



THE WORLD BANK

Report on the Observance of Standards and Codes (ROSC)

Corporate Governance

Corporate Governance Country Assessment

Azerbaijan

July 2005

Overview of the Corporate Governance ROSC Program

WHAT IS CORPORATE GOVERNANCE?

Corporate governance refers to the structures and processes for the direction and control of companies. Corporate governance concerns the relationships among the management, Board of Directors, controlling shareholders, minority shareholders and other stakeholders. Good corporate governance contributes to sustainable economic development by enhancing the performance of companies and increasing their access to outside capital.

The *OECD Principles of Corporate Governance* provide the framework for the work of the World Bank Group in this area, identifying the key practical issues: the rights and equitable treatment of shareholders and other financial stakeholders, the role of non-financial stakeholders, disclosure and transparency, and the responsibilities of the Board of Directors.

WHY IS CORPORATE GOVERNANCE IMPORTANT?

For emerging market countries, improving corporate governance can serve a number of important public policy objectives. Good corporate governance reduces emerging market vulnerability to financial crises, reinforces property rights, reduces transaction costs and the cost of capital, and leads to capital market development. Weak corporate governance frameworks reduce investor confidence, and can discourage outside investment. Also, as pension funds continue to invest more in equity markets, good corporate governance is crucial for preserving retirement savings. Over the past several years, the importance of corporate governance has been highlighted by an increasing body of academic research.

Studies have shown that good corporate governance practices have led to significant increases in economic value added (EVA) of firms, higher productivity, and lower risk of systemic financial failures for countries.

THE CORPORATE GOVERNANCE ROSC ASSESSMENTS

Corporate governance has been adopted as one of twelve core best-practice standards by the international financial community. The World Bank is the assessor for the application of the OECD Principles of Corporate Governance. Its assessments are part of the World Bank and International Monetary Fund (IMF) program on Reports on the Observance of Standards and Codes (ROSC).

The goal of the ROSC initiative is to identify weaknesses that may contribute to a country's economic and financial vulnerability. Each Corporate Governance ROSC assessment reviews the legal and regulatory framework, as well as practices and compliance of listed firms, and assesses the framework relative to an internationally accepted benchmark.

- Corporate governance frameworks are benchmarked against the OECD Principles of Corporate Governance.
- Country participation in the assessment process, and the publication of the final report, are voluntary.
- The assessments focus on the corporate governance of companies listed on stock exchanges. At the request of policymakers, the ROSCs can also include special policy focuses on specific sectors (for example, banks, other financial institutions, or state-owned enterprises).
- The assessments are standardized and systematic, and include policy recommendations. In response, many countries have initiated legal, regulatory and institutional corporate governance reforms.
- Assessments can be updated to measure progress over time.

By the end of June 2005, 48 assessments had been completed in 40 countries around the world.

REPORT ON THE OBSERVANCE OF STANDARDS AND CODES (ROSC)

Corporate governance country assessment

Azerbaijan

July 2005

Executive Summary

This report assesses Azerbaijan's corporate governance framework—its laws and regulations, enforcement and common business practices. The report notes recent improvements in corporate governance regulation, makes recommendations of policy and institutional strengthening, and provides a benchmark against which to measure corporate governance in Azerbaijan. Note that the report covers only publicly-traded companies, although many of the recommendations may also apply to closely-held companies and state-owned enterprises.

In recent years there have been a number of major reforms of securities markets and corporate governance issues. However, experience in other countries suggests that implementation and enforcement remain central.

The report identifies three steps for improvement of corporate governance in Azerbaijan. They are:

1. Institution building, including strengthening of enforcement and independence of SCS;
2. Legal reform, specifically taking stock of recent legal changes and assuring their smooth interaction and functioning; and
3. Focus on several key areas for enforcement:
 - ❑ Related party transactions;
 - ❑ Reporting and transparency, including ownership disclosure and annual reporting;
 - ❑ Supervisory boards and other company governance organs;
 - ❑ Continued enforcement of bank CG rules;
 - ❑ Awareness raising.

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The assessment reflects technical discussions with the State Committee for Securities, Baku Stock Exchange, Ministry of Finance, National Bank of Azerbaijan, Ministry of Justice, and the Ministry of Economic Development, as well as commercial banks, issuers, and numerous market participants.

The ROSC assessment for Azerbaijan was cleared for publication by the State Committee for Securities in October 2005.

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Country assessment: Azerbaijan

Market profile

Corporate governance is underdeveloped

In comparison with other transition countries, the corporate governance framework in Azerbaijan is relatively weak. The lack of investor rights protection, transparency, and accountability has stunted securities market development, curtailed foreign investor interest, precluded the formation of strong local institutional investors, and permitted the stock exchange to remain illiquid and lacking in breadth and depth. There are no officially listed companies on the upper tier, and no listing requirements for companies trading on the lower tier of the exchange. 90% of the trading occurs off-exchange. Companies admitted to trading do not have to be open joint-stock companies, or to maintain their share registers with an independent share registrar. A large part of the joint-stock companies are inactive, and a considerable share of the large companies (by production) are state-owned. State-owned enterprises have no corporate governance structures or procedures. The main problems are minimal to no public disclosure, limited observance of annual shareholder meetings, and insufficient clarity in the functions of the supervisory and management boards. Corporate governance reform efforts are limited to a handful of banks. Banks have a regulatory regime that incorporates an advanced corporate governance practices, and the Law on banks supersedes the revised Civil Code articles on JSCs in the parts where the two are inconsistent.

Active recent legislative effort, little implementation

The legal and regulatory framework has improved in Azerbaijan. Following the establishment of main capital markets institutions, a considerable legal base was developed. Such active legislative activity has necessarily left gaps and overlooked matters that will need to be systematized and integrated into the legal framework. Whereas legislative efforts have been dynamic, enforcement has lagged behind. The National Bank of Azerbaijan has strengthened its institutional capacity, but more work needs to be done, especially in the case of the State Securities Commission, the Baku Stock Exchange, the National Depository Center, the courts and the State Registrar.

Advanced corporate governance regulatory regime for banks

Main institutions are the State Committee for Securities and the Bank Stock Exchange

With respect to capital markets, the main institutions are the State Committee for Securities (SCS), the Baku Stock Exchange, and the National Depository Center. SCS reports to the President and does not have budgetary independence. BSE performs some functions traditionally associated with the depository, such as clearing, settlement, and depository services.

There are no institutional investors

Portfolio investment funds and private pension funds do not exist. Banks and insurance companies do not invest in equity, and most of them belong to an industrial-financial group, and operate and invest largely within the group. There are no foreign institutional investors. Post-privatization companies are therefore held by insiders and a minimal share participation of employees.

Key issues

Several key features distinguish Azerbaijan's corporate governance framework.

Investor protection

Basic shareholder rights poorly enforced

The law provides for basic shareholder rights. However, compliance is weak, e.g. in the area of supervisory board election and proper maintenance of share registers. Companies are required by law to provide an investor any public information upon inquiry. In practice, accessing corporate information is difficult. Not all open JSCs are required to have supervisory boards. Due to poor profitability, dividends are rarely, if ever, paid.

AGM rules

By law, AGMs are mandatory, though some legal provisions require further clarification, e.g. limits on the location where the AGM is held. In practice, AGMs are not regularly held, even in banks. Effectively, dispersed shareholders are excluded from the decision-making process.

10% share capital can call a shareholder meeting

10% of voting shares can call a shareholder meeting (5% in the case of banks). The law allows shareholders in principle to seek amendments to the agenda, but does not provide specific procedures for adding agenda items.

Aggrieved shareholder rights are weak

There are no shareholder redemption rights that would allow a shareholder to demand that the company redeem his shares in case of oppression or disagreement on major corporate actions. Civil Code provision §105.1.1 does not elaborate sufficiently these rights to be functional.

10% of shareholders can request an inspection of the company by the revision committee, and can also request a company audit.

No takeover legislation

Currently there is no takeover law or regulation that would require an investor to offer to buy all the shares of a company after crossing a certain ownership threshold, and the legislation does not envisage tender offers or equal prices for control-control block shares. Takeover issues may not be relevant at this time, due to limited trading and concentrated ownership.

Disclosure

Ownership disclosure not enforced

By law, shareholders have a right to request the shareholder register from the company once a year. Companies must also publicly disclose their 10% shareholders. There is no requirement to disclose indirect and ultimate owners. In practice, official information on share ownership is unusually difficult to obtain in Azerbaijan.

No access to company charters, and limited access to State Registry information

By law, the State Register should provide public access to company charters and other company details. However in practice access to the records is limited at best, largely due to the absence of implementing regulations—and lack of public awareness of the right to access this information. Access to corporate charters is outright unavailable.

Lack of detailed regulation on disclosure of RPTs and large transactions

Related party transaction regulations are rudimentary and incomplete. For example, the precise RPT information to be disclosed to the supervisory board is not stated in the law. RPT regulations do not extend to members of the supervisory board or large shareholders, and do not require AGM approval. Related loans are allowed. RPT disclosure to the public, and filing of RPT information with the SCS is not regulated. The NBA has issued a detailed RPT regulation on banks, which could be used as a model for JSCs.

The AGM approves transactions of more than 25% of net assets. There are no rules for the exact information to be disclosed, and no mandatory external assessment assuring that such transactions occur at market prices.

Compliance with annual report regulations remains to be observed

All JSCs are required to prepare and publish audited financial statements. Market participants (and experience from other countries) suggest that the conversion to high-quality IFRS is in its early stages in most companies, and will take considerable additional time and effort. JSCs in practice rarely publish and file full annual reports, but a few larger firms publish key figures in the press. Consolidation, cash-flow statements, and publication of the notes to the financial statements is only required for banks, whose compliance with annual report disclosure is also much better.

Poor accounting and auditing quality, new legislation expected to forge a major step forward starting in 2006

In spite of the progress achieved, significant gaps exist between IFRS and the Azeri Accounting system, as well as ISA and the National Audit Standards. The new Law on Accounting 2004 will require public interest entities (financial firms and larger companies) to prepare consolidated audited IFRS statements by 2006. Currently, IFRS is not applied outside of the banking sector and firms with foreign participation, and some JSCs still use tax accounting standards. JSC, all banks, and legal entities above a certain size must have their financial statements externally audited, but the absence of a well-developed auditing sector may hinder the effective implementation of the law. By estimates of market participants, only 20% of open JSCs actually undergo an external audit. Audit services are regulated by the Chamber of Auditors, whose scarce staff and resources do not allow an effective enforcement effort in maintaining high audit quality. The legal provisions for disciplinary actions by the Chamber are lax, as well. As a result, there are wide ranging differences in audit quality, which leads most in-country stakeholders to disregard audit opinions.

Material events not disclosed in practice

Material facts are not routinely disclosed in the media or to the SCS. By law, information on main events and actions exerting an influence on the financial-economic activity of the issuer must be disclosed within 15 days of occurrence to the SCS. There is no detailed definition of materiality or examples to guide companies in their disclosure.

Weak disclosure of non-financial information

Non-financial disclosure, such as information on board members, pay, risk factors, employees, and governance policies, is not strictly regulated for JSCs. For example, a statement of company objectives is not generally mandated for JSCs, though larger companies are required by law to present a report of the “state of affairs”, containing plans for the following financial year. Banks have stricter provisions for non-financial disclosure, and can serve as a model for JSCs.

Company oversight and the board

Little guidance on functioning and rules for JSC boards by law, regulations for bank boards may serve as an example

Large companies in Azerbaijan have a two-tier board structure, consisting of a supervisory board and a management board (often called an executive body). The specific authorities, functioning of the supervisory board, including frequency of meetings, size, and decision-making procedures, are left to the company charter. There are no detailed guidelines for the roles, responsibilities, operation, qualifications or structure of supervisory boards. In practice, boards tend to be dominated by the controlling shareholder, have not assumed an independent oversight function, and are considered to play a relatively minor role in providing strategic guidance for corporations. Regular supervisory board meetings are not held in most companies. JSCs with less than 50 shareholders are not mandated to have a supervisory board at all.

The supervisory board of banks is more strictly regulated, with provisions on voting, quorum, membership, frequency of meetings, limits on the number of board seats held, functions, fiduciary duties, and liabilities.

The management board is responsible for the day-to-day operations of the company. The management board can either be a collective body (management board) or a single individual, effectively making the management board optional. In practice, the management board is often obliged to consult on a daily basis with controlling owners.

No rules on board independence

There are no independence provisions for the supervisory board members by law. Members of the management board cannot sit on the supervisory board. Shareholders with 20% or more cannot sit on the management board. In practice, supervisory boards tend to be beholden to controlling owners.

In the case of banks, members of the supervisory board, auditor commission and management board, as well as chief accountant, cannot be members of other governance bodies of the bank (with the exception of the AGM); cannot be employees; cannot be relatives to the supervisory board, auditor commission and management board, as well as chief accountant; and cannot be government employees.

No statutory fiduciary duties

There are no specific duties of loyalty and care for supervisory board members of JSCs. For banks, there are specific fiduciary duty provisions.

