

REPORT ON THE OBSERVANCE OF STANDARDS AND CODES (ROSC)

Corporate Governance Country Assessment REPUBLIC OF LITHUANIA

July 2002

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This Corporate Governance Assessment of Lithuania has been completed as part of the joint World Bank-IMF program of Reports on the Observance of Standards and Codes (ROSC). It benchmarks the country's observance of corporate governance against the OECD Principles of Corporate Governance and is based on a template developed by the World Bank. The findings are supported by a review of legislation and extensive discussions with Government officials, financial supervisors, and numerous segments of the private sector. This Assessment was undertaken in the context of the joint IMF-World Bank Financial Sector Assessment Program (FSAP) for Lithuania. The assessment was conducted based upon (1) a pre-FSAP self assessment by the Lithuanian authorities, completed with the help of the local law firm Lideika, Petrauskas, Valiunas and Partners; (2) a review of relevant legislation and regulations; and (3) discussions with representatives of the Lithuanian Securities Commission (LSC), the Ministry of Economy (MOE), the National Stock Exchange of Lithuania (NSEL), the Central Securities Depository of Lithuania (CSDL), the Department of Civil Law and Civil Procedure of Vilnius University, the law firm Glimstedt, the investment banking firm Suprema, Vilnius Bank and Hansa Bank. The assessment was conducted in October and November 2001 by Cally Jordan (Senior Counsel, World Bank) with the assistance of John Hegarty (Regional Financial Management Adviser for the Europe and Central Asia Region, World Bank) and Peter Modeen (Consultant) and in collaboration with the Private Sector Advisory Services Corporate Governance Unit of the World Bank. The ROSC assessment was cleared for publication by the Ministry of Finance on July 16, 2002.

I. EXECUTIVE SUMMARY

This assessment benchmarks the Lithuanian corporate governance system against the OECD Principles of Corporate Governance, which have been recognized by the Financial Stability Forum as one of the core standards underpinning the international financial architecture, and highlights a number of areas where Lithuania's corporate governance system can be strengthened. Lithuania has already invested considerable resources in upgrading its legislation to meet EU Directives, and the legislative and regulatory framework dealing with corporate governance issues is quite robust. Strengths and weaknesses are highlighted, and policy recommendations are made where appropriate.

The policy recommendations can be grouped under three broad categories: legislative reform, institutional strengthening and voluntary/private initiatives. The legislative and regulatory framework dealing with corporate governance practices has undergone substantial change. The most serious problem is compliance and enforcement. While the assessment highlights several areas where Lithuania's corporate governance system could be strengthened, the priority should be given to the enforcement of existing laws.

This report promotes private sector initiatives and capacity building to follow up on the legislative progress on corporate governance reform. It recommends the development of a Lithuanian or regional voluntary code of best practice in corporate governance. The code should be prepared by a task force coordinated by the LSE and made up of public and private sector representatives. In addition, the report proposes the creation of a regional Institute of Directors, to provide training for supervisory board members, disseminate best practice and play a vital role in the dialogue between the public and private sector. Together, these measures give issuers the choice to implement best practice and investors a benchmark against which to measure corporate governance in Lithuania.

A number of areas warrant attention. The recommendations focus on strengthening six key areas and are summarized in Annex Table C. Summary scoring results are presented in Annex Table D. For a detailed discussion on the legal and institutional framework, please refer to Annex E.

II. CAPITAL MARKETS AND INSTITUTIONAL FRAMEWORK

A new Civil Code (effective as of July 1, 2001), modeled on modern Dutch and Quebec Civil Codes, provides the basis for private and commercial law in Lithuania. The primary legal framework for publicly traded companies consists of the Law on Companies (effective as of July 1, 2001 and replacing earlier legislation), the Law on Public Trading in Securities (LPTS - adopted on January 16, 1996 with subsequent amendments) and its numerous rules, and the Rules of the NSEL, as well as Rules of the CSDL. On December 17, 2001, a new Law on Securities Market (SML) was adopted by Seimas (Parliament). Entering into force on April 1, 2002, the SML replaces the LPTS.

The NSEL is the only public exchange. It has three tiers, the Official Market, the Current Market and the Unlisted Market. As of end December 2001 there were six companies listed on the Official Market, 40 on the Current Market and about 880 forming the Unlisted Market. Recently,

there has been a marked trend towards strategic investors, primarily foreign, taking companies “private,” i.e. taking majority or 100 percent interests.

The corporate governance structure in Lithuania reflects several important aspects of the recent history of Lithuanian enterprises, including: a history of social ownership; the transition to a market economy; the legacy of voucher privatization; ongoing privatization of state-owned enterprises; the impact of strategic investment on concentration of ownership; and imminent EU accession (planned for 2004).

Interest in corporate governance is low, although improvements in corporate governance are seen to have the potential for improving access to capital and promoting efficient development of the new private sector. The corporate governance of the small number of upper tier public companies will be determined by international markets, where they are seeking financing. These companies have received a large portion of the total amount of foreign direct investment (USD 2.5 billion by mid-2001) that has flowed into Lithuania. Several international financial institutions, mainly the European Bank for Reconstruction and Development, have provided debt and equity financing to the largest Lithuanian companies. International debt issues by Lithuanian companies have so far been few, but an increasing number of companies are reaching a level of development where such financing becomes feasible. For the immediate future, however, the activities of strategic investors, the contraction in the number of publicly traded companies, and the dearth of retail and institutional investors in Lithuania means that bank and internal financing, rather than the capital markets, will be the primary source of corporate funding.

III. REVIEW OF CORPORATE GOVERNANCE PRINCIPLES

Section I: The Rights of Shareholders

Principle IA: *Largely observed*

Description of practice: With the introduction of the Central Securities Depository of Lithuania (CSDL), share registration has been centralized for shares that are traded. Publicly traded shares must be dematerialized. Title to shares is evidenced by a record in a personal securities account with a brokerage firm, an authorized commercial bank or the issuer.

Recent statutory amendments to take effect January 1, 2004 revoke the right of issuers to maintain personal securities accounts for their own shareholders.¹ Such accounts must be transferred to a licensed and specialized entity, a brokerage firm or an authorized commercial bank, thereby enhancing the integrity of the share title system.

Shares of companies traded on the National Stock Exchange of Lithuania (NSEL) or registered with the CSDL are freely transferable. Except for the special category of “workers’ shares,” public limited liability companies are prohibited from introducing any restrictions on the right of shareholders to transfer fully paid shares.² Restrictions on transfer of private limited liability

¹ Law on Companies Article 41(5), Securities Market Law Article 65(3)

² Law on Companies Article 49 (8)

companies shares, an essential characteristic of a non-publicly traded company, are limited by statute.³

Information for companies listed on the NSEL is available (online access through the web pages of the LSC, NSEL and CSDL), although there is gross non-compliance with disclosure requirements by those companies that are not on the Official or Current Lists. The Law on Companies provides shareholders with rights of access to various kinds of internal company information, in some cases conditional upon entering into a confidentiality agreement with respect to commercial secrets. Shareholders holding five percent of authorized capital or 50 percent of all voting shares have access to a greater amount of internal company information.

Shareholders have the right to attend Annual General Meetings (AGMs) of the company in person or to authorize another person to vote their shares as a proxy.⁴ The Law on Companies stipulates requirements for notice and agenda to be given to shareholders about meetings; shareholders have the right to obtain information pertaining to agenda items. Meetings must take place in a specified locality. In practice, however, participation at shareholders meetings is largely confined to majority shareholders.

Shareholders voting at the AGM elect members of the Supervisory Board, or in the case where there is no Supervisory Board, the Management Board. Cumulative voting is mandatory.⁵

The AGM approves apportionment of net after tax profit or loss. Several safeguards are in place to help ensure that all shareholders share in profits.⁶ In practice, few companies are paying dividends currently as profits are low and formerly state-owned enterprises struggle with structural adjustments and solvency issues. Concerns also remain with respect to potential self-dealing to the detriment of minority shareholders' financial interests.

Policy recommendations: Rationalization of ownership structure of companies resulting from voucher privatization would address non-compliance with disclosure obligations. Voting by secret ballot should be mandatory. The company should be obliged to publish or circulate shareholder proposals at company cost. Electronic voting should be considered.

Principle IB: Largely observed

Description of practice: Amendments to company statutes must be made by a $\frac{2}{3}$ vote of shareholders represented at the shareholders' meeting (rather than a minimum percentage of share capital). Increase or decrease of share capital, which requires amendment to company statutes, requires a separate $\frac{2}{3}$ vote of the holders of each type and class of shares.⁷ The AGM requires a quorum or more than 50 percent of all shareholders (but there are no further quorum requirements for adjourned meetings).

³ Law on Companies Article 49 (9) – (12)

⁴ Law on Companies Article 21, 24

⁵ Law on Companies Articles 32, 34.

⁶ Law on Companies Articles 61, 62.

⁷ Law on Companies Articles. 28(5), 51(1) and 54(3).

The AGM must adopt a resolution by $\frac{2}{3}$ votes (present at the meeting) to increase the authorized capital and to issue convertible debentures; a separate $\frac{2}{3}$ vote is required for each type and class of shares.⁸ A 75 percent vote is required to waive pre-emptive rights⁹.

