijan in improving corporate governance. With the financial support of SECO through the end of September 2006, this project is to build on IFC's programmes in Russia and Ukraine where IFC has worked with the governments and with companies to improve corporate governance. Under the new project IFC is expected to provide advice to Azerbaijan on improving its legislative framework for corporate governance. IFC is also planning to offer consultations to Azeri companies and banks on corporate governance practices and to work with training institutions in Azerbaijan to include corporate governance into their curricula. Furthermore, IFC is considering launching a broad educational campaign among government agencies, private companies, financial institutions and the general public on the importance of corporate governance and its relevance to Azerbaijan.\(^{34}\)

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\(^{32}\) Basically, a reporting company is required to file annual, semi-annual and so-called "material event" reports with the National Securities Commission of Georgia ("NSCG") and the reports should meet the requirements set by the NSCG.

\(^{33}\) The Rule on Rights of the Reporting Companies' Securities Owners and on Respective Obligations of the Managing Body Members.

\(^{34}\) See press release by IFC on 5 September 2003, No. 03/0068.
IV. What's Next

Building on the assessment work of 2002 and 2003, the EBRD is considering undertaking two new initiatives through its Legal Transition Programme in order to continue its efforts to monitor corporate governance developments in the countries where the EBRD operates. One is to revise the Checklist that has been used for this CG Assessment Project, taking into consideration the OECD's revised *Principles of Corporate Governance*. The revision work will also consider lessons learned from the assessments conducted in the last two years. The aim of this initiative is to make the assessment Checklist up-to-date and more useful in gauging how a country is progressing in establishing a sound corporate governance legal environment. Another new initiative is to undertake a different kind of assessment project, the focus of which will be on how the relevant laws and regulations "on the books" are being implemented and enforced in practice by the country in question. The aim of this initiative is to determine the status of corporate governance practices in the countries where the EBRD operates.\(^\text{35}\) Hopefully, together with the CG Assessment Project, these new initiatives will further facilitate corporate governance related reform in the countries of central and eastern Europe and the Commonwealth of Independent States.

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\(^{35}\) For an example of this kind of new assessment initiative in the secured transactions area, please see EBRD, *Transition Report 2003* (London 2003), Annex 2.2.
Annex
EBRD Corporate Governance Assessment 2003 Rating

Rating Legend
A - Very High Compliance (0)
B - High Compliance (9)
C - Medium Compliance (10)
D - Low Compliance (4)
E - Very Low Compliance (4)