No director guidelines or training, outside of the banking sector

No code of corporate conduct has been developed to assist supervisory board members in their duties, and there are no institutions responsible for formal training of supervisory board members for JSCs. In the banking sector, such tools are available and actively used. The corporate governance regulations of the NBA have the force of law over banks, and the Azerbaijan Bank Training Center provides valuable awareness raising and coaching services to bank directors and managers.

Revision commission for JSCs and auditor commission for banks are not fully independent board committees

Companies are not required to have an audit committee of the board. However, all JSCs with more than 50 shareholders must have a “revision committee”, elected by the AGM. Revision committee members cannot be shareholders, or members of the supervisory or management board. Banks have a second organ (called “auditor commission”), also elected by the AGM. Members of the committee cannot be members of other governance bodies of the bank (with the exception of the AGM); cannot be bank employees; cannot be relatives to members of the supervisory board, auditor commission and management board, or the chief accountant; and cannot be government employees. The revision commission and auditor commission risk having overlapping responsibilities.

Enforcement

SCS powers are sufficient by law; implementation is weak

SCS regulates securities markets, including implementation of laws, creation and enforcement of regulations, control over the activities of BSE, NDC, issuers and other market participants, and licensing of professional market participants and investment funds. SCS is responsible for enforcement of all commercial legislation for JSCs, as well as for securities. SCS can obtain information from market participants, conduct inspections, summon witnesses, impose sanctions, initiate civil suits against violators and act as a side in the dispute, suspend and terminate licenses and trading. SCS could make even more use of its powers.

Shareholders can and have turned to the SCS for protection of their rights. SCS can conduct administrative hearings and impose direct penalties as a result, but

Court effectiveness insufficient to provide adequate investor redress

cannot assess damages that a company would pay to shareholders without a court decision. Monitoring and enforcement of violations is not as active as is currently needed. Fines may not be sufficiently high to have a preventive effect.

Though the law permits shareholders to turn to the court for redress, in practice this is next to impossible. First, corporate or securities disputes where one party is an individual do not go to the Economic Court, but to the general courts. Further, court proceedings can be indefinitely prolonged, and are reputed to be partial, ridden by high case loads, lack of judge training on securities and corporate issues, as well as the low level of shareholder awareness of their rights. Still, there have been some isolated court cases on shareholder or securities issues.

Recommendations

Policy recommendations are broken down into changes to institution building and key areas for legislation and enforcement, and are further categorized into high priority (immediate action), medium (1-2 years) and lower priority (3-5 years).

Institution Building

High Priority

State Registry The Registry requires major institutional and operational reform, including the development of modern filing systems, training, legal reform, and the implementation of appropriate information technology, in order to create a workable and effective system of archiving the records and providing public (electronic) access to documents, including company charters.

State Commission for Securities (SCS) Strengthen SCS institutional capacity to meet the increased need of enforcement of new legislation. Further, a list of specific reasons for removal of SCS top officials needs to be spelled out in the law. Further legitimacy to SCS actions can be promoted, for example via public consultation on new regulation, reports to Parliament, independence provisions for SCS staff vis-à-vis regulated entities to preclude conflicts of interest.

Baku Stock Exchange Several steps could be undertaken to encourage listing. Listing requirements for the upper tier need to be adjusted to reflect realistic expectations for a few best practice companies to list. On the other hand, the lower tier should be subjected to at least some minimal requirements, such as filing of annual audited financials, to decrease the gap between the requirements for the two tiers. A few large state-owned enterprises should be encouraged to list and serve as a model, together with some banks, of best practice listed companies. BSE's enforcement effectiveness may benefit from granting it the power to impose fines.

Medium Priority

The following rules would encourage a fair and well-regulated exchange market:

- companies admitted to trading on BSE should not be permitted to trade off-exchange, or at least the price and trade information on off-exchange trades should be communicated to BSE.
- SOE privatization through listing should be encouraged.
- companies admitted to trading on BSE should be banned from maintaining the share register themselves.

Long Term

State Commission for Securities In the long term, establishing SCS independence (including budget independence) would further increase its legitimacy and effectiveness. An IOSCO assessment may be useful in this regard.

National Depository Center (NDC) In the long term, the NDC should become a central registry for all JSCs, and should assume the clearing and settlement

functions of the BSE.

Courts Involving the general courts in securities and corporate matters where an individual is a party to the case makes poor use of the specialization of economic courts, as well as subjects general courts to a further backlog of highly complex cases. Those cases should be tried by the Economic Court. Training of judges at the Economic Court on securities and corporate matters is of the essence.

Key focus areas for stricter legal rules and improved enforcement

High Priority

Code of Best practice A corporate governance code should be adopted for JSCs, perhaps with the force of law to ensure compliance (e.g. as an SCS regulation). Given that the JSC regulations are part of the Civil Code and are hard to reform, some of the legislative changes below could instead be made part of the SCS regulation on Corporate Governance. The respective bank regulation could be used as a model.

Director training Awareness raising on corporate governance issues is needed, including training for corporate, SOE, and bank management and supervisory boards, as well as general public campaigns on basic securities markets awareness. An institute of directors may best promote corporate governance.

Disclosure The enforcement of disclosure rules and procedures is the single most effective corporate governance reform. The first order of priority is enforcement for ownership disclosure, including full shareholder lists and disclosure of 10% shareholders. An initial reform successfully applied in certain countries to promote ownership disclosure is to require NDC to disclose 10% direct owners. Disclosure of indirect and ultimate ownership should be mandated by law and effectively enforced. As the Accounting Law provisions come into force in 2006, SCS and BSE should work on improving enforcement of filing of annual financials for JSCs, and providing public access to audited financials.

Medium Priority

AGM rules and procedures:

- require that AGMs are held in the town of the company office (or in Azerbaijan).
- include details on newly nominated directors, and auditor, in the AGM notice.
- mandate annual board election, at the AGM meeting.
- specify exact procedures for adding agenda items on the AGM agenda (e.g. 5% of shareholders can propose items on the agenda).
- specify the right of shareholders to ask questions (and be answered) at the AGM.
- The law could list the specific grounds for dispute of AGM decisions.
- The law should establish a record date concept and should specifically regulate how the list of shareholders is drawn up for AGM purposes.

Supervisory boards The law must specify rules for JSC supervisory boards, including exact authorities of the board (e.g. supervision over related party transactions, approval of the annual report, strategic issues). Daily management of the companies should be specifically excluded from the duties of the supervisory board. The procedures by law for meetings / minutes should be clarified, including the size of boards, frequency of meetings, absence policies, quorum, and exact procedures for board election by the AGM. Cumulative voting may be considered. Fiduciary duties for management and supervisory boards should be specified. The supervisory board provisions for banks can be used as models.

Related party transactions Approval and disclosure procedures for related party transactions should be legislated and enforced. In this effort, the bank legislation

can be used as a model, and IAS 24 should be enforced for all listed firms.

- define a related party in the law, including supervisory and management board members, 10% shareholders, as well as their families.
- state explicitly what information is disclosed by related parties on each RPT.
- require AGM approval for larger RPTs.
- forbid related loans.
- regulate RPT disclosure to the public and SCS.
- define explicitly sanctions on RPTs in the law.
- include in the law provisions that ban related parties from competing with the company and exploiting business opportunities belonging to the company.

Pre-emptive rights should be mandated by law for open JSCs.

Bank corporate governance Though banking corporate governance rules can be generally used as a model for regulating most JSC corporate governance areas, the continued enforcement of those rules for banks is not to be neglected, if they are truly to serve as champions for corporate governance standards in the country.

Long Term

Takeover legislation Modern takeover legislation should be adopted.

Withdrawal rights The law should elaborate on the general Civil Law provision §105.1.1 that allows shareholders to request withdrawal of shares if allowed by law or company charter. Specific procedures and conditions should be outlined, such as cases when the shareholder is entitled to request withdrawal (e.g. after disagreeing with an AGM decision, after merger, etc); price of withdrawal (some notion of a fair market price), and other details.

Audit Committee The institution of the revision committee or auditor commission may sometimes play a complementary role in protecting the interests of minority shareholders. However, these traditional organs of corporate vigilance are not substitutes for a well-functioning audit committee as part of the supervisory board in overseeing the adequacy of the company's internal control systems and the integrity of its independent external audit.

Principle - By - Principle Review of Corporate Governance

This section assesses Azerbaijan's compliance with each of the OECD Principles of Corporate Governance. Policy recommendations may be offered if a Principle is less than fully observed. **Observed** means that all essential criteria are met without significant deficiencies. **Largely observed** means only minor shortcomings are observed, which do not raise questions about the authorities' ability and intent to achieve full observance in the short term. **Partially observed** means that while the legal and regulatory framework complies with the Principle, practices and enforcement diverge. **Materially not observed** means that, despite progress, shortcomings are sufficient to raise doubts about the authorities' ability to achieve observance. **Not observed** means no substantive progress toward observance has been achieved.

SECTION I: ENSURING THE BASIS FOR AN EFFECTIVE CORPORATE GOVERNANCE FRAMEWORK

The corporate governance framework should promote transparent and efficient markets, be consistent with the rule of law and clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities.

Principle IA: The corporate governance framework should be developed with a view to its impact on overall economic performance, market integrity and the incentives it creates for market participants and the promotion of transparent and efficient markets.

Assessment: Materially Not Observed

Over the last few years, the legal and regulatory framework has improved in Azerbaijan. Following the establishment of main capital markets institutions, a considerable legal base has been developed and perfected. Since the completion of the FSAP Corporate Governance Assessment in late 2002, the draft JSC law has been adopted, as part of the Civil Code (not as a self-standing law). The March 2004 modifications to the JSC section strengthens some major functions of some corporate governance bodies, e.g. the AGM, but does not go far enough in closing the gap with respective regulations for banks. Since 2002, the other major advance has been the adoption of the Law on Accounting, introducing IFRS for large and financial companies, as well as other improvements in financial reporting. The Law on Auditor Services 2003 falls short of adopting international Audit Standards. In 2004, the Law on Banks and the NBA Regulation on Implementation of Corporate Governance Standards in Banks came into force, introducing advanced corporate governance regulations for banks. While listing and trading rules are still under revision, SCS has made some important steps in legislating on share issuance and prospectuses, insider trading, and annual reporting, in 2004. Such active legislative activity has necessarily left gaps and overlooked matters that will need to be systematized and integrated into the overall matter of law and framework.

Whereas legislative efforts have been dynamic, enforcement has lagged behind. Poor corporate governance, transparency, and accountability conditions have stunted securities market development, curtailed foreign investor interest, precluded the formation of strong local institutional investors, and permitted the stock exchange to remain illiquid and lacking in breadth and depth. Such enforcement deficiencies can be explained by several factors. First, the legislation is relatively recent. Second, enforcement is to a large extent dependent on an eventual need for an effective state registry, court, a parallel continued privatization program, and functioning accounting and audit institutions. Finally, the markets are starved on qualified and trained practitioners.

Corporate governance practices, though perceived as modern and prestigious, are not understood outside of banks and firms dealing with foreign investors, and not widely applied. First steps in the application of corporate governance practices have been made by some 10-12 banks, and may be expected to bear fruit in the short to medium run.

Capital markets. The capital market in Azerbaijan is at an early stage of development. There are no listed companies on the upper tier of the Baku Stock Exchange (BSE), and there are 234 companies with more than 100 shareholders, whose shares must trade only on the stock exchange by law.¹ But 90% of the trades occur off exchange, mostly via notary sales contracts. In 2004, there were 5066 over-the-counter trades via brokers and 1895 trades on exchange. Though trading is still low, it has significantly increased from 2001-2, when 50-100 trades occurred annually. It is not possible (even for the regulator) to obtain information about directly negotiated trades via a notary. Market capitalization figures are meaningless in the case of the BSE, but the volume of trades for 2004 was \$113,751,342, or 1.57% of GDP. Seven companies (all banks) offer bonds. In 2004, there were \$20,643,737 worth of new issues. State-owned enterprises (SOEs) have no corporate governance structures or procedures (e.g. a supervisory board or disclosure practices), and a process is being contemplated to transform some SOEs into joint-stock companies (JSC).

There are few, if any, institutional investors. Portfolio investment funds and private pension funds do not exist.² There are

¹ Outside of directly negotiated trades with a specifically identified counterpart via a notary.

² The 1997 privatization experience of both local and foreign investment funds has been negative, with the result of closure and exit of funds from the market.

42 banks and 30 insurance companies, which rarely, if ever, invest in companies.³ A large part of the banks and insurance companies belong to an industrial-financial group, and operate and invest largely within the group. There are no foreign institutional investors. There are 4 active broker/dealers, out of 9 broker and 10 dealer licenses currently active.

Ownership framework. After privatization, ownership concentration has been steadily on the increase, as cash-constrained employees sold their privatization shares to controlling owners, typically at artificially low prices due to lack of a market and liquidity. Most JSCs, formed via privatization with 15% employee participation, have now more than 95% of their shares closely held (in some estimates, this figure is 99%). Ownership data is widely unavailable, but the dominant owners are local business leaders, with few foreign strategic investors in the oil and banking sectors, and no portfolio investors. The state remains a significant owner, including in the banking sector. Foreign ownership restrictions on portfolio investment and in the banking sector have been recently lifted.