The AGM must adopt a resolution by $\frac{2}{3}$ votes (present at the meeting) to approve a transfer, lease or mortgage of fixed assets, or a guarantee or surety obligation, the value of which exceeds five percent of the company's authorized capital. A separate class vote is required for company reorganizations.¹⁰

Policy recommendations: Best practice would require that all fundamental corporate changes be put to a minimum quorum of all shares outstanding (not those represented at the meeting). Where majority ownership of publicly traded companies predominates, the threshold should be high enough to promote minority shareholder participation in the decision making process. Alternatively, a class vote or a majority of the minority vote may be required to protect certain fundamental or particular interests; for example, amendments to statutes that would vary class rights.

Protection of minority shareholders against dilution of their ownership interest must be balanced against flexibility in capital raising activity. At this stage of development of the capital markets, and given the concentration of ownership of publicly traded companies, the balance should favor minority shareholders. Dilutive activities should require a vote of the majority of the minority.

A transfer, lease or mortgage of a significant portion of a company's assets, whether fixed or not, should require a minimum quorum vote of all shares outstanding (not those present at the AGM).

Principle IC: *Observed*

Description of practice: Upon publication of the agenda, a five percent shareholder has fifteen days in which to supplement the agenda. The shareholders may make decisions on issues not on the agenda, if all voting shareholders unanimously agree to do so.

Shareholders have the right to vote by proxy (which must be notarized where the shareholder is a natural person) unless given to the intermediary where the shareholder's securities account is maintained. The proxy must be appointed in writing and the proxy card delivered to the company for safe-keeping. There are no restrictions as to who may be appointed proxy. Voting by mail is permitted only if authorized in the company statutes.

Notice of meetings and agenda, including changes, is adequate.

Principle ID: *Materially not observed*

Description of practice: Although "special shares" (issued to government or a municipality and conferring a veto right and other rights disproportionate to equity ownership), are recognized in the Law on Companies, no new special shares may be issued. Special shares exist in a few privatized companies. The capital structure and share attributes are described in the company's

⁸ Law on Companies arts. 28(5), 51(1) and 57(2).

⁹ Law on Companies arts. 24, 29.

¹⁰ Law on Companies Article 70(1).

statutes. There is a requirement to disclose voting agreements among shareholders exceeding certain thresholds over ten percent of voting rights under LPTS rules.

In practice, however, informal relationships among shareholders may not always be disclosed, especially where parties wish to conceal their arrangements.

Policy recommendations: Greater enforcement of existing disclosure rules appears warranted. The identity of ultimate controlling shareholders should be disclosed.

Principle IE: *Materially not observed*

Description of practice: Acquisitions and disposals of shares representing in excess of $\frac{1}{10}$, $\frac{1}{5}$, $\frac{1}{4}$, $\frac{1}{3}$, $\frac{1}{2}$, $\frac{2}{3}$ or $\frac{3}{4}$ of the voting rights must be disclosed by rule under the LPTS. Procedures for acquisition are clearly laid out in the rules under the LPTS. LPTS tender offer rules provide for voluntary and mandatory tender offers. If a person or a group of related persons acquire more than 50 percent of votes in a company, he/they shall be obliged to make a mandatory tender offer to buy the remaining shares for the price determined as a weighted average price of shares acquired by the offerer(s) during the 12 month period before exceeding the 50 percent limit. However, in practice, there are cases where controlling shareholders engage in activities that artificially depress market price, rendering the buy-out offer unattractive to the minority. The rules of the new LSM – lowering the threshold triggering the mandatory tender offer to 40 percent of votes and requiring the tender offer price to be the highest price of acquisition of shares during 12 month period prior to exceeding the 40 percent - are aimed at improvement of the situation.

Defensive maneuvers such as poison pills and dilution techniques would trigger supermajority shareholder approval requirements.

Policy recommendations: The LSC should invoke its powers to deter and sanction price manipulation to the detriment of minority shareholders. Proposed changes in the calculation of the acquisition price should help deter such actions.

Principle IF: *Materially not observed*

Description of practice: There are few domestic institutional investors (to date only life insurance companies; there are no private pension funds yet and only one index fund); however, sophisticated investors appear capable of undertaking this analysis. Also, once private pension funds begin to appear, the fiduciaries of these funds should be required to disclose their holdings.

Policy recommendation: The development of shareholders' associations as a means of invigorating a shareholder culture should be encouraged.

Section II: Equitable Treatment of Shareholders

Principle IIA: *Largely observed*

Description of practice: The Law on Companies and for traded securities, the Law on Public Trading in Securities, do require disclosure of restrictions on voting rights and that changes in voting rights be subject to a vote of the shareholders' meeting. See also Section I for comments and recommendations.

Art. 21 of the Law on Companies requires the proxy to be delivered to the company. In case of vote by a custodian having issued depository receipts, he is bound to vote according to the written instructions of the beneficial shareholder or the shareholders' agreement.

Shareholders with at least ten percent of the voting shares may request that the Management Board call an extraordinary shareholders' meeting. Shareholders at the AGM may name another shareholder to be the inspector for the next AGM.¹¹ The company statutes may provide for voting by mail in advance of the general meeting. If requested by shareholders holding at least ten percent of votes, voting is confidential.¹² Processes and procedures appear adequate to promote fairly efficient and cost-effective management of meetings.

Policy recommendations: Require that custodians and nominees vote in agreement with instructions from owners of shares. Confidential voting should be adopted. The percentage required to request a meeting could be lowered to five percent.

Principle IIB: Largely observed

Description of practice: Under the LPTS, insider trading is prohibited and subject to both fines and imprisonment. According to International Accounting Standards (IAS), which are currently applicable to the Official List companies, and starting from 2004 will be applicable to all listed companies, related party transactions must be disclosed on an annual basis and in certain circumstances a shareholder cannot vote to approve contracts he is entering into with the company.

An evaluation requirement applies to acquisition of assets from a company incorporator within two years of incorporation if the aggregate amount involved exceeds ten percent of the company's share capital.¹³ There are restrictions on the company borrowing from its shareholders and advancing or guaranteeing payments for its own shares.¹⁴ Management bodies are prohibited from making decisions that are manifestly unprofitable such as those constituting transfer pricing.¹⁵

Policy recommendations: Insider trading reporting should be required for five percent shareholders, and monetary fines for insider trading should be increased, civil and administrative insider trading offenses should have a reduced evidentiary burden, and there should be clear rules for disclosure of and approval for potential self dealing transactions.

Principle IIC: Largely observed

Description of practice: Art. 2.87 of the Civil Code requires that conflict of interest situations be disclosed by the members of the management bodies of legal entities. Article 23 of the Law on Companies contains restrictions on members' of the managing bodies occupying positions in companies active in the same field, downstream companies or sales distributors (or in the case of

¹¹ Law on Companies Article 25.

¹² Law on Companies Article 29.

¹³ Law on Companies Article 15.

¹⁴ Law on Companies Article 16.

¹⁵ Law on Companies Article 22 (8).

the Chief Executive Officer – any other enterprise). Disclosure is required where there is active participation as well as shareholdings of 25 percent or more in such enterprises.

Policy recommendations: Consider the creation of a disinterested voting mechanism for potential self-dealing transactions.

Section III: Role of Stakeholders in Corporate Governance

Principle IIIA: Largely observed

Description of practice: There is no well-defined legal requirement for consideration of the interests of all stakeholders; however, the law contains numerous provisions aimed at protecting creditors' interests. The Law on Companies requires that management bodies act only for the benefit of the company and its shareholders.¹⁶

Principle IIIB: Largely observed

Description of practice: Where certain actions of the company are detrimental to creditors, such creditors may avail themselves of recourse against the company. Creditors can ask for annulment of company decisions or stop equity investments, capital reductions and reorganization of the company. In addition, there are bankruptcy and restructuring proceedings available.

Principle IIIC: Observed

Description of practice: There are employee shares to encourage stakeholder participation; these shares may be offered on special terms.

Principle IIID: Materially not observed

Description of practice: Stakeholders do not appear to participate actively in the corporate governance process, although employee shareholders are entitled to the same information as other shareholders. Creditors are mostly limited to publicly available information. New accounting legislation coming into force from 2002 onwards, however, will significantly improve the quality of public disclosure.

Policy recommendations: See policy recommendations in Section IV.

Section IV: Disclosure and Transparency

Principle IVA: Partially observed

Description of practice: Financial reporting and accounting by Lithuanian enterprises are currently governed by laws and other regulations issued mainly in 1992, but new laws were approved in 2001 and come into effect from 2002 onwards. The new laws significantly increase conformity between Lithuanian requirements and EU Directives, establish a new national standard setting body and require greater compliance with IAS.

Financial reporting by Lithuanian enterprises is governed by the 1992 Law on the Principles of Accounting (replaced by a new Accounting Law, which takes effect in 2002; see below) decrees and other pronouncements issued by the Ministry of Finance, the *Rules of Periodic Disclosure of*

¹⁶ Law on Companies Article 22(8).

Information About Issuers' Activities and Their Securities issued by the LSC and the regulations of the Bank of Lithuania (BoL). The BoL requires banks to comply with IAS insofar as these standards do not conflict with its own regulations.