Principle IB. The legal and regulatory requirements that affect corporate governance practices in a jurisdiction should be consistent with the rule of law, transparent and enforceable.

Assessment: Materially Not Observed

Corporate legal framework. The main laws governing JSCs are the Civil Code articles 98-134 on JSCs, and the Law on State Registration and State Registry of Legal Entities.

Company types. There are about 1700 open JSCs and about 200 closed JSCs. Of those, only about 200 may trade in a given year. The vast majority of those JSCs are non-operational. Only open JSCs can issue shares, make a public subscription, and trade shares freely (CC §98.2, 99.1). Companies with 100 or more shareholders must trade their shares on exchange, barring directly negotiated trades via a notary. The law does not, however, preclude even limited liability companies to issue bonds traded on exchange.⁴ Currently, there are no limited liability companies trading on the exchange, but two closed JSCs do offer bonds. All JSC fall under SCS oversight. There is no body with express oversight functions for other company forms. The minimum limit of charter capital for open JSCs (excluding banks) is US\$4,000, for closed JSCs – US\$2,000.⁵ Closed JSCs can restrict free transfer of shares, may not issue shares publicly, and may have at most 50 shareholders (CC §100). Banks must be established as open JCSs.

Securities legal framework. Articles 987-997 and 1078 of the Civil Code regulate the securities market and trading. In addition, the Law on Protection of Investor Rights on the Stock Market 2000 (amended 2002), and SCS regulations have been instrumental in providing a legal framework in the area of securities.⁶ BSE and NDC regulations, as well as regulations on public share registers, provide the framework for the stock exchange, depository, and registry services.

Listing rules. The listing and trading rules of the BSE regulate operations on the stock exchange.⁷ The BSE trading department is responsible for enforcement of listing and trading rules. BSE can de-list companies or suspend trading, but cannot impose fines.

There are two listing tiers. Any legal entity may issue securities on the second tier of the BSE. To list, the applicant must only file a charter, but is not expected to perform any periodic disclosure. The higher tier requires 500 shareholders, 2 years of existence, audited financials, and a minimum capital of US\$1 million.⁸ The rules are currently being revised with a view of relaxing the listing requirements. In order to list, a company must file its charter, list of shareholders, audited financial statements for the past two years, a list of the Supervisory Board and Management Board members; among other information. Periodically, the issuer must present unaudited quarterly statements and audited annual financials.

Codes. There is currently no code of corporate governance for JSCs. The NBA has issued essentially a code for banks, with the force of law, in 2004.⁹ Implementation among the top 10 banks has already started. The Azerbaijan Bank Training Center provides valuable awareness raising and coaching services to bank administrators. IFIs have actively supported numerous training and technical assistance projects in the area of corporate governance and related areas. Examples include IFC, KFW, and USAID work on development and implementation of corporate governance standards of banks and the associated training and implementation, IFC and others' work with BSE and NBA on legislative initiatives, such as the

³ By law insurance firms are allowed to invest up to 10% of their shares in equity. Law on Insurance, 1999: Section 45.

⁴ There are about 8000 limited liability companies.

⁵ Decision #224 of the Government of Azerbaijan, December 23, 2000.

⁶ The more noteworthy SCS regulations from a corporate governance perspective are:

- SCS rules on preparation and disclosure of annual reports of investment securities issuers 2004,
- SCS rules on preventing security manipulation on the security market 2004,
- SCS rules on storing, using, and presenting overhead information on the stock market 2004,
- SCS rules on stock issue with the purpose to increase authorized capital 2004,
- SCS regulation on decreasing of authorized capital of JSC by means of stock redemption and dividends payment 2004.

⁷ Specifically, those are: BSE rules of membership, BSE rules of security admittance to auction, BSE rules of trading, BSE clearance and settlement rules, BSE listing and delisting rules.

⁸ As well as a minimum annual profit of US\$100,000, minimal monthly average volume of listed securities sales of at least US\$40,000, availability of market-makers, and daily availability of bid and ask offers for securities.

⁹ NBA Regulation on Implementation of Corporate Governance Standards in Banks.

NBA audit regulations, as well as the TACIS manual on BSE listing procedures. EBRD investments in banks are also helping raise the corporate governance level.

Principle IC. The division of responsibilities among different authorities in a jurisdiction should be clearly articulated and ensure that the public interest is served.

Assessment: Partially Observed

Securities regulator. The SCS regulates securities and securities markets, including implementation of state legislation, creation and enforcement of regulations, control over activities of BSE, NDC, issuers and other market participants, and licensing of professional market participants and investment funds. SCS establishes standards for the work of investment funds, private pension funds and insurance funds, as well as companies managing these funds, banks, and insurance companies. SCS inspects securities trade records, ensures public information, and examines disclosures of issuers, professional participants, and the BSE. SCS organizes and develops the securities markets in coordination with other executive bodies (e.g. NBA), and protects the rights of the investors, per its mission.¹⁰ SCS is legally subordinated to and reports to the President, who appoints the SCS Chairman and his deputies.¹¹ There are currently no independence provisions for SCS staff vis-à-vis regulated entities to avoid conflicts of interest. SCS is financed by state budget, approved by the Cabinet of Ministers.¹² SCS can issue regulations and rules which it makes available to the public, but the practice of public consultation on proposed regulations still needs to be developed (CC §1078-40.1). SCS is responsible for enforcement of all commercial legislation for JSCs, as well as on securities.

Stock exchange. BSE was established in 2000 as a closed JSC with 18 owners, mostly brokers. It is supervised by the SCS.¹³ BSE can act as a depository for securities, and is the only provider of clearing and settlement services.

Central depository. The National Depository Center (NDC) acts as a depository and can act as a share registrar. 1037 companies are using NDC as a registry, and about 300 JSCs who should be using NDC by law are not.

Banking and other regulators. Banks and credit companies are regulated by the National Bank of Azerbaijan (NBA), and insurance firms by the Ministry of Finance.

Company Registry. The Ministry of Justice is responsible for maintaining the commercial registry of legal entities, of which there are over 70,000 in Azerbaijan. JSC must file their charters, a list of initial board members, and the holdings of shareholders, at the Ministry of Justice, and companies can be stricken from the register for failing to comply with these regulations.¹⁴ The Registry has no capacity to enforce a high quality of the information filed, and has limited storage and processing capacity as well. Records are not computerized, which limits their searchability and presents a risk of loss of information. By law, the State Register provides access to this documentation to the public.¹⁵ However in practice public access to the records is limited at best. Access to corporate charters is outright unavailable, due to implementation constraints.¹⁶

Court. The Economic court only tries disputes between legal entities; cases where one side is an individual go to the general courts, even if the case concerns securities (Civil Procedures Code, §25, 26). Courts afford the opportunity of endless appeal procedures, at the Appellate Court and further at the Supreme Court level. The court is rarely used for corporate and securities disputes. Training of judges on corporate and securities issues is also a major hurdle.¹⁷

Regulatory Overlap. SCS regulations in the area of capital markets are binding to other executive bodies.¹⁸ NBA and SCS both need to consult the other on regulations in areas of overlap of jurisdiction.¹⁹

Responsibility for market surveillance lies with both BSE and SCS, with BSE daily reporting to SCS.

Principle ID. Supervisory, regulatory and enforcement authorities should have the authority, integrity and resources to fulfill their duties in a professional and objective manner. Moreover, their rulings should be timely, transparent and fully explained.

Assessment: Partially Observed

¹⁰ Regulations of the SCS, §5, 6. Article 6.9 lists the securities market participants' activities: brokerage, dealership, depository operations, securities management, clearing, maintenance of the securities owners register.

¹¹ Regulations of the SCS, §1, 10, 12.

¹² Regulations of the SCS, §8, 9; Decree on ensuring operations of SCS, §4.

¹³ Regulations of the SCS, §11.5; Civil Code, §1078-35.

¹⁴ Law on State Registration and State Registry of Legal Entities 2003, §5, 6, 7, 8; Civil Code, §130, 134.

¹⁵ Law on State Registration and State Registry of Legal Entities 2003, §15, 18.

¹⁶ The Ministry of Justice has undertaken some reforms recently, resolving some procedural issues have, mainly with a focus on easing the administrative procedures of company registration, but not in the area of disclosure and public information provision. The current effort in this respect is directed to securing a storage space for the records. In the future, plans envision the creation of a unified electronic register.

¹⁷ Some activities in that respect are in planning with EU assistance.

¹⁸ Regulations of the SCS, §7.1; Decree on ensuring operations of SCS, §2, 5.

¹⁹ Regulations of the SCS, §15; Civil Code, §1078-43.5.

Authority, integrity and resources of regulators. SCS is funded through state budget allocations, and all collections return to the state budget. Its 2005 budget is US\$2,774,300.²⁰ SCS's has 75 employees.²¹ The salary level of SCS is half of that of the private sector, and two-thirds that of BSE.

SCS can obtain information from market participants, conduct inspections, summon witnesses, impose sanctions, initiate civil suits against violators and act as a side in the dispute, suspend and terminate licenses and trading.²² Due to a conflict between the Civil Code JSC and securities sections, SCS cannot cancel a granted license to a professional market participant, and needs to petition the court for that. There have been no civil or criminal cases filed by the SCS in 2004. SCS's legal department (staff of 7) is mainly responsible for enforcement, though other departments participate as well.

SCS does not carry out on-site inspections; however, 580 company documents were examined in-house in 2004, and 104 administrative proceedings were carried out. SCS administrative proceedings are adjudicated by the Chairman of the SCS, and can be appealed administratively and in court.²³ Some enforcement cases of SCS on traded companies are available on the SCS website.

BSE can delist for breach of listing rules, and can suspend trading, but has never done so. The trading department is responsible for surveillance. BSE can issue fines only to members (brokers).²⁴

SECTION II: THE RIGHTS OF SHAREHOLDERS AND KEY OWNERSHIP FUNCTIONS

The corporate governance framework should protect and facilitate the exercise of shareholders' rights.

Principle IIA: The corporate governance framework should protect shareholders' rights. Basic shareholder rights include the right to:

Assessment: Partially Observed

(1) Secure methods of ownership registration	<p>Shares can be bearer and registered, and registered shares can be certificated or dematerialized (CC§989, 990). Banks must issue shares in registered form (Law on Banks §19.3). Companies with registered shares and 20 or more shareholders must keep their shares at a private registry or at NDC, while those with less than 20 shareholders have also the option of maintaining their own share registers(CC §106-2.2, 1078-34.6). In practice, the NDC maintains the registry of all companies except for International Bank.²⁵ There are about 300 firms who have not registered with NDC and have more than 20 shareholders. NDC acts as a depository and registry.²⁶</p> <p>Legal proof of ownership rights is provided by the NDC (for immaterialized shares) or a company-issued share certificate (for companies who keep their shares in physical form) (CC §1078-20.3, 1078-21). NDC keeps record of direct ownership only. Nominee ownership is recognized by law. NDC, brokers, and private registries can keep shares in the name of the nominee (CC§992-1.6, 1078-34.10, 1078-12-16). In practice, only brokers act as nominees. The concept of custodian is not defined in the law.</p>
(2) Convey or transfer shares	<p>There are no restrictions on the transfer of shares of open JSCs. Clearing and settlement of all securities traded on the BSE is conducted by the BSE, not NDC. DVP (delivery-versus-payment) is not fully attained. Settlement is real time on a gross basis. NDC handles all share settlement, on the basis of instructions received from the BSE.</p>
(3) Obtain relevant and material company information on a timely and regular basis	<p>Access to corporate information is generally difficult in Azerbaijan. By law, shareholders have the right to request from the company the register of shareholders once a year, the charter, and the annual report (CC §101-3.2, 106-2.3, 1078-43). In practice, companies consider this information confidential, and do not share it publicly, and in some cases may not file it with the relevant regulator. Market participants estimate that fewer than 5% of JSCs publish their financial statements and make them available to shareholders.</p>

²⁰ Presidential Decree on Implementation of the Azerbaijan Republic Law on State Budget for 2005, of December 29, 2004.

²¹ President Decree #161, of July 26, 1999.

²² SCS Rules on removal of violations in the securities market and conducting of supervision over the protection of the rights of investors, §3; Regulations of the SCS, §7.20, 11.16; Law on protection of investor rights on the stock market, §6, 7, 8.

²³ Code on administrative offences; Code on administrative offences.

²⁴ Law on protection of rights of investors on stock market, §11.

²⁵ Private registrars are allowed by law (licensed by the SCS) but only one is currently active, the Corporate Trust Agency, which services exclusively the International Bank.

²⁶ Presidential Decree #580, "About the National Depository System", of May 14, 1997.

(4) Participate and vote in general shareholder meetings	Shareholders have a general right to attend AGMs. Whether preferred shareholders are allowed to attend the AGM is left up to the company charter. Preferred shares vote on liquidation, reorganization, and issues concerning their rights, but they don't vote by law in case of non-payment of dividends (CC §106.1.3.5, 106-1.4, 106-1.5).
(5) Elect and remove board members	<p>Process. Supervisory boards must be formed in companies with more than 50 shareholders. The AGM has the exclusive right to elect and can remove the supervisory board by simple majority for JSCs and 75% majority for banks (CC §106-1.3.1, 107).</p> <p>Cumulative voting/proportional representation. The law does not provide for cumulative voting or proportional representation.</p>
(6) Share in profits of the corporation	Dividends are proposed by the supervisory board and approved (but cannot be increased) by the AGM, and cannot exceed corporate profits (CC §106-3, 107.1). There is no mandatory minimum dividend. A greater problem is the lack of profitability on the books, for a vast majority of JSCs, which are therefore not paying dividends.
Principle IIB. Shareholders should have the right to participate in, and to be sufficiently informed on, decisions concerning fundamental corporate changes such as:	
Assessment: Materially not Observed	
(1) Amendments to statutes, or articles of incorporation or similar governing company documents	Amendments of the company chapter require 2/3 rd s AGM majority in enterprises, and 75% majority for banks. This is an exclusive AGM right, by law (CC §107.1).
(2) Authorization of additional shares	<p>Issuing share capital. The AGM authorizes changes in share capital with 2/3rds in JSCs and 75% in banks (CC §107.1.1). Issuing share capital can be delegated to the supervisory board.</p> <p>Pre-emptive rights. Pre-emptive rights exist for closed JSCs. There are no provisions for mandatory preemptive rights for open JSCs, though the company charter may specify those rights (CC §101.1, 104.2). Thus, there have been cases of share issues solely to the controlling shareholder, excluding smaller shareholders and in some cases not even informing them of the capital increase.</p>
(3) Extraordinary transactions, including sales of major corporate assets	<p>AGM decisions on reorganization and liquidation require 2/3rds majority for enterprises and 75% for banks (CC §107.1.5).</p> <p>Sales of major corporate assets. The AGM approves transactions of more than 25% of net assets. The information on such transactions must be disclosed, according to procedures provided in the company charter (CC §99.3). There are no provisions for external assessment of such transactions, to assure that they occur at market prices.</p>
Principle IIC: Shareholders should have the opportunity to participate effectively and vote in general shareholder meetings and should be informed of the rules, including voting procedures, that govern general shareholder meetings:	
Assessment: Materially not Observed	
(1) Sufficient and timely information on date, location, agenda, and issues to be decided at the general meeting	<p>Meeting deadline. The AGM must be held annually. It is called by the supervisory board within 6 months of the financial year end (for companies with less than 50 shareholders, by the executive body). There is no requirement by law fixing the location of the AGM, so theoretically the AGM could be held outside of the country. 10% of voting shares can call an EGM (CC §107-1).</p> <p>Meeting notice. Notice must be published in the mass media 45 days before the AGM, and mailed to shareholders and nominees, who assure the transmission of the information to the beneficial owners.</p> <p>Information available. The notice includes the date, time, venue, and agenda, but does not provide background information on newly nominated directors, or auditor details.</p>

	<p>Quorum rules. The AGM quorum is 60% of voting shares on first call, 40% on second call, and 25% on third and fourth call.²⁷ If four attempts to achieve a quorum in a year are not successful, the SCS may initiate court proceedings to liquidate the company.</p> <p>AGM minutes must be prepared within 3 days, signed by the Chairperson and secretary of the meeting, and disclosed to shareholders within 15 days. A copy of the minutes must be provided to a shareholder upon request (CC §107-5.3, 107-6.1, 107-6.3).</p> <p>For banks, the AGM has an exclusive right to decide on changes of charter and of capital, election and dismissal of supervisory board, sale, reorganization and liquidation of bank (decisions taken by 75% majority), as well as election and dismissal of auditor commission and approval of audited financials (decisions taken by 50%). Approval of bank investments in other entities, appointment of external auditor, and appointment / dismissal of management board can be delegated to the supervisory board. The AGM is held within 2 months of the preparation of the audited annual report. The Controller's Board, Auditor Commission, the Supervisory Board, and 5% voting shareholders can call an EGM (Law on Banks, §24.1, 24.3, 24.5).</p>
	<p>AGMs are not regularly held, even in banks. It is difficult to provide a statistic on how many companies hold their AGMs, but SCS estimates at least a 30% failure rate. Only companies with a very large number of shareholders appear to hold AGMs regularly.²⁸ However, even in those cases, AGMs often lack sufficient authority in governing corporations. To the extent dispersed shareholders exist, those are employees who have received shareholder rights during privatization. Their share in companies has been dwindling, as controllers buy them out gradually, and in practice they are effectively excluded from the decision-making process, as AGMs are held pro-forma, and controlling shareholders tend to monopolize the meeting.</p>
(2) Opportunity to ask the board questions at the general meeting	<p>Forcing items onto the agenda. The law allows shareholders in principle to seek amendments to the agenda, but does not provide specific procedures for adding agenda items. Issues not on the agenda cannot be decided at the AGM (CC §106-1.3, 107-5.2).</p> <p>Questions. The law is silent on the right of shareholders to ask questions and be answered at the AGM.</p>
(3) Effective shareholder participation in key governance decisions including board and key executive remuneration policy	<p>In JSCs with more than 100 shareholders, the law provides for a counting commission of at least 3 members. The procedures for supervisory board election and procedures of the counting commission are left to the charter. In practice, shareholders vote by show of hands. Minutes of the counting commission are added to the AGM minutes (CC §107-4). Supervisory and executive pay is not disclosed or approved by the AGM.</p>
(4) Ability to vote both in person or in absentia	<p>Proxy regulations. Proxies are provided for by law and require a notarized power of attorney (CC §107-3, 362). They are sometimes used in practice. There are no regulations on the use of proxies, and no requirements, for example, that shareholders must instruct proxy-holders on voting preferences of the shareholder.</p> <p>Postal and electronic voting. The company charter can provide for voting by mail based on specific written voting institutions for each item on the agenda (CC §107-3).</p>
<p>Principle IID: Capital structures and arrangements that enable certain shareholders to obtain a degree of control disproportionate to their equity ownership should be disclosed.</p>	
<p>Assessment: Materially not Observed</p>	
<p>Classes of shares. A JSC can issue common and preferred shares. Preferred shares cannot make up more than 25% of company capital. Preferred shares do not convey the right to participate in company management, but the law allows them to vote on reorganizations, liquidations, and charter amendments which change preferred share rights. Other rights of preferred shares are left to the company charter (CC §106.2, 106-1). There are no minimum dividends for preferred shares by law, though the law provides that "as a general rule, a preferred share dividend [is a]... fixed percentage of the nominal value of those shares regardless of outcomes of economic activity of a joint-stock company" (CC §106.3-4). Preferred shares are rarely used in practice.</p>	

²⁷ Civil Code §107-1, 107-2. The second call is decided by the board and the information is published in the mass-media in 3 days and notice is sent about the second meeting to all shareholders or their nominees in 5 days. The second meeting should be announced during 3 days after the first one and held in period of not earlier than 30 and not later than 45 days after.

²⁸ As noted, there are 234 JSCs out of 1700 who have more than 100 shareholders.

Voting caps are allowed (CC §103.6). There is no requirement that disproportionate share structures be specifically disclosed, although some of those issues may be discussed in the company charter.

Ownership disclosure by companies. Shareholders have a right to request the shareholder register from the company once a year, and to receive it within 5 days (CC §106-2.3). Companies must disclose their shareholders with 10% or more holdings, in the annual report.²⁹ There is no requirement to disclose indirect and ultimate owners. The disclosure must contain the number of shares held, executive / board positions held, and (in case the owner is a legal entity), the members of its boards. Companies must disclose their holdings in related companies in the notes to their annual report (CC §124.4). SCS is responsible for monitoring and enforcement of ownership disclosure.³⁰ NDC, the State Registrar (Ministry of Justice), private registers, and companies themselves also by law must keep ownership information. In practice, official information on share ownership is unusually difficult to obtain in Azerbaijan. Enterprise registries are not yet publicly accessible, largely due to the absence of implementing regulations for public access—and lack of public awareness of the right to access to the information in the commercial registries. There have been no penalties by SCS on non-disclosure of ownership so far.

Fit and proper provisions for banks provide for NBA sanction of large bank owners. Specifically, banks inform NBA upon notification of any changes in the holdings of their direct and indirect 10% shareholders, including shareholders with “significant influence”, and enclose extensive information on the shareholder.³¹ Banks further have investment limits by law – they cannot own entities where their equity investment is more than 10% of the bank capital, or total equity investment in all owned entities is more than 40% of bank capital (Law of Banks, §30.1, 30.2).

Ownership disclosure by shareholders. Ownership disclosure by shareholders is not required by law.

Disclosure of shareholder agreements. Shareholder agreements disclosure is not required, and there is no practice to conclude written agreements in open JSCs, though informal agreements are common.

Principle IIE: Markets for corporate control should be allowed to function in an efficient and transparent manner.

Assessment: *Materially Not Observed*

(1) Transparent and fair rules and procedures governing acquisition of corporate control

Basic description of market for corporate control. Currently there is no takeover law or regulation that would require an investor to offer to buy all the shares of a company after buying a minimum percentage, such as 25 percent or 50 percent, and the legislation does not envisage tender offers. To date, there has been only limited trading on the Baku Stock Exchange and none included tender offers. Virtually all share trading is conducted by brokers or through notaries and the share transfer registered through changes to the shareholders’ register. As a result, transparency pricing is rare—so much so that the BSE argues that calculation of market capitalization based on the registered trades would be meaningless. The market for corporate control in Azerbaijan is also limited by the substantial presence of business groups, as well as by concentrated ownership.

Control transactions of banks are carried out with NBA permission (Law of Banks, §29).

Tender rules/mandatory bid rules. Tender rules, mandatory tender offers, squeeze-out rules and associated fair pricing provisions are not currently mandated by law.

Delisting/going private procedures. Going private decisions are taken by the AGM with 2/3rd majority. There are no rules governing the process of buying out shares on-exchange in order to take the company private. Terms (price) of going-private transactions off exchange are to be decided by the AGM (CC §105-1.3). In a recent case, an open JSC attempted to transform itself into a closed JSC in order to eliminate a large part of its minority shareholders. SCS requested the Ministry of Justice to stay the company’s registration as a closed JSC, due to the illegality of the company’s actions.³²

Abuse to buy-backs/treasury shares. Price, quantity, and disclosure of transactions where companies buy back their own shares on-exchange are not regulated. Off-exchange, the price of the transaction must be approved by the AGM. There are no limits on the amount of bought-back shares, except in consideration of minimum capital requirements. Treasury shares cannot be voted and need to be either re-sold or cancelled within a year (CC §105-1.5).

²⁹ Regulation on preparation and disclosure of annual reports of issuers of investment securities §2.2.8; Civil Code §1078-47.1.4.

³⁰ Code on administrative offences, §206, 220, 324.

³¹ Law on Banks, §22.2, 22.3, 22.4, 22.8 & 22.9. The information includes, for a legal entity, audited financial reports for the last 3 years, auditor opinions, the list of board members, and the list of 10% stakes of banks or other legal entities in their capital; for an individual, the information filed includes a list of legal entities owned and controlled; and for both legal entities and individuals, a list of their 10% stakes in banks or other legal entities.

³² March, 2005, “Janubtikintiservis” JSC.