There is no requirement to prepare consolidated financial statements and, therefore, the Law on Accounting does not comply with the EU Seventh Company Law Directive. However, it, and related decrees and guidance, incorporate some of the EU Fourth Company Law Directive. The new Law on Consolidated Financial Statements, which comes into effect on January 1, 2003, requires that all parent entities (with certain exceptions) should prepare and publish consolidated financial statements. The new law incorporates many of the requirements of the Seventh Directive and IAS 27. The quality of IAS financial statements of listed companies is generally good. There is currently no 'standards gap' as far as accounting standards for listed companies are concerned. The rules of the LSC require that the financial statements of all companies on the Official List be prepared in accordance with IAS. Beginning in 2004, all listed companies will be required to prepare financial statements in accordance with IAS. There is a significant 'standards gap' as far as accounting standards for all companies other than banks and companies listed on the Official List. The LSC does not enforce or monitor compliance with IAS or national standards. Although it has the legal power to do so, the LSC currently undertakes no systematic review of the audited financial statements submitted to it, because of a lack of sufficient staff with the necessary skills.

The Law on Companies requires disclosure of the company's objectives in the company statutes. The main activities of the company also have to be disclosed in the annual, semi-annual reports and prospectuses.

Owners of more than five percent of all voting shares must be disclosed at the AGM and in the annual and semi-annual reports, in conformity with EU directive.¹⁷ Shareholders are entitled to receive the shareholder list from the company.¹⁸

The LPTS requirements for disclosure of incremental increases or decreases in interests exceeding ten percent of voting shares also serve to reveal accumulations and major shareholdings. These rules apply to related parties as well and should thus reveal ultimate controllers of block acquisitions or dispositions of voting shares. In practice, however, ultimate ownership of companies is not adequately disclosed in some cases, because the shareholders disregard the disclosure rules.

The voting rights attached to different categories of shares are disclosed in the company statutes.

Salaries, benefits, bonuses and other payments from company profits have to be disclosed, in aggregate, in the annual report or prospectus. Risk factors pertinent to the activities of issuers, such as economic, political, social, technical, technological and environmental risks, as well as credit risk of the issuer, must be disclosed under the LPTS. To the extent there is a "material event" (i.e. an event that could significantly affect the price of securities) there would be disclosure.

¹⁷ Rules on Periodic Disclosure of Information about Issuers Activities and their Securities under the LPTS.

¹⁸ Law on Companies Articles 20(7) and (9)

There are no requirements to disclose governance structures and policies. The structure of the management bodies is outlined in the company statutes, which are publicly available, and in disclosure documents files with the LSC.

Policy recommendations: The new standard setting body should ensure that its standards are consistent with IAS, appropriate to the specific circumstances of small and medium-sized enterprises and meet the legitimate information needs of external stakeholders such as banks. It should also establish procedures designed to ensure consistent application of IAS in circumstances that arise in Lithuania, but which have not been dealt with directly by the IASC/IASB or its Standing Interpretations Committee. The Bank of Lithuania should require banks to comply fully with IAS and, if necessary, distinguish between the information it requires for prudential supervision purposes and that required for transparent reporting to investors and other users of published financial statements.

The disclosure of remuneration in aggregate form is consistent with European practice and US securities law requirements for foreign private issuers. However, there is a trend toward disclosure of individual compensation for Supervisory and Management Board members and key executives, even in Europe.

Finally, board committees for risk management and monitoring should be created, and governance structures and policies should be disclosed. This could be made mandatory through the Commercial Code or included as part of the voluntary code of best practice.

The LSC should enhance its accounting and auditing skill base and more actively enforce IAS compliance.

Principle IVB: *Materially not observed*

Description of practice: See IVA.

Policy recommendations: The LSC should conduct a detailed review of financial filings by issuers and focus on adequacy of risk disclosure and how funds are applied.

Principle IVC: *Materially not observed*

Description of practice: The Law on Companies requires that the financial statements of all public limited liability companies and all limited liability companies, except small companies, be audited by auditors qualified in accordance with the Law on Audit.

The Law on Companies allows every shareholder to contract an audit firm to audit the activities and accounting documents of the company.¹⁹ The purposes of such shareholder audits are wide-ranging and include such matters as:

- determination of any indications of insolvency or fraudulent bankruptcy;
- the squandering of assets and the existence of loss-making contracts; and
- the infringement of shareholders' rights.

¹⁹ Law on Companies Article 60(3).

The costs of such an audit are borne by the relevant shareholder(s), but may be recovered from the company if the audit confirms the concerns of the shareholder(s).

Neither the Ministry of Finance nor the Chamber of Auditors has been carrying out any quality assurance activities in respect of individual auditors or audit firms. However, at the initiative of the Chamber of Auditors, an Audit Quality Control Committee has recently been established. In addition to the Chamber, the Ministry of Finance, the financial regulators and the new accounting regulator are represented on the Committee. The Chamber of Auditors is employing a person working full time on audit quality control and assisting the Committee. The Audit Quality Control Committee has been included in the proposed amendments to the Law on Audit. There is currently a large 'standards gap' as far as the auditing standards are concerned, but that gap will decrease significantly in the near future.

While many audit firms make strenuous efforts to carry out audits in accordance with ISA, there are significant variations in the quality of audits and the quality of some audits is materially affected by management attitudes. It is clear that many audits are carried out to a high standard by both local member firms of major international networks and other firms and comply fully with ISA. Nevertheless, the quality of some audits is affected by management attitudes including misconceptions about the nature of the audit.

Policy recommendations: The Chamber of Auditors should give urgent priority to:

- bringing Lithuanian auditing standards fully into line with ISA;
- bringing its Code of Ethics fully into line with EU requirements and the IFAC Ethics Code; and
- ensuring that these auditing standards and the Code of Ethics are observed in practice.

The Chamber of Auditors should establish a unified quality assurance regime that includes adequate mechanisms of accountability to the public interest and which complies with the recommendations of the European Commission and IFAC. It is desirable that the LSC and BoL should be involved in this regime, given their direct interest in the quality of audits of listed companies and banks. Auditors should be required to review annual reports and published financial statements prior to filing with the LSC.

Principle IVD: Largely observed

Description of practice: Financial and non-financial information of public companies is made available at the LSC and NSEL. The prospectuses, annual, semi-annual and quarterly reports of companies listed on Official and Current Lists as well as other larger companies that meet certain criteria have to be submitted in electronic form in addition to hard copies. The LSC provides access to the prospectuses, the annual and semi-annual reports in its web page. Material event reports to the LSC, the NSEL and the mass media may be provided in electronic form too, if so agreed with these institutions. The NSEL publishes material events in its web page. However, there is gross non-compliance with reporting requirements by many of the public companies that are not listed in the Official or Current Lists.

Policy recommendations: Equitable, effective means should be employed to delist, liquidate or change the corporate form of companies that are not trading, are insolvent or inactive. Electronic filing and dissemination of all reporting would facilitate access and reduce costs.

Section V: Responsibilities of the (Supervisory) Board

Principle VA: Largely observed

Description of practice: The Law on Companies provides for an optional dual board system for public limited liability companies and where the AGM is the “supreme management body.” Management bodies are required to “act only for the benefit of the company and its shareholders.”²⁰ With a dual board structure, if adopted, the Supervisory Board monitors management, i.e. the Management Board and the Chief Executive Officer. The AGM determines the compensation (which must be from net profits) of the Supervisory Board and elects its members. The AGM can also remove the entire Supervisory Board.²¹ The AGM can also appoint an Internal Auditor to monitor the financial activities of the company on behalf of the shareholders.²² The powers and responsibility of the different management bodies are clearly set out and well balanced in terms of providing monitoring mechanisms and promoting accountability. Management must prepare an annual report; if the AGM fails to approve it, the Management Board or the Chief Executive Officer, as the case may be, loses all authority to act.²³ Both Supervisory Board and Management Board members face significant liability for failure to properly exercise the oversight functions, in the case of the Supervisory Board, or violation of the company articles or law; action may be taken by any shareholder.²⁴

Where there is a majority shareholder, as is often the case, particularly in instances of strategic investors, the majority shareholder controls the actions of the Supervisory Board and management in accordance with its own corporate culture.

Policy recommendations: Develop a corporate governance code (preferably on a regional basis, given the small number of issuers) that would provide details on the roles, responsibilities, operation, structure and qualifications for members of supervisory boards. The code should also make recommendations regarding the committee structure within supervisory boards, providing for specialized committees on such areas as audit and finance, risk policies and management and remuneration of executive management. It should also discuss the criteria for ensuring full disclosure of conflicts of interest and mechanisms for disinterested voting and approvals. Consideration should be given to requiring minimum professional qualifications for Supervisory Board members.²⁵

Principle VB: Largely observed

Description of practice: Board members appear to treat each group of shareholders fairly.

²⁰ Law on Companies Article 22

²¹ See generally Law on Companies Article 32

²² Law on Companies Article 37

²³ Law on Companies Article 36.

²⁴ Law on Companies Articles 23,33,35

²⁵ Although it may only be a question of the English translation of the Law on Companies, it is not clear how Supervisory Board functions are accomplished where there is no Supervisory Board.