(2) Anti-take-over devices	There are no anti-takeover provisions in the law. Voting caps are allowed (CC §103.6).
Principle IIF: The exercise of ownership rights by all shareholders, including institutional investors, should be facilitated.	
Assessment: Not Observed	
(1) Disclosure of corporate governance and voting policies by institutional investors	<p>General obligations to vote/disclosure of voting policy. There are no regulations. Institutional investors are rare (if any) on the Azerbaijan market.</p> <p>Special rules for institutional investors/pension funds. There are no regulations. There are no private pension funds and mutual funds in Azerbaijan so far.</p> <p>Blocked shares/record date. There are no regulations on record dates. Shares are not blocked before the AGM.</p>
(2) Disclosure of management of material conflicts of interest by institutional investors	There is no disclosure of management of material conflicts of interest by institutional investors, and there are few if any institutional investors on the market.
Principle IIG: Shareholders, including institutional shareholders, should be allowed to consult with each other on issues concerning their basic shareholder rights as defined in the Principles, subject to exceptions to prevent abuse.	
Assessment: Partially Observed	
<p>Rules on shareholder cooperation in board nomination/election. No rules exist.</p> <p>Rules on communication among minority shareholders. No rules exist.</p> <p>Proxy solicitation or other formalities required. No rules exist.</p> <p>Rules on communication among institutional investors. No rules exist.</p>	
SECTION III: THE EQUITABLE TREATMENT OF SHAREHOLDERS	
The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.	
Principle IIIA: All shareholders of the same series of a class should be treated equally.	
Assessment: Materially not Observed	
(1) Equality, fairness, and disclosure of rights within and between share classes	<p>Availability of share class information. By law, information about the voting rights attached to all classes of shares should be included in the prospectus, as well as the charter. In practice, access to such information is limited.</p> <p>Equal rights within classes. All shares within one class have the same rights by law.</p> <p>Approval by the negatively impacted classes of changes in the voting rights. Preferred shares have the right to vote, together with common shares (not as a class), on any changes in preferred share rights (CC §106-1.5).</p>
(2) Minority protection from controlling shareholder abuse; minority redress	<p>Shareholders have few effective redress possibilities.</p> <p>Ability to call meeting. 10% of voting shares can call an EGM for JSCs, and 5% in the case of banks (CC §107-1, law on Banks §24.5).</p> <p>Withdrawal rights. There are no shareholder redemption rights that would allow a shareholder to demand that the company redeem his shares if he/she did not vote in favor of, for example, a charter amendment that substantially violates his/her rights or mergers, divisions or transformations or the purchase, disposal or exchange of real estate at less than book value. The Civil Code contains a very general provision that allows shareholders to request withdrawal of shares if allowed by law or company charter, but no specific procedures or conditions have been outlined (CC §105-1.1).</p> <p>Independent audit. 10% of shareholders can request an inspection of the company by the revision committee, and can also request a company audit (CC §106.6).</p> <p>Ability to sue to overturn meeting decisions. A shareholder has the right to dispute an AGM decision in court, though the law does not specify the grounds for dispute (CC §107-5.4). Given the inefficiency of the court system, this right has little value to shareholders.</p>

	<p>Regulatory Redress. Shareholders can turn to the SCS for protection of their rights., and instances of that have occurred. The SCS may investigate violations of laws and regulations related to companies issuing shares. Decisions by the SCS may be appealed to the court. SCS can conduct administrative hearings and impose direct penalties as a result, but cannot assess damages that a company would pay to shareholders without a court decision.</p> <p>The SCS fines by law are US\$28-99 for individuals and US\$99-330 for legal entities, which is relatively low for serious prevention. There were 104 fines imposed in 2004, totaling US\$72,205. The majority of fines were issued for improper AGM procedures, 27 for infraction of investor rights, 10 for failure to maintain a proper shareholder register. Collections are carried out via the bailiff service, and about 50% of the fines have been collected so far for 2004. There were 104 administrative hearings held in 2004, 12 appeals and no reversed decisions.</p> <p>Ability to sue directors. Shareholders have a general blanket civil law right to a lawsuit, which in theory would apply also to supervisory board and management board members.</p> <p>Signatories of disclosure documentation are responsible for the false disclosure (CC §1078-11.7).</p> <p>General court redress. Shareholders can turn to the court for redress. Disputes among legal entities are tried at the Economic Court; those where one party is an individual are tried at the general court.³³ Court proceedings can be indefinitely prolonged, and are reputed to be partial. The enforcement of shareholder rights appears to be difficult given the weaknesses in the court system, i.e., high case loads, lack of familiarity by judges of the issues presented in shareholder rights cases, as well as the low level of shareholder awareness of their rights. The legislation allows direct and derivative suits, but provides no thresholds thereto (class action suits are not provided for). There have been some court cases on shareholder or securities issues.</p>
(3) Custodian voting by instruction from beneficial owners.	<p>The law does not provide for custodians. Nominees whose name appears in the shareholder register are required to forward the AGM agenda to beneficiary owners. Nominees must receive voting instructions from beneficiaries.³⁴</p> <p>The manner of voting blank or abstaining votes is not addressed in the legislation. The votes of shareholders not present or represented at the meeting are not counted.</p>
(4) Obstacles to cross border voting should be eliminated.	<p>There are no shares held in depository receipt form. There are few foreign investors, who hold significant or majority stakes, and do not engage in portfolio investment.</p>
(5) Equitable treatment of all shareholders at GMs	<p>The legislation provides only limited guidance for AGMs and thus little provision to ensure equitable treatment of all shareholders. It appears that company procedures do not generally make it unduly difficult or expensive to cast votes.</p>
Principle IIIB: Insider trading and abusive self-dealing should be prohibited.	
Assessment: Partially Observed	
<p>Basic insider trading rules. Insiders are defined as persons who currently or in the past 6 months have been members of the supervisory and management board, or 10% shareholders. Also considered as insiders are others in position to obtain non-public information (including via contracts or via insiders), and persons under the influence of the management or the supervisory board. Family members of insiders are specifically designated as insiders by law. Insiders cannot trade on inside information, or disclose it to third parties.³⁵ Blackout periods are not specified in the legislation.</p> <p>Disclosure of wrong or misinterpreted information in the equity market, and carrying out unfair advertisements is forbidden, as is instigating other persons to trade providing wrong, misinterpreted or insider information. Price manipulation, churning and similar activities are banned.³⁶ The 2004 insider trading rules may not be perfectly aligned with existing Civil Code legislation.³⁷</p>	

³³ Civil Procedure Code, Section 3.

³⁴ Civil Code, §107-1.4, 1078-34. Nominees must be instructed by the beneficiary owner in order to exercise any rights over the nominee shares. Nominees inform the registry within 3 days of trades they have concluded, and submit a list of beneficiary owners within 7 days of registry's request.

³⁵ SCS Regulations on storage, use and presentation of service information in the equity market, §2.2, 3; Civil Code, §1078-47.

³⁶ Regulations on prevention of manipulations with prices in the equity market, §2.1.

³⁷ For example, Civil Code §107-10.6 requires, in a somewhat unprecedentedly strict rule per international practice, that supervisory and

Insider trading disclosure. Insiders should file with the SCS their trades within one day. SCS may request additional information, and if such information is not provided, penalize the insider, interrupt the trade or apply to court to reverse it, as well as publish the transaction in the media.³⁸ The law is too new to foresee how it would function in practice.

Criminal/civil/administrative penalties. SCS is charged by law with monitoring the market in order to prevent insider trading abuse. The BSE trading department prepares daily reports to SCS on trading activities, and also monitors insider trading. NDC ownership information is also used in insider trading monitoring. The law provides administrative, but not criminal, sanctions for insider trading. Sanction amounts are not specified by law currently. Professional participants should stop insider transactions after they have been cleared, and inform SCS (CC §1078-47.3, 1078-47.4). The importance of insider trading regulations is limited by the low levels of liquidity of the Azeri stock exchange and the small size of the Azeri business community.

Principle IIIC: Members of the board and key executives should be required to disclose to the board whether they, directly, indirectly or on behalf of third parties, have a material interest in any transaction or matter directly affecting the corporation.

Assessment: Not Observed

RPT disclosure rules. RPT regulations are rudimentary and incomplete. RPTs of executive board members are disclosed to and approved by the supervisory board (CC §107-10.5). The information to be disclosed to the supervisory board is not stated in the law. RPT regulations do not extend to members of the supervisory board or 10% shareholders, and do not require AGM approval. Related loans are allowed. RPT disclosure to the public, and filing of RPT information with the SCS is not regulated. Sanctions, including transaction reversal and liability, are not specifically determined by law in the case of RPTs. SCS does not monitor RPTs. Market participants opine that RPTs are prevalent especially in context of financial-industrial groups with "pocket" banks.

The NBA has a detailed RPT regulation on banks, but enforcement has been limited so far to warnings and some transaction reversals upon discovery of infraction. Members of the supervisory and management boards and the auditor commission disclose to the supervisory and management boards their and their family members' major commercial interests, at a frequency and per procedures specified internally by the bank. RPTs are approved by the supervisory board, with reclusion (Law of Banks, §28). The supervisory board notifies NBA of reported or discovered conflict of interest, as well as calls an EGM where it presents its decisions on the issue. Related parties are defined as members of the supervisory and management board, as well as all committees, employees, their families, 10% shareholders in the bank and in any entities controlled by the bank. The rules also limit related loans of banks to 10% for loans to legal entities, and 3% to individuals, with the provision of full collateral coverage, on market terms (Law of Banks, §34.2.5).

Disclosure of indirect and third parties' material interest. Not provided by legislation.

RPT approval rules/rules for approval of board/AGM. Specific rules for RPT approval by the supervisory board are not provided in the legislation. The AGM does not approve or receive disclosure on RPTs.

Conflict of interest rules and use of business opportunities. For JSCs, there are no specific rules on insiders using company business opportunities for personal gain, or involvement of company insiders in the ownership or governance of competitor companies. In the case of banks, management and supervisory board members have a duty to never use a business opportunity which they learn of in their capacity as members of their bank's boards without first fully describing such opportunity to the supervisory board and offering it exclusively to their bank.³⁹

SECTION IV: THE ROLE OF STAKEHOLDERS IN CORPORATE GOVERNANCE

The corporate governance framework should recognize the rights of stakeholders established by law or through mutual agreements and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises.

Principle IVA: The rights of stakeholders that are established by law or through mutual agreements are to be respected.

Assessment: Partially Observed

List of relevant codes for stakeholders. The level of awareness of corporate social responsibility is weak. There are no specific legal provisions that require that the company recognize the rights of stakeholders or encourage active cooperation

management board members disclose their intention to trade shares *prior* to the insider trade, in the media.

³⁸ Regulations on storage, use and presentation of service information in the equity market, §2.4, 2.5, 4. The additional information includes: date and venue of insider trade; whether it was a buy or sell; the identity of the sides to the trade; name of the issuer; type of the security traded, its nominal value and state registration number; and amount and price of the trade.

³⁹ Regulation on implementation of corporate governance standards in banks, §7.4.2.

with the stakeholders. Labor relations are governed by the Labor Code. An employee can join trade unions or other representative bodies or public organizations, and take part in strikes, meetings, gatherings and other mass actions.⁴⁰ During the privatization program, employees were entitled to obtain company shares.⁴¹ Creditor rights are regulated by the Civil Code and the Law on insolvency and bankruptcy.⁴² Corporate duties related to consumers are provided in the Civil Code and the Law on Consumer Protection.⁴³ Corporate duties related to the environment are outlined in the Law on Protection of the Environment and the Law on Underground Oil Exploitation.⁴⁴ There are no voluntary codes on stakeholder rights.

Principle IVB: Where stakeholder interests are protected by law, stakeholders should have the opportunity to obtain effective redress for violation of their rights.

Assessment: Partially Observed

Redress mechanisms available to stakeholders. The court and relevant Ministries are empowered to conduct enforcement and may provide redress.

Principle IVC. Performance-enhancing mechanisms for employee participation should be permitted to develop.

Assessment: Not Observed

Rules on employee stock option plans. Employee Stock Ownership Plans are not regulated by law.

Principle IVD: Where stakeholders participate in the corporate governance process, they should have access to relevant, sufficient and reliable information on a timely and regular basis.

Assessment: Not Observed

Annual report discloses economic and financial prospects. There are no regulations in this regard.

Annual report discloses significant facts on employees. There are no regulations in this regard.

Information is sufficient and reliable. Information is not available on stakeholders.

Information is timely and regular. Information is not available on stakeholders.

Principle IVE: Stakeholders, including individual employees and their representative bodies, should be able to freely communicate their concerns about illegal or unethical practices to the board and their rights should not be compromised for doing this.

Assessment: Not Observed

Whistleblower rules. There are no whistleblower regulations by law.

Principle IVF: The corporate governance framework should be complemented by an effective, efficient insolvency framework and by effective enforcement of creditor rights.

Assessment: Materially Not Observed

Effectiveness of bankruptcy, security/collateral, and debt collection/enforcement codes. Bankruptcy and collection procedures are notoriously slow and ineffective. Some recent reforms have been introduced in the area of credit registries, leasing, and reforms are contemplated in the legislation on pledges. Creditors cannot block a dividend distribution by law. Creditors have the right to call in their debt upon reduction of the charter capital of a debtor (CC §105.2). There are no early warning mechanisms for financially distressed debtors. The legal regime does not restrict trading in the companies stock when it is effectively insolvent. Azerbaijan compares unfavorably in debt collection but slightly better in bankruptcy than regional averages, and is significantly worse than OECD averages in those areas:

Indicator	Azerbaijan	Regional	OECD
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⁴⁰ Labor Code, §9.

⁴¹ State Program II of privatization; State Program on Poverty Reduction and Economic Development.

⁴² Briefly, they are, to call on and execute the debt of individual and legal entities; to claim their dues from relevant third parties; and to request the bankruptcy of the debtor.

⁴³ Briefly, those are the right to goods and services consistent with government standards; and the right to information on origin, brand name, production date, "use by" date, and other relevant information.

⁴⁴ Briefly, those are: to undertake measures on environmental protection; to obey limits on hazardous waste; to develop internal regulations on ecology norms (eco audit, eco passport etc); and to report periodically to the relevant authority.

		Average	Average
Cost to create collateral (% of income per capita)	9.2	7.7	5.2
Legal Rights Index – creditors	6	5.4	6.3
Credit Information Index	0	2	5
Public credit registry coverage	0	6.3	76.2
Private bureau coverage	0	46.7	577.2
Time for bankruptcy procedures (years)	2.7	3.3	1.7
Cost for bankruptcy procedures (% of estate)	8	13.1	6.8
Recovery rate for bankruptcy procedures (cents on the dollar)	33.2	30.5	72.1

Source: Doing Business data 2005, <http://rru.worldbank.org/DoingBusiness/>.

SECTION V: DISCLOSURE AND TRANSPARENCY

The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company.

Principle VA: Disclosure should include, but not be limited to, material information on:

Assessment: Materially not Observed

(1) Financial and operating results of the company

Annual report. All JSC must prepare and publish audited financial statements (CC §99.2, 100.3, 1078-43.1, 1078-43.3). Companies are not required to file consolidated financial statements. JSCs must publish and submit to SCS their annual report, material information, and prospectus (§1078-43.1). The annual report must contain, among other information, balance sheet, income statement, auditor's report, the number of shareholders, a list of 10% shareholders (name, number of shares held, percent of capital held), 10% or higher holdings of the company in other legal entities; name of share register that the company uses or a note confirming that the register is being kept by the company, and information on the AGM (date, place, minutes). The notes to the financial statements must also include by law a list of management and supervisory board members, as well as management and supervisory board pay (CC §124.3, 124.6). There is no requirement for the annual report to include a cash-flow statement, and no rule to publish the annual accounts notes in the media. The annual report must be filed with the SCS within 15 days of the AGM, and published in the mass media within 30 days (i.e., within 7 months of the end of the financial year).⁴⁵ Since the regulation dates as of 2004, there has been no opportunity to observe compliance with annual report filings before July 2005. SCS is responsible for enforcement. JSCs in practice rarely publish and file full annual reports, but few larger firms may publish key figures in the press.⁴⁶

Banks must prepare and file with the NBA, publish in the mass media and on their webpage, and provide to shareholders as well as clients (upon request), audited consolidated financials prepared in accordance with IFRS, within 5 months of the end of the financial year. The disclosed financial information must be signed by the Chairman of the Management Board and the Chief Accountant (Law of Banks, §12, 45.1). In practice, 15-20 banks do publish annual reports.

There are no requirements for the publication of information for non-JSC companies.

Semi-annual and quarterly reports, current reports. There is no requirement for filing semi-annual or quarterly reports. Filing with SCS cannot be done electronically.

Prospectus. By law, the prospectus contains, among other information, a list of 10% shareholders, information about management, executive and control bodies of issuer, charter capital and its structure, last balance sheet and income statement, last 5 years of dividend payments, rights of preferred shares (CC §1078-11.6, 1078-12). In practice, few companies have issued a prospectus.

Charter. The charter contains the type, nominal value, and amount of shares issued by the company; amount of the charter capital; rights of shareholders; composition and powers of managerial bodies; procedures for adoption of decisions by the managerial bodies. Companies must make the charter available to shareholders (§47.2, 102.4, 130.3). Charters are unusually difficult to obtain. Since December 2004 the Ministry of Justice

⁴⁵ Regulations on preparation and disclosure of issuers' annual reports, §2.2, 3; Civil Code §107.6, 121.1, 124, 1078-43.3.

⁴⁶ Market participants estimate that about 100-200 of the 1700 JSCs do so, while the SCS estimate is 25% of JSCs.

	<p>provides some basic information, on newly registered companies only, but not the charters. Bank charter rules are somewhat stricter, and charters and changes thereto are filed with NBA within 5 days.⁴⁷</p> <p>Companies are required by law to provide an investor any public information upon inquiry.⁴⁸ In practice, reporting requirements are not currently observed. SCS monitors compliance via inspections based on complaints received. SCS can issue notices, warnings, fines, suspend trading, void transactions and limit company operations causing the infraction.⁴⁹ No sanctions on disclosure have been applied yet. NBA, SCS, and the State Registry each keep different documentation, which may also create inconveniences for an investor interested in obtaining a complete set of information on a given company.</p> <p>The BSE financial information department works with companies on their disclosure compliance, and are planning the creation of a database of company disclosures.</p>
(2) Company objectives	<p>Companies with assets of more than US\$1,000,000 and revenue over US\$500,000 must present a report of the "state of affairs", containing plans for the following financial year.⁵⁰</p> <p>Bank supervisory or management boards must develop a strategic plan and mission statement of the bank, confirmed by the AGM, and planning for at least the following 3 years, which must be regularly reviewed.⁵¹</p>
(3) Major share ownership and voting rights	<p>Companies must disclose their shareholders with 10% or more holdings, in the annual report. There is no requirement to disclose indirect and ultimate owners. There is no compliance with these provisions currently.⁵²</p>
(4) Remuneration policy for board and key executives, and information about directors	<p>The names of the members of the supervisory board must be filed with the company register, as well as reflected in the annual report. The notes to the financial statements must contain information on salary, profit shares, reimbursements, insurance costs, commissions and other payments to supervisory and management board members. Payment for services rendered to the company other than as a board member must be reported separately. Pensions and other compensations for past supervisory and management board members should be reported in the notes as well, with separate entries for members who also receive similar compensation from associated entities (CC §124.3). In practice, easy public access to the company register or the annual report is not yet in place and such information may be difficult for shareholders to obtain.</p>
(5) Related party transactions	<p>There are no RPT disclosure requirements in the annual report. The National Audit Standard 33 on related parties 2003 introduces some rules in this regard by law, but is not being applied yet. These transactions are not transparent.</p>
(6) Foreseeable risk factors	<p>There are no legal requirements for disclosure of issues regarding risk factors. Banks must address risk factors in the notes to the financial statements.</p>
(7) Issues regarding employees and other stakeholders	<p>There are no specific requirements for disclosure of issues regarding employees and other stakeholders.</p>
(8) Governance structures and	<p>There is no legal requirement for disclosure of a company's governance structures and</p>

⁴⁷ Law on Banks, §20. In the case of banks, the charter contains, among other standard charter-type information, the organizational and managerial structure of the bank, including its operational and administrative departments, their divisions and functions, subordination and reporting procedures; the responsibilities of the head of departments and divisions, managed and controlled by the bank; the functions of the internal audit service, other permanent internal commission and committees; the authorities of bank administrators and heads of structural units on implementation of banking activities; and the rules for appointment and dismissal of administrators of branches and divisions, as well as their authorities for implementation of banking activities. A copy of the notarized bank certificate, internal procedures, and the list of bank executives with signatory powers is filed with the NBA as well.

⁴⁸ Regulation on protection of rights of investors on stock market, §3.1.

⁴⁹ Code on administrative offices, §206.0.1, 206.0.5, 214, 324; Law on protection of the rights of investors, §6, 8, 9, 11.

⁵⁰ Civil Code, §122.1, 125, Resolution #77 of the Cabinet of Ministers of 5 April, 2001; Decree #386 on approval, enforcement of the Civil Code and legal regulation of problems arising from them, 2000.

⁵¹ Regulation on implementation of corporate governance standards in banks, §3.

⁵² Regulation on preparation and disclosure of annual reports of issuers of investment securities, §2.2.8; Civil Code, §124.4, 1078-47.1.4. The disclosure contains the number of shares held, executive / board positions held, and (in case the owner is a legal entity), the members of its boards. Companies disclose their holdings in related companies in the notes to their annual report.

policies	policies.
Principle VB: Information should be prepared and disclosed in accordance with high quality standards of accounting and financial and non-financial disclosure.	
Assessment: Materially Not Observed	
<p>Compliance with IFRS. In spite of the progress achieved, significant gaps exist between IFRS and the Azeri Accounting system applicable to the enterprise sector, and to a much lesser extent, banks.</p> <p>The new Law on Accounting 2004 makes a significant step towards improving accounting standards. It requires public interest entities to prepare consolidated IFRS audited statements starting from 2006.⁵³ National Accounting Standards must be adopted for commercial entities other than public interest entities and SMEs. Public interest entities will be required to post their financials on their websites, including the auditor report, publish those in the press, and provide them upon request. The company charter would determine which governing body is responsible for preparation, presentation, and publication of the financial statements (Law on Accounting, §6.0.2, 10.1, 10.3, 12.3, 12.4). Banks prepare audited consolidated IFRS statements (Law on Banks, §43.1, 43.2, and 44.1). In practice, Azeri financial reporting is moving only slowly towards international standards and IFRS are utilized minimally in the non-banking sector, usually in firms with some foreign participation. Some JSCs still use tax accounting standards. 24 of the 42 banks are using IFRS, though some important parts of the notes may be missing. It is important to note that presenting IFRS statements without ISA audit falls short of good practice, as the notes to the financial statements, containing important information, are missing.⁵⁴ For additional information, see the Country Financial Accountability Assessment (CFAA).</p> <p>Review/enforcement of compliance. Per the Law on Accounting 2004, the state accounting supervisor is given the right to develop standards, but not the effective power to enforce. Accounting rules and financial statements format for credit organizations is determined by the NBA with the consent of the accounting state regulator (Law on Accounting, §4.4). Unreliable financial reporting is an important issue for corporate governance in Azerbaijan.</p>	
Principle VC: An annual audit should be conducted by an independent, competent and qualified, auditor in order to provide an external and objective assurance to the board and shareholders that the financial statements fairly represent the financial position and performance of the company in all material respects.	
Assessment: Materially Not Observed	
<p>Compliance with ISA. An audit conducted in accordance with Azeri auditing standards provides less assurance than an audit conducted in accordance with ISA. Although Azeri Auditing standards are in the process of converging with ISA, these standards are not enforced in the spirit of ISA. For additional information, see the Country Financial Accountability Assessment.</p> <p>Who must be audited. JSC, all banks, and legal entities above a certain size must have their financial statements externally audited,⁵⁵ but the absence of a well-developed auditing sector may hinder the effective implementation of the Law. By estimates of market participants, only 20% of open JSCs actually undergo an external audit.</p> <p>Auditor independence. A licensed auditor cannot be connected with the company or its shareholders / managers through property interests, or through being a prior employee of that company.⁵⁶ There is no mandatory auditor rotation. Auditors are not generally barred from performing other services.⁵⁷ Auditor fees for other services are not disclosed.</p> <p>Audit committee. Companies are not required to have an audit committee. Banks have a mandatory auditor commission, and all JSCs have a revision commission, which are not board committees, and are discussed below.</p> <p>Requirements for oversight of audit. The law does not specify the governing body which has a right to appoint / dismiss and compensate the external auditor in JSCs. For banks, the law mandates the AGM to appoint the auditor, but appointment / dismissal can be delegated to the supervisory board, which also determines compensation. Auditors have the right to full information needed for the audit, including inspection of inventories and other assets if needed. They can request explanations from management and employees, and can refuse to audit due to insufficiency of information provided. Auditors are required by law to report infractions discovered to the state organs only in limited circumstances.⁵⁸</p> <p>Audit services are regulated by the Chamber of Auditors, whose members are approved by Parliament. The Chamber also updates existing legal documents and drafts standards of audit, as well as ensures monitoring and enforcement, by law. The</p>	

⁵³ Law on Accounting, §2.9, 6.0.1, 8.1, 8.2, 10.2, 17. Public interest entities are defined as credit organizations, insurance firms, investment funds, private social funds, issuers, commercial organizations above a certain size.

⁵⁴ While Article 43.1 of the Law on Banks requires that banks prepare their financial statements in accordance with IFRS, Article 44 does not require audits in accordance with ISA.

⁵⁵ Civil Code, §99.2, 107.6, 122.1, 126.1; Law on Banks, §44; Rules on preparation and disclosure of annual reports of issuers.

⁵⁶ Civil Code §107.6, 126.5, Law on Auditor Services §18, Code of Professional Ethics of Auditors, section 8.

⁵⁷ Except broker/dealer, investment adviser, or investment banking services. Civil Code §1078-28.4, Code of Professional Ethics of Auditors, sections 9 and 10.

⁵⁸ Law No. 882 on Auditor Services 1994, §12.

Chamber has the disciplinary powers of warning, inspection, and de-licensing of auditors. The Chamber also resolves disputes between auditors and clients (and failing that, the conflict would proceed to the court). The Chamber can revoke an audit license only in extreme cases, namely for low quality of audit occurring at least 3 times in a year, for obtaining a license under false pretenses, or for gross infraction of the law.⁵⁹ The institutional arrangements governing the audit function fall short of generally accepted good practices and undermine audit quality. The Chamber uses its scarce staff resources sparingly for inspections, only in the case of complaint or grave suspicion. For the first time since its creation, the Chamber revoked the licenses of three individual (independent) auditors in 2005 for gross violations. This presents a significant deficiency because there is no competent and legitimate oversight body to monitor auditors.