Policy recommendations: While there are no legal requirements of corporate governance guidelines to encourage fair treatment, a code of best practice should be introduced.

Principle VC: Largely observed

Description of practice: The primary duty of management bodies is to act in the best interests of the company and its shareholders. However, with respect to actions that might impair the capital of the company to the detriment of creditors (such as a reduction of capital or reorganization), or otherwise be detrimental to their legitimate interests, the creditors are provided with a means to participate in the decision making process and certain recourses. In a broader sense, the Board when taking decisions and actions, is obliged to comply with all legal requirements, which protect interests of certain stakeholders, like employees, consumers, etc.

Principle VD: Largely observed

Description of practice: The functions of the management bodies are stated in the Law on Companies. Division of the above functions among the management bodies is normally established in detail in corporate documents of the company, such as statutes and standing orders of the management bodies.

The Supervisory Board elects the Management Board (or the Chief Executive Officer, if no Management Board) and must consider the suitability for the positions if the company operates at a loss.²⁶ The Supervisory Board also monitors management and may remove the Management Board or its members. The Management Board elects and removes the Chief Executive Officer.

Key executive (i.e. Management Board) and Supervisory Board remuneration is determined by the AGM, as is usual in continental European corporate law. However, Management Board members could have employment contracts and a monthly wage if they perform daily work in the company. This removes the conflict of interest inherent in Anglo-American corporate law, where the board of directors sets its own remuneration. Shareholders possessing five percent or more of the voting shares may nominate candidates to the managing bodies of the company.

Conflicts of interest of management and board members are addressed in restrictions on management participating in similar business activities, or in the case of the Chief Executive Officer, any other enterprise. Disclosure is required of such participation, as well as shareholdings of 25 percent or more in such enterprises.²⁷ Conflicts of interest must also be disclosed.²⁸ Implementation of conflict of interest rules varies among companies, depending on the Supervisory Board's functioning, the shareholding structure and general corporate culture.

The Chief Executive Officer is responsible for the organization of accounting in a company.²⁹ Management must provide the auditors with the necessary information, documents, calculations and explanations), and the Management Board is prohibited from limiting the auditor's powers or hindering his assignment.³⁰

²⁶ Law on Companies Article 33.

²⁷ Law on Companies Article 23.

²⁸ Civil Code Article 2.87

²⁹ Law on Accounting Article 21.

³⁰ Law on Audit Article 27, Law on Companies Article 35(12)

Each managing body of a company monitors governance practices within its scope of competence and makes necessary changes. For example, the Management Board is responsible for establishment of the management structure of the company, and the decisions concerning the structure of governing bodies lies with the shareholders, who may decide on relevant amendments of the company statutes.

Generally, company management is responsible for disclosure and communication to the public. In practice, larger companies have chosen to have designated officers responsible for this task.

Policy recommendations: Where unitary boards are prevailing, practices associated with them, such as audit committees, etc. should be adopted. A code of best practice is useful in this context. Institutions promoting corporate governance awareness and practices, such as Institutes of Directors, are also useful. Small countries like Lithuania could benefit from participating in regional institutional initiatives.

Public limited liability companies should have an investor relations officer.

Principle VE: Largely observed

Description of practice: Supervisory Board Members are independent to the extent that overlap with the Management Board is prohibited. The AGM determines compensation of both boards and the Internal Auditor oversees financial reporting.

Members of the Management Board and the Supervisory Board are not required by law to devote a certain amount of time to their assignments (except for the members of the Management Boards of commercial banks, which are required to be the full time employees of the bank). Therefore, performance of the members of the Management Board and Supervisory Board is first of all influenced by their statutory duties to the company and the shareholders, and may depend on the requirements the shareholders establish for the governing of the company.

Policy recommendation: Board meeting attendance by supervisors should be reported at the AGM.

Principle VF: Largely observed

Description of practice: The Management Board itself is responsible for establishing the governing structure of the company, and thus, may assure access to accurate, relevant and timely information for itself.³¹ The Management Board and the Chief Executive Officer must grant the Supervisory Board access to documents pertaining to the activity of the company as well as assure possibilities to check the assets of the company.³²

IV. SUMMARY OF POLICY RECOMMENDATIONS

This section sets out policy recommendations to improve compliance of listed companies with the OECD Principles of Corporate Governance. The next step is the development of a detailed action plan. The action plan should be formulated in close cooperation with the Lithuanian

³¹ Law on Companies Article 35(1)

³² Law on Companies Article 33(4)

authorities and in consultation with the private sector and other stakeholders. The detailed policy recommendations made in the principle by principle review for the less than fully observed Principles can be grouped under the following broad categories: legislative reform, institutional strengthening and voluntary/private initiatives.

Legislative Reform: Lithuania has already invested considerable resources in upgrading its legislation, and the current, strong legislative and regulatory framework dealing with corporate governance issues is already in compliance with the relevant EU Directives. However, several additional detailed legislative issues are proposed in the policy recommendations of the principle-by-principle review section above. *Priority: medium*

Institutional Strengthening: The assessment highlights a number of areas where Lithuania's corporate governance system need strengthening, but priority should be given to enforcing existing law. To this end, the judiciary should be strengthened. *Priority: high*

Voluntary/Private Initiatives: Develop a voluntary corporate governance code detailing recommendations on the roles, responsibilities, operation (including policies for remuneration of supervisory board members and meeting frequency), structure and qualifications for supervisory board members. The code should recommend committee structure within supervisory boards, providing for specialized committees on areas like audit and finance, risk policies and remuneration of executive management. It should discuss criteria for determining board member independence and procedures for ensuring full disclosure of conflicts of interest—and for ensuring that independent directors are present on key board committees. The code could be prepared by a business advisory task force to the NSEL or other organization, in partnership between the public and private sectors, and should be adapted to Lithuanian financial market conditions. *Priority: high*

It is advisable that the code be voluntary but that listed companies be required to disclose the level of their compliance with the code. Consideration should be given to modify the listing requirements of the official list of the NSEL, so that companies listed on this compartment abide by the above-recommended voluntary code of best practice. Companies not wishing to subject themselves to such strict disclosure standards would be listed on the second list. This approach provides choice for issuers and investors. In an increasingly global economy, competition for capital is intense, and good corporate governance can make a difference in how Lithuanian companies are viewed. *Priority: high*

At the same time, it is recommended that training in the code be provided for supervisory board members, for example through an Institute of Directors. *Priority: high*

ANNEX A: OECD PRINCIPLES OF CORPORATE GOVERNANCE

Section I: The Rights of Shareholders

Principle IA. The corporate governance framework should protect shareholders' rights. Basic shareholder rights include the right to: 1. secure methods of ownership registration; 2. convey or transfer shares; 3. obtain relevant information on the corporation on a timely and regular basis; 4. participate and vote in general shareholder meetings; 5. elect members of the board; and 6. share in the profits of the corporation.

Principle IB. Shareholders have the right to participate in, and to be sufficiently informed on, decisions concerning fundamental corporate changes, such as: 1. amendments to the governing documents of the company; 2. the authorization of additional shares; and 3. extraordinary transactions that in effect result in the sale of the company.

Principle IC. 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 them. 1. Shareholders should be furnished with sufficient and timely information concerning the date, location and agenda of general meetings, as well as full and timely information regarding the issues to be decided at the meeting. 2. Opportunity should be provided for shareholders to ask questions of the board and to place items on the agenda at general meetings, subject to reasonable limitations. 3. Shareholders should be able to vote in person or in absentia, and equal effect should be given to votes whether cast in person or in absentia.

Principle ID. Capital structures and arrangements that enable certain shareholders to obtain a degree of control disproportionate to their equity ownership should be disclosed.

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

Principle IF. Shareholders, including institutional investors, should consider the costs and benefits of exercising their voting rights.

Section II: The Equitable Treatment of Shareholders

Principle IIA. 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. All shareholders of the same class should be treated equally: 1. Within any class, all shareholders should have the same voting rights. All investors should be able to obtain information about the voting rights attached to all classes of shares before they purchase. Any changes in voting rights should be subject to shareholder vote. 2. Votes should be cast by custodians or nominees in a manner agreed upon with the share's beneficial owner.

Principle IIB. Insider trading and abusive self-dealing should be prohibited.

Principle IIC. Members of the board and managers should be required to disclose any material interests in transactions or matters affecting the corporation.

Section III: Role of Stakeholders in Corporate Governance

Principle IIIA. The corporate governance framework should recognize the rights of stakeholders as established by law and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises. The corporate governance framework should assure that the rights of stakeholders that are protected by law are respected.

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

Principle IIIC. The corporate governance framework should permit performance-enhancement mechanisms for stakeholder participation.

Principle IIID. Where stakeholders participate in the corporate governance process, they should have access to relevant information.

Section IV: Disclosure and Transparency

Principle IVA. 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 the governance of the company. Disclosure should include, but not be limited to, material information on: 1. The financial and operating results of the company. 2. Company objectives. 3. Major share ownership and voting rights. 4. Members of the board and key executives, and their remuneration. 5. Material foreseeable risk factors. 6. Material issues regarding employees and other stakeholders. 7. Governance structures and policies.