Audit enforcement competent/qualified. As of end 2004, there were 42 local auditing firms, 5 international firms, and 51 independent (individual) auditors. There are wide ranging differences in audit quality, which leads most in-country stakeholders to disregard audit opinions. The local audit profession contributes only marginally to the enforcement of accounting standards. The market share of local audit services has risen from 7% in 1997 to almost 50% in 2004, raising the issue of audit quality and begging the question of the urgent need for the development of a second tier of local reputable companies. Local member firms of international audit firm networks are generally more reliable. In this regard, the existing enforcement mechanisms require improvement. 16 banks are audited by a big four firm. Other financial companies, the oil sector, as well as companies involved with foreign capital, use those audit firms as well. The remaining companies use local audit services. In 2003, 221 larger firms were audited by foreign audit firms.⁶⁰

For banks, in addition to a standard audit report as provided by law, the auditor also prepares a statement on completeness and truthfulness, and informs NBA on infractions and deficiencies. NBA may demand the replacement of a bank's auditor and a repeat audit at the bank's expense. NBA also inspects banks itself or via an external auditor at least once a year, and can request accounting books, documentation and other records, clarifications, as well as require from the supervisory and management board, large shareholders, employees and others all necessary information (Law on Banks, §44, 46). SCS is not involved in auditor oversight.

Auditor qualifications. Auditors are certified by the Chamber of Auditors. For certification, they must have a higher education in accounting, finance, economics or law and a minimum of 3 years of professional experience, and must have passed the professional licensing exam of the Chamber of Auditors (Law on Auditor Services, §6).

Statutory auditors or similar company organs. Companies with more than 50 shareholders must have revision committees, elected by the AGM, and functioning per provisions in the company charter. There are no rules on the number of members, but they cannot be shareholders, or members of the supervisory or management board. The revision committee does not attend supervisory or management board meetings, and there are no expertise requirements. It reports on the annual financial statements to the AGM, and can require the needed documentation from management (§107-11). It also conducts a company inspection upon the request of 10% of shareholders. The revision committee is not an adequate replacement of a fully independent audit committee.

Banks are required to maintain an auditor commission, elected and compensated by the AGM.⁶¹ The committee is composed of at least 3 members, and elected and compensated by the AGM.⁶² Quorum is at 50% of members, meetings must occur at least quarterly, and members are under certain independence and eligibility restrictions.⁶³ The duties of the auditor committee include oversight of the external auditor reports, the internal audit and control systems, and/or risk management system (Law on Banks, §27). The auditor committee does not recommend the appointment / dismissal / compensation of the external auditor, nor review / approve RPTs or large transactions. The auditor committee functions are likely adequate given the current needs for such an organ in Azerbaijan; however, in the long term a fully independent audit committee as part of the supervisory board would be a better vehicle for oversight.

Implementation of auditor commissions in practice is at an early stage. Though the majority of banks have formed such commissions, it is doubtful whether at this stage even existing auditor commissions meet regularly, or understand their functions. Further, auditor commissions are beholden to the controlling party, and in practice there may be overlap and confusion between the functions of an auditor commissions and those of the internal audit organs (the revision committee, see below).

Principle VD: External auditors should be accountable to the shareholders and owe a duty to the company to exercise due professional care in the conduct of the audit.

Assessment: Materially Not Observed

⁵⁹ Law on Auditor Services, §9, 15, 19, 20; Charter of the Chamber of Auditors 1995, §1, 8.

⁶⁰ "Audit of Azerbaijan", Chamber of Auditors, 2004.

⁶¹ Regulation on implementation of corporate governance standards in banks §5.5.7; Law on Banks §24, 27.

⁶² For up to 4 years, and re-election is permitted..

⁶³ Members of the committee cannot be members of other governance bodies of the bank (with the exception of the AGM); cannot take other employment positions at the bank; cannot be relatives to members of the supervisory board, auditor commission and management board, or the chief accountant; and cannot be government employees (Law on Banks, §10). The committee members must have higher education in economics or law, or work experience.

Auditor accountability. Appointment and dismissal of the external auditor is decided by the AGM and can be delegated to the supervisory board (CC §126.4; Law on Banks, §24.1, 24.3). The auditor in practice interacts with, and reports all findings to, the controlling owner, which fails to provide adequate checks and balances. Civil law allows lawsuits against auditors in principle (via a generic provision allowing general lawsuits), but there have been no cases.

Auditor liability. Auditors have voluntary obligations under the Code of Professional Ethics of Auditors developed by the Chamber of Auditors. Further, by law auditors must carry out the audit "objectively and in good faith", and maintain confidentiality, or they carry liability for compensation of losses (CC §126.6). Liability provisions are vaguely defined and do not realistically permit auditor lawsuits by shareholders.

Auditor insurance. Auditors are not required to, and typically do not, purchase auditor liability insurance.

Principle VE: Channels for disseminating information should provide for equal, timely and cost-efficient access to relevant information by users.

Assessment: Materially Not Observed

Corporate information is rarely available. Few companies file their annual reports with SCS or publish them. Charter information is not available due to the limited accessibility of documentation at the State Registrar. Material facts are not routinely disclosed in the media. Ownership information is not in practice provided by companies. The prospectuses of some companies are provided on the BSE website.

Material facts. Information on main events and actions exerting an influence on the financial-economic activity of the issuer must be disclosed within 15 days of occurrence to the SCS, by law (CC §1078-43.4). There is no detailed definition of materiality or examples to guide companies in their disclosure. There is no disclosure of material facts in practice.

Published information (papers, web). Some banks publish their annual reports in the media and on their website. Some JSCs also publish basic annual figures in the press.

Principle VF: The corporate governance framework should be complemented by an effective approach that addresses and promotes the provision of analysis or advice by analysts, brokers, rating agencies and others, that is relevant to decisions by investors, free from material conflicts of interest that might compromise the integrity of their analysis or advice.

Assessment: Not Observed

Disclosure of conflicts of interest by analysts, brokers, rating agencies, etc. Conflicts of interest or the relationship between brokers, investment management companies, and banks are not regulated. There are no analysis or rating agencies in the market. Recent regulation with a grandfather clause forbids banks to possess broker licenses necessitating the brokerage business to be operated via a subsidiary.

SECTION VI: THE RESPONSIBILITIES OF THE BOARD

The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders.

Principle VIA: Board members should act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the company and the shareholders.

Assessment: Materially Not Observed

Basic description of board. The executive body of a company can be collective (called "managing board" or "directorate") or individual (referred to as a "director" or "general director") (CC §107.4). The responsibilities of the management board may be contractually delegated to a third party, e.g., a commercial entity or an individual entrepreneur (CC §107.4). JSCs with 50 or more shareholders also have a supervisory board which oversees management, and members of the management board cannot sit on the supervisory board. By law, management powers are vested with the management board; however, in practice members of the supervisory board, usually the controlling owner or a closely related party, tend to micro-manage the company, out of their permanent offices on company premises. The specific authorities, functioning of the supervisory board, including frequency of meetings, size, and decision-making procedures, are left to the company charter (CC §107).

The supervisory board of banks is composed of at least 3 members, and elected and compensated by the AGM (CC §107). Quorum is at 50% of members, and meetings must occur at least quarterly. The supervisory board of a bank oversees management and reports to the AGM. The board is also responsible for reporting internal violations to the AGM and the NBA, management of internal conflicts of interest, and approval of RPTs and of large transactions.

Size requirements and typical size. For JSCs, limits on supervisory board size are not fixed by law, but are determined by the charter. For banks, the minimum supervisory and management board size is 3 (CC §107, Law on Banks §25.2, 26.2). In practice, boards can have 5-7 members in larger companies and banks, and about 3 members in smaller firms.

Nomination and election. The AGM elects members of the supervisory and management board for up to 3 years, and

removes them. For banks, the term is 4 years. Shareholders with 20% or more cannot sit on the management board.

Eligibility requirements. There are no foreign nationality restrictions. Members of supervisory boards of banks are subject to fit and proper criteria administered by NBA, and whose enforcement is unassessed so far. Legal entities cannot serve as board members. Members need not hold shares to sit on the board, unless the charter so requires (CC §107-7).

For banks, members of the management and supervisory boards must have higher education in economics or law, and work experience in banking. Members of the supervisory and management board, the auditor commission and the chief accountant of the bank, cannot be members of other governance bodies of the bank (with the exception of the AGM); cannot take other employment positions at the bank; cannot be relatives to other members of the supervisory and management board, the auditor commission or the chief accountant of the bank; and cannot be government employees. In addition, supervisory board members cannot own, manage, or supervise more than three legal entities. Finally, management board members and the chief accountant cannot be employed elsewhere (Law on Banks, §10, 25.3, 26.3).

Adequacy of duties of loyalty and care. There are no specific duties of loyalty and care for supervisory board members of JSCs, besides the general civil law liability for acting against the law. For banks, there are minimal fiduciary duty provisions. There have been no court cases on director liability.

Fiduciary duties for supervisory board members of banks include the responsibility for monitoring and assessing the financial performance of the bank and ensuring that the bank is in compliance with all applicable laws and regulations including the prevention of conflicts of interest by the supervisory and management board.⁶⁴ Specifically, fiduciary duties include duty to keep oneself informed, duty to devote sufficient time and attention (diligence), duty to be “prudent, circumspect and conservative”, duty of independence (which includes not acting principally in the interest of a given shareholder group), duty of good faith, loyalty, and confidentiality and acting in the bank’s best interests. The sanctions for fiduciary duties in banks are in the process of being legislated – conflicts between the concept of fiduciary duties and the structure and functioning of the penal code and criminal law may render implementation difficult.

Insurance for directors. There is no requirement for board insurance, and it is not usually used.

Business judgment rule/board accountability. There are no “business judgment rule” provisions, except for banks.

Principle VIB: Where board decisions may affect different shareholder groups differently, the board should treat all shareholders fairly.

Assessment: Materially Not Observed

There is no provision in the law requiring that supervisory board members treat all shareholders fairly. For banks, the supervisory board is mandated not to “make decisions or vote as directed by or principally in the interests of any shareholder or group of shareholders” (Regulation on implementation of corporate governance standards in banks §7.3.2)

Principle VIC: The board should apply high ethical standards. It should take into account the interests of stakeholders.

Assessment: Materially Not Observed

The current framework does not provide a code or law on ethical standards for JSCs, or on protection of the interest of stakeholders. The Civil Code and the Law on Banks contain provisions, enforced by the respective regulators, on illegal activities. The regulation on implementation of corporate governance standards in banks contains provisions for the creation of a Code of Ethics for bank employees.⁶⁵

Principle VID: The board should fulfill certain key functions, including:

Assessment: Materially Not Observed

(1) Board oversight of general corporate strategy and major decisions

Board functionality by law and in practice. There are no detailed guidelines for the roles, responsibilities, operation, qualifications or structure of JSC supervisory boards. In practice, boards have not assumed an independent oversight function, and are considered to play a relatively minor role in providing strategic guidance for corporations. Boards tend to be dominated by the controlling shareholder(s), who typically head the board. Regular supervisory board meetings are not held in a sizeable part of companies. The management board, on the other hand, tends to be stripped of some of its daily management responsibilities, instead being obliged in practice to consult on a daily basis

⁶⁴ Regulation on implementation of corporate governance standards in banks, definitions, and §7.

⁶⁵ Regulation on implementation of corporate governance standards in banks, §15.2.

	<p>with controlling owners, who tend to hold a permanent office at company premises.</p> <p>For banks, the supervisory board by law manages strategic corporate planning, oversees management and reports to the AGM. Its other notable duties include management of conflicts of interest, and approval of RPTs and large transactions.⁶⁶ In practice, the effective dominance of the controlling shareholder(s) over the functioning of the governance bodies is a factor in the case of banks as well.</p> <p>Director training, IOD. No code of corporate conduct has been developed to assist supervisory board members in their duties and there are no institutions responsible for formal training of supervisory board members for JSCs. In the banking sector, such tools are actively used. The corporate governance regulations of the NBA have the force of law over banks, and the Azerbaijan Bank Training Center provides valuable awareness raising and coaching services to bank administrators.</p>
(2) Monitoring effectiveness of company governance practices	There are no provisions for supervisory boards to monitor corporate governance practices. Some major corporate governance practices are monitored by law in the case of banks, as part of the functional and structural requirements of bank management and governance.
(3) Selecting / compensating / monitoring / replacing key executives	<p>For JSCs, management is hired and removed by the supervisory board, but the function can theoretically also be performed by the AGM. The AGM does not have powers to set compensation by law (CC §107.1.3).</p> <p>In the case of banks, the AGM is responsible for the hiring, compensation and replacement of management, but the power can be delegated to the supervisory board. The supervisory board reviews management performance annually by law.</p>
(4) Aligning executive and board pay with long term company and shareholder interests	There are no relevant provisions for JSCs as a whole. In the case of banks, one of the duties of the supervisory board by law is to assure that the company (including management) compensation system focuses on long-term corporate results, and avoids short-term profit goals. ⁶⁷
(5) Transparent board nomination / election process	The AGM does not play an effective role in the nomination or election of the supervisory or management boards in practice, though by law the AGM has the right to elect and remove both boards. The law does not require any background information on newly nominated directors to be provided to the AGM to facilitate their decision.
(6) Oversight of insider conflicts of interest, including misuse of company assets and abuse in RPTs	By law, oversight of insider conflicts of interest is only mandated for banks, not for JSCs generally. In practice, boards may lack sufficient independence from the controlling owners to effectively monitor conflicts of interest, even for banks.
(7) Oversight of accounting and financial reporting systems, including independent audit and control systems	<p>For JSCs, the charter specifies the persons responsible for signing off the financial statements, and they carry liability for false information.⁶⁸ Criminal liability is added, in the case of false information in the prospectus.⁶⁹ The supervisory board does not have to certify the truthfulness or otherwise of the information within the financial statements.</p> <p>In the case of banks, the management board as a whole is responsible for financial reporting systems and the chairman of the management board and the chief accountant certify the veracity of the financial statements. It is required to establish systems that clearly allocate responsibility and accountability.⁷⁰ The supervisory board is responsible for the oversight of financial reporting and audit systems. The auditor commission bears independent responsibility on those, as well.</p>
(8) Overseeing disclosure and communications processes	The process of disclosure and communications is not included by law among the duties of the JSC supervisory board. In practice, there is little disclosure and communication that companies engage in.
Principle VI E: The board should be able to exercise objective independent judgment on corporate affairs.	

⁶⁶ Law on Banks, §25; Regulation on implementation of corporate governance standards in banks, §3, 5.

⁶⁷ Regulation on implementation of corporate governance standards in banks, §15.1.

⁶⁸ Civil Code, §1078-11.7; Rules on preparation and disclosure of annual reports of issuers of investment securities, §2.4.

⁶⁹ Criminal Code, §203, 211, 212, 213.

⁷⁰ Regulation on implementation of corporate governance standards in banks, §8.3.

Assessment: Materially Not Observed	
(1) Director independence	<p>Director independence in law. There are no independence provisions for the supervisory board members by law. Members of the management board cannot sit on the supervisory board. Shareholders with 20% or more cannot sit on the management board. In the case of banks, members of the supervisory board, auditor commission and management board, as well as chief accountant, cannot be members of other governance bodies of the bank (with the exception of the AGM); cannot take other employment positions at the bank; cannot be relatives to the supervisory board, auditor commission and management board, as well as chief accountant; and cannot be government employees.</p> <p>Director independence in practice. In practice, supervisory boards tend to be beholden to controlling owners.</p>
(2) Clear and transparent rules on board committees	<p>Audit committees. There are no supervisory board sub-committees performing audit committee functions. Auditor commissions composed of members independent of the supervisory board are required for banks only, and are described in detail in section VC.</p> <p>Other committees. In JSCs, the law does not require other committees, and there is no practice establishing such committees. For banks, several such committees are required at the level of the management, not supervisory, board. Specifically, the law mandates that the supervisory board, in consultation with the management board, establishes the following committees: for the purpose of effective implementation of credit risk management processes Credit Committee, for the purpose of effective management of liquidity and funds Assets and Liabilities Management Committee, for the purpose of secure and effective functioning of Information Technologies of the bank, Information Technologies Committee may be appointed (Regulation on implementation of corporate governance standards in banks, §5, 10). In banks with total assets above US\$6 million or having a branch network of more than three branches, a Risk Management Committee is established to coordinate the activities of internal committees and manage other risks. 10-12 banks have already started implementing these legal requirements.</p>
(3) Board commitment to responsibilities	<p>Restrictions on the number of board seats. There are no legal restrictions on the number of board seats held by supervisory board members. For banks, a supervisory board member cannot be an owner, manager, or supervisor in more than 3 companies.</p> <p>Board meeting requirements. There are no legal requirements for the frequency of board meetings or member attendance for JSCs in general. JSCs as a rule do not hold frequent regular supervisory board meetings. For banks, supervisory boards must hold at least quarterly meetings. It is difficult to estimate the frequency of board meetings in banks in practice.</p> <p>Public availability of board attendance. Supervisory board members are not required to disclose their attendance at board meetings. Minutes of board meetings and board attendance are not available publicly.</p>
Principle VIF: In order to fulfill their responsibilities, board members should have access to accurate, relevant and timely information.	
Assessment: Materially Not Observed	
<p>For JSCs, there are no special provisions in the law on supervisory board access to information or professional advice. In the case of banks, supervisory boards (but not individual members) have access to all requisite information from the management board. The Regulation on implementation of corporate governance standards in banks provides a detailed list of information that the management board and various committees distribute at supervisory board meetings (§5.2).</p>	

Recommendations - Checklist

Institution building

SCS

Spell out in the law a list of specific reasons for removal of SCS top officials.
Promote further legitimacy to SCS actions, for example via public consultation on new regulation, reports to Parliament, independence provisions for SCS staff vis-à-vis regulated entities to preclude conflicts of interest.
In the long term, establish SCS independence (including budget independence). An IOSCO assessment may be useful in this regard.
Strengthen SCS capacity to meet increased enforcement needs of the new legislation.

BSE and NDC

Forbid the trading of closed JSC or limited liability companies on the Baku Stock Exchange.
Adjust listing requirements for the upper tier to reflect realistic expectations for a few best practice companies to list, including a requirement for minimal disclosure (annual audited financials) from companies admitted to trading on the lower tier.
Require all companies admitted to trading on the Baku Stock Exchange to use an independent share register, and should be banned from maintaining the share register themselves.
Ban the off-exchange trading of companies admitted to trading on the stock exchange, or at least assure that the price and trade information on off-exchange trades is communicated to the exchange.
A few large state-owned enterprises should be encouraged to list on the upper tier and serve as a model, together with some banks, of best practice listed companies.
BSE's enforcement effectiveness may benefit from granting it the power to impose fines.
Harmonize the thresholds used for mandating a supervisory board (50 shareholders) and maintaining an independent share register (20 shareholders), with the distinction between open and closed JSC. For example, one way to regulate the issue is to mandate that in order to trade on the exchange, the company needs to reorganize as an open JSC, and that all open JSCs (independent of the number of shareholders) must use an independent register and have a supervisory board. The use of multiple thresholds creates confusion, and may theoretically result in suboptimal outcomes such as a company without a supervisory board trading on BSE.
National Depository Center (NDC) In the long term, the NDC should become a central registry for all JSCs, and should assume the clearing and settlement functions of the BSE.

State Registry

Computerize the State Registry, creating a workable and effective system of archiving the records and providing public access to documents, including company charters.

Courts

The General courts should not be involved in securities and corporate matters where an individual is a party to the case - those cases should be tried by the Economic Court as well.
Training of Economic Court judges on securities and corporate matters is of the essence.

Key focus areas for stricter legal rules and improved enforcement

Code of Corporate Governance and director training

A corporate governance code should be adopted for JSCs, perhaps with the force of law to ensure compliance (e.g. as an SCS regulation). Given that the JSC regulations are part of the Civil Code and are hard to reform, some of the legislative changes below could instead be made part of the SCS regulation on Corporate Governance. Use the bank regulation as a model.

Introduce training for corporate, SOE, and bank management and supervisory boards, as well as general public campaigns on basic securities markets awareness. An institute of directors may best promote corporate governance.

Disclosure

Strengthen enforcement for ownership disclosure, including full shareholder lists and disclosure of 10% shareholders. An initial reform successfully applied in certain countries to promote ownership disclosure is to require NDC to disclose 10% direct owners.

Disclosure of indirect and ultimate ownership should be mandated by law and effectively enforced.

As the Accounting Law provisions come into force in 2006, SCS and BSE should work on improving enforcement of filing of annual financials for JSCs, and providing public access to audited financials.

AGM rules and procedures

Require that AGMs are held in the town of the company office (or in Azerbaijan).

Include details on newly nominated directors, and auditor, in the AGM notice.

Mandate annual board election, at the AGM meeting.

Specify exact procedures for adding agenda items on the AGM agenda (e.g. 5% of shareholders can propose items on the agenda).

Specify the right of shareholders to ask questions (and be answered) at the AGM.

The law could list the specific grounds for dispute of AGM decisions.

The law should establish a record date concept and should specifically regulate how the list of shareholders is drawn up for AGM purposes.

Supervisory boards

The law must specify rules for JSC supervisory boards, including exact authorities of the board (e.g. supervision over related party transactions, approval of the annual report, strategic issues). Daily management of the companies should be specifically excluded from the duties of the supervisory board. The procedures by law for meetings / minutes should be clarified, including the size of boards, frequency of meetings, absence policies, quorum, and exact procedures for board election by the AGM. Cumulative voting may be considered. Fiduciary duties for management and supervisory boards should be specified. The supervisory board provisions for banks can be used as models.

Related party transactions

Approval and disclosure procedures for related party transactions should be legislated and enforced. In this effort, the bank legislation can be used as a model, and IAS 24 should be enforced for all listed firms.

Define a related party in the law, including supervisory and management board members, 10% shareholders, as well as their families.

State explicitly what information is disclosed by related parties on each RPT.

Require AGM approval for larger RPTs.

Forbid related loans.

Regulate RPT disclosure to the public and SCS.

Define explicitly sanctions on RPTs in the law.

Include in the law provisions that ban related parties from competing with the company and exploiting business opportunities belonging to the company.

Pre-emptive rights

Pre-emptive rights should be mandated by law for open JSCs.

Bank corporate governance

Though banking corporate governance rules can be generally used as a model for regulating most JSC corporate governance areas, the continued enforcement of those rules for banks is not to be neglected, if they are truly to serve as champions for corporate governance standards in the country.

Takeover legislation

Modern takeover legislation should be adopted.

Withdrawal rights

The law should elaborate on the general Civil Law provision that allows shareholders to request withdrawal of shares if allowed by law or company charter. Specific procedures and conditions should be outlined, such as cases when the shareholder is entitled to request withdrawal (e.g. after disagreeing with an AGM decision, after merger, etc); price of withdrawal (some notion of a fair market price), and other details.

Audit Committee

The institution of the revision committee or auditor commission may sometimes play a complementary role in protecting the interests of minority shareholders. However, these traditional organs of corporate vigilance are not substitutes for a well-functioning audit committee as part of the supervisory board in overseeing the adequacy of the company's internal control systems and the integrity of its independent external audit.

Azerbaijan Terms/Acronyms

AGM: Annual General Shareholders Meeting
NBA: National Bank of Azerbaijan
BSE: Baku Stock Exchange
ANAS: Azerbaijan National Accounting Standards
NDC: National Depository Center
EGM: Extraordinary Shareholders Meeting
GDP: Gross Domestic Product.
ISA: International Standards on Auditing
IFRS / IAS: International Financial Reporting Standards (previously called International Accounting Standards)
JSC: Joint-Stock Company
CC: Civil Code
ASA: Azerbaijan Standards of Audit
SCS: State Commission for Securities
SRO: Self-Regulatory Organization
Cumulative voting: Cumulative voting allows minority shareholders to cast all their votes for one candidate. Suppose that a publicly traded company has two shareholders, one holding 80% of the votes and another with 20%. Five directors need to be elected. Without a cumulative voting rule, each shareholder must vote separately for each director. The majority shareholder will get all five seats, as s/he will always outvote the minority shareholder by 80:20. Cumulative voting would allow the minority shareholder to cast all his/her votes (five times 20%) for one board member, thereby allowing his/her chosen candidate to win that seat.
Pre-emptive rights: Pre-emptive rights give existing shareholders a chance to purchase shares of a new issue before it is offered to others. These rights protect shareholders from dilution of value and control when new shares are issued.
Proportional representation: Proportional representation gives shareholders with a certain fixed percentage of shares the right to appoint a board member.
RPT: Related party transactions. The OECD Principles of Corporate Governance hold that it is important for the market to know whether a company is being operated with due regard to the interests of all its investors. It is therefore vital for the company to fully disclose material related party transactions to the market, including whether they have occurred at arms-length and on normal market terms. Related parties can include entities that control or are under common control with the company, and significant shareholders, such as relatives and key managers.
Shareholder agreement: An agreement between shareholders on the administration of the company, shareholder agreements typically cover rights of first refusal and other restrictions on share transfers, approval of related-party transactions, and director nominations.
Squeeze-out right: The squeeze-out right (sometimes called a "freeze-out") is the right of a majority shareholder in a company to compel the minority shareholders to sell their shares to him. The sell-out right is the mirror image of the squeeze-out right: a minority shareholder may compel the majority shareholder to purchase his shares.
Withdrawal rights: Withdrawal rights (referred to in some jurisdictions as the "oppressed minority," "appraisal" or "buy-out" remedy) give shareholders the right to have the company buy their shares upon the occurrence of certain fundamental changes in the company.

This report is one in a series of corporate governance country assessments carried out under the Reports on the Observance of Standards and Codes (ROSC) program. The corporate governance ROSC assessments examine the legal and regulatory framework, enforcement activities, and private sector business practices and compliance, and benchmark the practices and compliance of listed firms against the OECD Principles of Corporate Governance.

The assessments:

- use a consistent methodology for assessing national corporate governance practices
- provide a benchmark by which countries can evaluate themselves and gauge progress in corporate governance reforms
- strengthen the ownership of reform in the assessed countries by promoting productive interaction among issuers, investors, regulators and public decision makers
- provide the basis for a policy dialogue which will result in the implementation of policy recommendations

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