Principle IVB. Information should be prepared, audited, and disclosed in accordance with high quality standards of accounting, financial and non-financial disclosure, and audit.

Principle IVC. An annual audit should be conducted by an independent auditor in order to provide an external and objective assurance on the way in which financial statements have been prepared and presented.

Principle IVD. Channels for disseminating information should provide for fair, timely and cost-effective access to relevant information by users.

Section V: Responsibilities of the Board

Principle VA. 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. 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.

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

Principle VC. The board should ensure compliance with applicable law and take into account the interests of stakeholders.

Principle VD. The board should fulfill certain key functions, including: 1. Reviewing and guiding corporate strategy, major plans of action, risk policy, annual budgets and business plans; setting performance objectives; monitoring implementation and corporate performance and overseeing major capital expenditures, acquisitions and divestitures. 2. Selecting, compensating, monitoring and, when necessary, replacing key executives and overseeing succession planning. 3. Reviewing key executive and board remunerations, and ensuring a formal and transparent board nomination process. 4. Monitoring and managing potential conflicts of interest of management, board members and shareholders, including misuse of corporate assets and abuse in related party transactions. 5. Ensuring the integrity of the corporation's accounting and financial reporting systems, including the independent audit, and that appropriate systems of control are in place, in particular, systems for monitoring risk, financial control, and compliance with the law. 6. Monitoring the effectiveness of the governance practices under which it operates and making changes as needed. 7. Overseeing the process of disclosure and communications.

Principle VE. The board should be able to exercise objective judgment on corporate affairs independent, in particular, from management: 1. Boards should consider assigning a sufficient number of non-executive board members capable of exercising independent judgment to tasks where there is a potential for conflict of interest. Examples of such key responsibilities are financial reporting, nomination and executive and board remuneration. 2. Board members should devote sufficient time to their responsibilities.

Principle VF. In order to fulfill their responsibilities, board members should have access to accurate, relevant and timely information.

ANNEX B: OECD Principles Assessment Matrix

Section I: The Rights of Shareholders

Principle IA. Basic shareholders rights:

(a) Observed	<input type="checkbox"/>	(b) Largely observed	<input checked="" type="checkbox"/>	(c) Partially observed	<input type="checkbox"/>
(d) Materially not observed	<input type="checkbox"/>	(e) Not observed	<input type="checkbox"/>		

Principle IB. The right to participate in decisions on fundamental corporate changes:

(a) Observed	<input type="checkbox"/>	(b) Largely observed	<input checked="" type="checkbox"/>	(c) Partially observed	<input type="checkbox"/>
(d) Materially not observed	<input type="checkbox"/>	(e) Not observed	<input type="checkbox"/>		

Principle IC. The right to be adequately informed about, participate vote in AGMs:

(a) Observed	<input checked="" type="checkbox"/>	(b) Largely observed	<input type="checkbox"/>	(c) Partially observed	<input type="checkbox"/>
(d) Materially not observed	<input type="checkbox"/>	(e) Not observed	<input type="checkbox"/>		

Principle ID. Disclosure of capital structures and arrangements enabling control disproportionate to equity ownership:

(a) Observed	<input type="checkbox"/>	(b) Largely observed	<input type="checkbox"/>	(c) Partially observed	<input type="checkbox"/>
(d) Materially not observed	<input checked="" type="checkbox"/>	(e) Not observed	<input type="checkbox"/>		

Principle IE. Efficient and transparent functioning of market for corporate control:

(a) Observed	<input type="checkbox"/>	(b) Largely observed	<input type="checkbox"/>	(c) Partially observed	<input type="checkbox"/>
(d) Materially not observed	<input checked="" type="checkbox"/>	(e) Not observed	<input type="checkbox"/>		

Principle IF. Requirement to weigh costs/benefits of exercising voting rights

(a) Observed	<input type="checkbox"/>	(b) Largely observed	<input type="checkbox"/>	(c) Partially observed	<input type="checkbox"/>
(d) Materially not observed	<input checked="" type="checkbox"/>	(e) Not observed	<input type="checkbox"/>		

Section II: Equitable Treatment of Shareholders

Principle IIA. Equal treatment of shareholders within same class

(a) Observed	<input type="checkbox"/>	(b) Largely observed	<input checked="" type="checkbox"/>	(c) Partially observed	<input type="checkbox"/>
(d) Materially not observed	<input type="checkbox"/>	(e) Not observed	<input type="checkbox"/>		

Principle IIB. Prohibition of insider-trading and self-dealing

(a) Observed	<input type="checkbox"/>	(b) Largely observed	<input checked="" type="checkbox"/>	(c) Partially observed	<input type="checkbox"/>
(d) Materially not observed	<input type="checkbox"/>	(e) Not observed	<input type="checkbox"/>		

Principle IIC. Disclosure by directors and managers of material interests in transactions or matters affecting the company.

(a) Observed (b) Largely observed (c) Partially observed
(d) Materially not observed (e) Not observed

Section III: Role of Stakeholders in Corporate Governance

Principle IIIA. Respect of legal stakeholder rights as established by law

(a) Observed (b) Largely observed (c) Partially observed
(d) Materially not observed (e) Not observed

Principle IIIB. Redress for violation of rights

(a) Observed (b) Largely observed (c) Partially observed
(d) Materially not observed (e) Not observed

Principle IIIC. Performance-enhancing mechanisms for stakeholder participation

(a) Observed (b) Largely observed (c) Partially observed
(d) Materially not observed (e) Not observed

Principle IIID. Access to relevant information

(a) Observed (b) Largely observed (c) Partially observed
(d) Materially not observed (e) Not observed

Section IV: Disclosure and Transparency

Principle IVA. Timely and accurate disclosure of material information

(a) Observed (b) Largely observed (c) Partially observed
(d) Materially not observed (e) Not observed

Principle IVB. Preparation of information, audit, and disclosure in accordance with high standards of accounting, disclosure and audit.

(a) Observed (b) Largely observed (c) Partially observed
(d) Materially not observed (e) Not observed

Principle IVC. Annual audit by independent auditor

(a) Observed (b) Largely observed (c) Partially observed
(d) Materially not observed (e) Not observed

Principle IVD. Channels for disseminating information allow for fair, timely, and cost-efficient access to information by users

(a) Observed (b) Largely observed (c) Partially observed
(d) Materially not observed (e) Not observed

Section V: Responsibilities of the Board

Principle VA. Act on an informed basis, in good faith, with due diligence and care, in the best interest of the company and shareholders

(a) Observed (b) Largely observed (c) Partially observed
(d) Materially not observed (e) Not observed

Principle VB. Fair treatment of each class of shareholders

(a) Observed (b) Largely observed (c) Partially observed
(d) Materially not observed (e) Not observed

Principle VC. Compliance with law and taking into account stakeholders' interests

(a) Observed (b) Largely observed (c) Partially observed
(d) Materially not observed (e) Not observed

Principle VD. Fulfillment of key functions, including corporate strategy, selection and monitoring of management, remuneration, board nomination, monitoring of conflict of interest including misuse of corporate assets and abuse in related party transactions, integrity of accounting, audit, governance practices and overseeing disclosure and communication.

(a) Observed (b) Largely observed (c) Partially observed
(d) Materially not observed (e) Not observed

Principle VE. Objective judgement on corporate affairs independent from management; devotion of independent time.

(a) Observed (b) Largely observed (c) Partially observed
(d) Materially not observed (e) Not observed

Principle VF. Access to accurate, relevant, and timely information

(a) Observed (b) Largely observed (c) Partially observed
(d) Materially not observed (e) Not observed

This table attempts to summarize the comments in this report, benchmarked against the main items set out in the OECD Principles of Corporate Governance.

Observed means that all essential criteria are generally met without any significant deficiencies

Largely observed means that only minor shortcomings are observed, which do not raise any questions about the authorities' ability and intent to achieve full observance within a prescribed period of time

Materially not observed means that, despite progress, the shortcomings are sufficient to raise doubts about the authorities' ability to achieve observance

Not observed means that no substantive progress toward observance has been achieved.

ANNEX C: Summary of Company Law and Securities Law Recommendations

Role of the Regulator:

- The LSC should deploy increased professional resources, especially in accounting and auditing.
- The LSC should be conducting detailed review of financial filings by issuers and focus on adequacy of risk disclosure and how funds are applied.
- Increased monetary penalties for regulatory violations, including fines on responsible individuals.
- The LSC should act to enforce disclosure obligations related to acquisitions of share blocks.

Disclosure and Transparency:

- Insider trading reporting obligations should be extended to large shareholders (over five percent, for example).
- The problem of gross violation of disclosure requirements by the hundreds of “public” companies resulting from voucher privatization should be addressed urgently. These companies should be removed from the NSEL, converted to an appropriate enterprise form and an equitable means provided for rationalization of their ownership structure. There are various ways in which this could be accomplished; special one-time legislation, buyout rights associated with valuation procedures, etc.

Supervisory or Board Structures:

- Supervisory board/management board training through associations or institutes, on a regional basis given the small number of actively traded companies.
- Where appropriate, board committees to deal with conflict of interest situations, risk management and monitoring, audit matters.
- Minimum professional qualifications for members of the Supervisory Board or its equivalent.

Shareholder Protection:

- Encourage the development of shareholders associations, in conjunction with mandate of the LSC to provide investor education.
- Appropriate mechanisms to address self-dealing and conflicts of interest that go beyond disclosure to include disinterested voting, independent valuation procedures, etc.
- Abusive exercise of voting rights, especially by majority shareholders, should give rise to remedies, possibly based on the doctrine of “abuse of right.”
- Abuses arising from corporate group structures (where actions may be taken by ultimate controlling shareholders or management to the detriment of a group member and its minority shareholders) should be addressed in legislation.
- A desirable balance of interests between majority and minority shareholders in publicly traded companies should be determined. Majority shareholders with a 90 percent or 95 percent interest, i.e. virtually 100 percent ownership, should be able to take their company private and avoid the burdens and costs of their status as publicly traded companies. This would also reduce the gross violations of disclosure requirements. Conversely, shareholders who find themselves in a very small minority should be able to put their shares to the company.

Accounting and Auditing:

- Strengthen local capacity for auditing/accounting and procedures for enforcement of accounting/auditing standards.
- Reform of auditing standards, which has lagged behind accounting standards reform, should be a priority, as well as increased oversight and enforcement of both sets of standards.

Codes, Legislation and the Courts:

- A civil and administrative insider trading offence with a reduced evidentiary burden should be created.
- Conflicts between the Civil Code and the Law on Companies should be reconciled. Consideration should be given to aligning the Law on Companies with corporate legislation in the Scandinavian countries, in the interests of drawing on comparable structures, management techniques and operational experience. The current Law on Companies is difficult legislation and appears to be badly understood.
- Develop a corporate governance code, on a regional basis, that would provide detail on the roles, responsibilities, operation (including policies for remuneration of supervisory board members and frequency of meetings), structure and qualifications for members of supervisory boards. The code should also make recommendations regarding the committee structure within supervisory boards, to the extent practicable, providing for specialized committees on such areas as audit and finance, risk policies and management and remuneration of executive management. -
Specialized arbitration to compensate for the relative lack of commercial sophistication in the court system.

ANNEX D: Summary of Observance of OECD Corporate Governance Principles

Principle	O	LO	PO	MO	NO	Comment
I. THE RIGHTS OF SHAREHOLDERS						
IA		X				<ul style="list-style-type: none"> Share registration centralized in Lithuania CSD. Public companies prohibited to restrict share transfers. Info on top-tier listings available online. In practice AGM participation confined to big shareholders. AGM approves dividends; in practice few dividends paid.
IB		X				<ul style="list-style-type: none"> AGM requires a quorum of 50%. 2/3 vote of shares at meeting required for increasing capital (each class), transactions larger than 5% of capital.
IC	X					<ul style="list-style-type: none"> Notice adequate. 5% shareholder has 15 days to supplement agenda. Shareholders can vote by proxy (with no restrictions).
ID				X		<ul style="list-style-type: none"> Informal relationships may not always be disclosed.
IE				X		<ul style="list-style-type: none"> Strong laws hampered by market manipulations depressing prices. Defensive techniques would trigger supermajority shareholder approval.
IF				X		<ul style="list-style-type: none"> Few institutional investors.
II. EQUITABLE TREATMENT OF SHAREHOLDERS						
IIA		X				<ul style="list-style-type: none"> Set by law, and processes appear adequate. Voting by mail is possible if mentioned in company statutes.
IIB		X				Insider trading prohibited; IAS rules apply to official list.
IIC		X				No "disinterested voting" mechanism.
III. ROLE OF STAKEHOLDERS IN CORPORATE GOVERNANCE						
IIIA		X				Numerous provisions aimed at protecting creditor rights.
IIIB		X				Many forms of creditor recourse available.
IIIC	X					Employee shares can be offered to encourage participation.
IIID				X		Must buy a share to access shareholders information.
IV. DISCLOSURE AND TRANSPARENCY						
IVA			X			<ul style="list-style-type: none"> Gross non-compliance and low standards, for small companies. In statutes; activities reported in annual / quarterly reports. In practice ultimate ownership is not adequately disclosed. Pay must be disclosed in aggregate. Risk factors must be disclosed. No requirement for disclosure.
IVB				X		IAS to be fully implemented by 2004. Current standards gap.
IVC				X		All audits not high-quality.
IVD		X				Financial and non-financial info available at LSE/NSEL.
V. RESPONSIBILITIES OF THE BOARD						
VA		X				Two-tier board (one-tier optional); powers well laid out.
VB		X				Treatment appears to be generally fair.
VC		X				Board required to comply with all legal requirements.
VD		X				<ul style="list-style-type: none"> No industry standards in place. AGM determines supervisory/management board pay. Boards generally play a weak role. Laws strong, but monitoring varies. CEO responsible for organization of accounting. Management of company responsible for disclosure.
VE		X				<ul style="list-style-type: none"> Two-tier board means supervisory board is non-executive. No specific requirements
VF		X				Management board must grant access to supervisory board.

ANNEX E: INSTITUTIONAL AND MARKET STRUCTURE OVERVIEW

A Capital Market Overview

A1 Capital market structure and legal framework

A1.1 Capital Market Structure

The two major determinants of the state of the capital markets in Lithuania are the size of the economy and the voucher privatizations of the early 1990s. Lithuania is a small country with a population of about 3.5 million people (according to the 2001 census). The Lithuanian securities market was created in the early 1990s as part of a mass voucher privatization scheme that involved the introduction of hundreds of public companies in the capital market, together with numerous newly created investment funds. The trading of the shares of these newly created public companies, and the investment funds created to concentrate their ownership, was designed to be conducted over the NSEL. The effects of the voucher privatizations, ten years on, are still working their way through the economy, in terms of ownership structure of the corporate sector and the nature of financial intermediation. There were approximately 1088 public companies registered with the LSC as of September 2001 that have issued shares of stock.

The NSEL has two tiers: a Central Market where companies trade that are listed on a primary, Official List and a secondary, Current List, and an Unlisted Market. Only 6 companies are on the Official List of the NSEL, with 40 more on the Current List. There are 895 companies on the Unlisted Market that either trade sporadically or not at all. The 46 companies on the Official and Current lists accounted for over 90 percent of share turnover in 2001, and shares of the five most actively traded stocks accounted for 57 percent of share trades in 2001. Lithuanian Government debt securities represent an increasingly large part of total securities turnover on the NSEL (54 percent in 2001 and 2001, up from 46 percent in 1999).

The market capitalization of the NSEL is shrinking (LTL 12.48 billion or USD 3.12 billion as of end 2001, representing an estimated 26 percent of GDP, compared to LTL 13.74 billion in 2000 and LTL 13.88 billion in 1999), due to a decline in both Central Market and Unlisted Market activity, although still sizeable compared to peer countries. Ownership of the corporate sector consolidated in part due to the activities of strategic investors who often aim to acquire a 100 percent ownership stake in their investment target. During 2001, the LSC, at the request of companies themselves, revoked registration of 128 companies' shares, about 69 percent (88) of them as a result of reorganization as a private company. Another 40 companies ceased operating as legal entities in 2001, and 57 reduced their capital due to losses.

Foreign investors dominate, both as strategic and portfolio investors. There are few institutional investors. As of February 2002 there were nine life insurance companies, for example – of which four were majority foreign owned - but total insurance assets amounted to only LTL 902 million (USD 225.5 million) or an estimated 1.9 percent of GDP at the end of 2001. There are no private pension funds, only one index mutual fund and virtually no retail investor base. Wealthy individuals invest offshore and the general public has little interest in capital markets (one, for lack of disposable income and two, for lack of confidence in the wake of the voucher privatizations). All these factors contributed to low securities trading volumes in Lithuania compared to the peer country group. Although securities market capitalization and the banking

sector assets are similar in size, little new financing has been raised from the capital markets in Lithuania in recent years (except Government debt), and the banking system has been and is likely to remain the key source of external financing for the corporate sector. This has important implications on the nature of corporate governance in Lithuania, as banks, in addition to controlling strategic investors, will play a significant role in providing managerial discipline to public corporations.

Table 1: Stock market size and trading volumes (all figures for 2000)

	GDP/Capita (USD)	Trading volume (USD mln.)	Market Capitalization (USD mln.)	Market Capitalization/GDP (%)	Annual trading volume per one dollar of GDP/capita (USD)
Lithuania	3,027	202	3,050	27.23	66,732
Latvia	3,000	228	563	7.82	76,000
Estonia	3,570	326	1,846	36.92	91,316
Slovakia	3,537	896	742	3.88	253,322
Slovenia	9,050	465	2,547	14.07	51,381
Denmark	30,340	91,560	107,660	66.95	3,017,798
Finland	23,038	206,643	293,635	245.10	8,969,659

Source: World Bank and NSEL Statistics

The NSEL was established in 1992. Currently, the NSEL has 20 members, banks and brokerage firms. The NSEL's major shareholder is the Ministry of Finance (MoF) and it is now organized as a public company. There is continuous trading at variable prices. All publicly traded securities must be dematerialized. The trading system of the NSEL is computer-based and order-driven. The system was provided to the NSEL by the French government in 1993 and was modified in 1996 and 1997-98 to facilitate greater order clearance and continuous trading. As of December 29, 2001, domestic investors accounted for 53.6 percent of the combined market capitalization of the Official and Current Lists whereas non-residents accounted for 46.4 percent. Block trading predominates on the NSEL; currently approximately 80 percent of trading in listed shares is effected through "block trades," i.e. negotiated purchases where price determination occurs outside the exchange and settlement through the exchange facilities.

The 1,260 or so public limited liability companies in Lithuania represent only 3.5 percent of all enterprises. Under the Law on Companies, other legal forms are permitted but only public limited liability companies may trade on the NSEL. On December 31, 2001 the market capitalization of NSEL was LTL 12.48 billion (USD 3.12 billion) representing an estimated 26 percent of GDP. Companies listed on the Official and Current Lists of the NSEL must, as a rule, have at least 25 percent of shares in free float. The NSEL can allow a lower free float, if such float is considered sufficient to support liquidity. According to a conservative calculation by the NSEL, the average free float was, in fact, only 14 percent in October 2001.

The trading systems (exchange, clearing and settlement) are modern and subject to appropriate regulatory authorization and supervision for the size of the market and level of activity. The CSDL acts a central depository for all publicly traded securities in Lithuania; it is fully automated and linked to Bank of Lithuania's (BoL) payments system, thus providing delivery-versus-payment settlement on T+3. The NSEL uses a direct link to transmit information on

concluded trades to the CSDL on a daily basis. A mutual guarantee mechanism enforces joint responsibility for all NSEL members to ensure full settlement of all trades.

There is limited use of Self Regulatory Organizations (SROs) and an increasing trend towards greater reliance on formal regulation administered by the LSC. The Association of Intermediaries in Trading Public Securities (AITPS) acts more as a trade association; membership is voluntary and submission to sanctions imposed is at the member's discretion. Given the size, level of development of the markets and its institutions, greater use of formal regulation under the oversight of the LSC is an acceptable, even preferable, approach. A new Securities Markets Law (SML), which was adopted by Seimas on December 17, 2001 and comes into force as of April 1, 2002, incorporates the standards of the AITPS Code of Ethics, for example, and thus makes them legally enforceable.

A1.2 Legal Framework

The formal capital market regulatory structure is well advanced in terms of harmonization with EU directives and may, in fact, be considerably ahead of the market. A new Civil Code (effective as of July 1, 2001), modeled on the modern Dutch and Quebec Civil Codes, provides the basis for private and commercial law in Lithuania. The primary legal framework for publicly traded companies consists of the Law on Companies (effective as of July 1, 2001), replacing earlier legislation, the Law on Public Trading in Securities (LPTS) (adopted on January 16, 1996 with subsequent amendments) and its numerous rules, and the Rules of the National Stock Exchange of Lithuania (NSEL) as well as Rules of the Central Securities Depository of Lithuania (CSDL). On December 17, 2001 a new Securities Market Law (SML) was adopted by Seimas (Lithuanian Parliament) and as of April 1, 2002, replaces the LPTS.

Only public limited liability companies governed by the Law on Companies, can issue shares that can trade publicly. The Law on Companies is the third corporate law this decade and is a hybrid form of legislation based on both European and Anglo-American concepts. The LPTS and its rules reflect certain concepts of Anglo-American securities market legislation but have been harmonized to comply with EU directives. Integration with the EU is imminent (2004), and efforts to comply with EU directives are well advanced. The new SML continues the harmonization efforts with EU directives, brings the legislation into line with the new Civil Code and authorizes integration of the NSEL with other exchanges. In particular, the SML includes more extensive prohibitions on and definitions of insider dealing and market manipulation. The LPTS, as well as the new SML, governs the securities markets and establishes the institutional structure: the Lithuanian Securities Commission (LSC), the NSEL and the CSDL. The LPTS also regulates the trading of securities and sets out the extent of liabilities or refers to other codes for determination of civil, administrative or criminal liability. Although the formal regulatory framework is adequate to empower the regulator to act effectively, a formalistic rather than substantive review process and a lack of professional resources, especially in the accounting and auditing field, are regulatory weaknesses. The use of information technology by the regulator is well advanced.

A2 Ownership Structure

The ownership structure of Lithuanian companies demonstrates several different characteristics: public companies created through voucher privatization (active with concentrated ownership and a large number of small investors, inactive and in liquidation, inactive with no determinable management or place of business); state owned enterprises identified for case-by-case privatization, primarily to strategic investors; public companies which have been recently “taken private,” through strategic investment. The market trend is towards closely-held companies, with a high degree of foreign ownership.

Generally, disclosure requirements established by the LPTS and the new SML together with the Rules and Regulations of LSC provide for a reasonable means to identify the ownership structure of public companies. For example, shareholders under the Law on Companies are entitled to receive full lists of the company shareholders, the LPTS disclosure rules concerning acquisition and disposal of blocks of shares over certain thresholds obligate not only the direct owners, but also related parties to disclose their equity interests, thus providing for a tool enabling to track not only the formal owners, but also the beneficial and ultimate owners of companies. However, in practice, informal relationships among shareholders may not be disclosed or the parties otherwise decide to keep their arrangements private. There are no comprehensive statistics yet on the type and holdings of investors. There is no legislation dealing specifically with corporate groups or holding company structures. The great majority of individual retail investors received their shares as part of voucher privatization and the registers of these shares are still maintained by the issuers (about 75 percent of all shares in terms of capitalization at the end of 2001). As a result of the new SML these shares will now be transferred to accounts maintained by licensed intermediaries. According to the CSDL, active investors, those making market purchases, already maintain their securities accounts with brokers. There are about 16,000 such individual investors, which at the end of 2001, held approximately 12.4 percent of shares in accounts maintained by brokers.

Lithuanian capital markets do not have many local institutional players. Most investment companies established pursuant to the Law on Initial Privatization of State Property as a means to accumulate privatization vouchers have been liquidated since introduction of the new Law on Investment Companies in 1995 and only 11 of those entities that have been reregistered, continued their activity as holding companies at the end of 2001. However, these holding companies have practically no investment activities and have the character of industrial holding companies rather than investment funds. After general revision of the Law on Investment Companies in 1999 the first investment fund (an index tracking fund) was established in Lithuania in 2000.

The Law on Pension Funds was adopted on June 3, 1999 putting in place a regulatory framework for the establishment and operation of a voluntary third pillar pension scheme. However, no voluntary pension funds exist as of yet in Lithuania and the political debate concerning the development of a mandatory second pillar scheme (compulsory accumulative pension insurance) continues. Until this issue is resolved, the development of voluntary pension funds will be impeded.

A3 Regulatory framework and professional/best practice bodies

The LSC was originally established in 1992 as an institution accountable to the Ministry of Finance and acquired its current status in 1996 through the implementation of the LPTS. The LSC is a government agency accountable to Seimas and is funded through the state budget. The LSC has a chairman and four commissioners appointed to five year terms by Seimas upon nomination by the President. They may serve a maximum of two terms. The LSC operates under the supervision of its Chairman.

Members of LSC must have appropriate professional expertise, abilities and work experience and be considered worthy of being a member of the LSC. The members of the LSC are prohibited from acting as members of the management, boards of directors, oversight committees or other bodies of issuers of securities. They may not perform any other service or function which might influence their independence, or diminish their public reputation. The LSC has a total staff of 44, and, according to the LSC, employees are paid comparably to their private sector peers in the financial industry. However, as a result of aligning LSC salaries with those of civil servants, salaries of the members of the LSC and managers were reduced to a level where it has become problematic to retain high quality staff. LSC has also not been able to hire accounting and auditing specialists.

As a supervisory and regulatory agency, the LSC is primarily responsible for: (1) the licensing and supervision of financial intermediaries; (2) the approval of offering documents for public offerings of securities, including takeover bids or tender offers; (3) the oversight of the NSEL and its members and the clearing and settlement systems; (4) the investment activities and portfolio composition of pension funds and collective investment vehicles; (5) market surveillance (insider trading, market manipulation); (6) oversight of the Association of Intermediaries of Public Trading in Securities (AIPTS); and (7) the imposition of sanctions for market violations. The LSC has investigatory and inspection powers as well as rule making authority (art. 32 (2) LPTS). The LSC can initiate investigations of its own accord or upon notification of third parties. In cases of non-compliance or violation of the LPTS by market participants, the LSC may give warnings, halt trading, publicize cases of abusive practices and impose fines. The LSC can only investigate violations directly related to securities trading. Violations of the criminal code are referred to the prosecutor-general. Administrative decisions by the LSC can be appealed to the court. The LSC has the ability to carry out electronic surveillance of all securities trading on the NSEL and is responsible for overseeing all trading on the NSEL.

The LSC's responsibilities extend to the securities dealing of banks and to that extent, banks in Lithuania are subject to dual supervision by the LSC and the Bank of Lithuania (BoL). The LSC has signed information-sharing agreements with both the BoL and the State Insurance Supervisory Authority (SISA), in recognition of the increasing overlap in their areas of supervision.

The CSDL started its activity as a subdivision of NSEL and was established as an independent institution in 1994. The mandate of the CSDL is to operate as the Lithuanian Central Registry/Depository for all kinds of dematerialized securities and to contribute to the

competitiveness of the Lithuanian capital markets through providing electronic clearing, settlement and depository services.

The main objective of the CSDL is to conduct the general accounting of dematerialized securities in Lithuania. The CSDL operates general securities accounts. In addition to general securities accounts, the CSDL may also manage personal securities accounts. The CSDL may issue binding instructions and directives detailing the procedures prescribed in the Rules of Accounting of Securities and their Circulation, approved by the LSC under the proposal of the CSDL. The CSDL is in compliance with the ISSA/G30 recommendations and clears and settles all trades executed on the NSEL. The systems for clearing and settlement and market surveillance are comprehensive and modern. Clearing and settlement is paperless, fully automated and based on delivery-versus-payment principles, and T+3 settlement.

Financial reporting and accounting by Lithuanian enterprises are governed by laws and regulations issued in 1992-93, but new laws were approved in 2001 and come into effect in 2002. The new laws significantly increase conformity between Lithuanian requirements and EU directives, establish a new national standard setting body, and require greater compliance with IAS. The Association of Accountants, which is the professional body for accounting professionals, will be represented on the board of the standard setting body.

There are other professional bodies, such as the AIPTS and the Chamber of Auditors, members of which agree upon market conventions or conduct standards and which have some limited capacity to take disciplinary action against their members, but which could not properly be described as SROs.

The audit of financial statements of Lithuanian enterprises is governed by an audit law, which was revised in 1999 and for which further revisions are being considered. The revised law established the Chamber of Auditors, the professional association for licensed auditors, as the standard setting body in Lithuania. The Chamber is in the process of preparing auditing standards in conformity with EU directives and ISA. Certain standards are already in force.

A4 Registration and listing requirements

The LPTS requires any issuer to register its securities with the LSC if any of the following conditions are satisfied: (i) the issuer is a public company (already in existence or in the process of creation); (ii) there were more than 100 holders of at least one class of securities of an issuer on the last day of the preceding business year ; or (iii) an issuer or investor intends to issue securities into public trading . The LPTS establishes standards for minimum disclosure of information in the prospectus. The prospectus must also provide the names of company management and the members of the Supervisory Board as well as disclose aggregate remuneration of the members of the boards. It is noteworthy that the new SML provides the LSC with the authority to grant exemptions from registration, previously not available under the LPTS. The LSC under the new law may also review private placement memoranda, specific registration procedures for the securities issued according to special programs and registration of securities, the prospectus for which was reviewed by the supervisory institution of an EU member state.

After receiving approval from the LSC, an issuer may submit an application to the NSEL, if the shares are to be listed there. The application must include information concerning the type of securities to be listed, the ownership structure of the company, a copy of the constitution and the company statutes, the prospectus, and any additional information on events which occurred after its publication.

The listing Department of the NSEL monitors compliance with listing requirements. The Department has three staff member responsible for supervision of the six companies listed on the Official List and the 40 companies on the Current List.

The NSEL has two market segments: a Central Market, where companies trade that are listed on a primary, Official List and on a secondary, Current List; and an Unlisted Market. Companies on the Unlisted Market (whose securities are unlisted but admitted for trading on the NSEL), should meet the following requirements: (i) securities are the object of public trading; (ii) securities are registered with the LSC; (iii) a general securities account is opened for these securities at the CSDL; (iv) securities traded on the secondary market are fully paid up; and (v) securities are accounted in accordance with legal requirements. In addition to certain general requirements (securities traded on the secondary market must be fully paid up and accounted in accordance with legal requirements), shares may be admitted to the Current List, once (i) the issuer's minimum authorized capital is not less than LTL 4 million (USD 1 million) and (ii) at least 25 percent of an issue or part of the issue with a nominal value of at least LTL 1 million (USD 250,000) has been distributed publicly and there are at least 100 shareholders.

SEL's listing and disclosure requirements for admission to the Official List are the most stringent. Shares may be admitted to the Official List following approval by the NSEL board (i) if market capitalization was no less than LTL ten million (USD 2.5 million) during the last financial year; (ii) there is a 25 percent public float, or otherwise sufficient liquidity; (iii) the annual prospectuses-statements are prepared in compliance with LSC rules, financial statements of the preceding three years are prepared in accordance with International Accounting Standards (IAS) and audited pursuant to the International Standards on Auditing (ISA); and (iv) the company was operating profitably in the course of the preceding fiscal year. The latter requirement may be waived if it is considered that investors have the possibility to familiarize themselves with information necessary to make an informed investment decision.

According to the LPTS (and this provision is preserved in the new SML), shares admitted to the Official or Current Lists may be traded only over the NSEL. Unlisted securities can be freely traded on the NSEL or off exchange. However, there are no price quotations for unlisted shares and deals are based on agreement between buyer and seller. The settlement can take place through or outside the NSEL.

B Shareholder Protections

B1 Shareholder rights and share registration

The Law on Companies sets out the fundamental rights of shareholders and their relationship to the governing bodies . Two types of shares may be issued: preferred and common. All common

shares have voting rights. Preferred shares may be non-voting if so provided in the company statutes. However, owners of preferred shares with cumulative dividend rights acquire voting rights if the company fails to pay all the dividends during two consecutive years. The total nominal amount of preferred shares may not exceed $\frac{1}{3}$ of the company's share capital. The Law on Companies indicates that voting rights are obtained only upon full payment for shares (subject to a minor exception).

Under the LPTS, all securities issued to the public must be dematerialized and registered with the CSDL. The CSDL is the only agency authorized to register dematerialized securities in Lithuania. The CSDL keeps track of the ownership of securities by operating a general securities account. It ensures the proper and timely clearance of transactions in securities between account operators, and takes measures to ensure the integrity and security of the overall securities management system. A record in a personal securities account, which currently may be operated by brokerage firms, authorized commercial banks as well as issuers, is direct evidence of the ownership of a dematerialized security. This new provision of the SML, effective as of January 1, 2004, is aimed at enhancing shareholder protection by transferring the operation of shareholders' securities accounts from issuers to licensed and supervised specialized entities.

B2 Shareholder meetings

Under Article 24 of the Law on Companies, the Annual General Meeting (AGM) of shareholders has sole authority to make decisions on the most important matters affecting the company: (1) changes in the company statutes, (2) increases and decreases in the company capital, (3) election and dismissal of members of the Supervisory Board, or the Management Board, if there is no Supervisory Board in the Company, or the Chief Executive Officer, if there is no Management Board, (4) the annual financial reports and the distribution of profit, (there is a mandatory formula for calculating dividends if the AGM fails to distribute profits) (5) appointment of external auditors, (6) liquidation and reorganization of the company, (8) transfer or encumbrance of substantial assets of the company and (7) other activities specified in the Law on Companies and company statutes. A resolution taken on an issue not included on the agenda of the General Meeting and procedural violations in convening the meeting or in drawing up the agenda may serve as unconditional grounds for invalidating the AGM resolutions. However, in other cases resolutions of the AGM may be invalidated only if the violation had a decisive effect upon the quorum of the meeting or the adoption or rejection of the resolution .

Companies are required to convene an AGM at least once each year. Extraordinary General Meetings may be convened by the company at the request of the holders of ten percent of the shares. Under the Law on Companies, the shareholders' meeting and its agenda must be announced 30 days in advance. For public companies, an announcement regarding the AGM, the proposed agenda and all decisions requiring a vote must be published in a newspaper indicated by the company statutes, or handed over personally with the written confirmation of receipt or sent by registered mail. For private companies any of the latter two forms of notification may be used . The Law on Companies permits shareholders' meetings to be held in the location of the company headquarters or that of the stock exchange . At least 30 days before the AGM, the shareholders must be granted access to documents available to the company, relating to the agenda of the meeting. If a shareholder so requests in writing, the Chief Executive Officer shall

within three days from the receipt of the written request deliver all draft resolutions of the meeting together with relevant explanations of the initiators of the draft resolution .

Shareholders can introduce items to the agenda of meetings. Not later than 15 days before the date of the AGM, shareholders representing $\frac{1}{20}$ of all the votes may request amendments or present counterproposals to issues requiring a vote. Shareholders have to be informed of amendments to the agenda not later than ten days before the date of the AGM in the same manner as convocation of the meeting. Neither the Management Board nor the Supervisory Board is required to respond to any questions submitted prior to the shareholders' meeting, but can do so during the meeting. The agendas for shareholders' meetings are usually prepared by the Management Board. The shareholders may make decisions on issues not on the agenda, if all voting shareholders with votes agree to do so. Such items are presented during the course of the meeting, and are not circulated in advance.

All persons who are shareholders of the company on the day of the meeting, irrespective of the number and class of shares they hold, have the right to attend the company's AGM, unless the company statutes provides that the General Meeting (including any adjournment thereof) may be attended by persons who were shareholders of the public company at the close of the shareholders' record day . In practice, the right to attend the shareholders' meeting is commonly understood to include the right to express an opinion and to ask questions concerning the items of agenda.

B3 Market for corporate control

A person or a group of related persons must notify the LSC of acquisitions or dispositions of voting shares in excess of $\frac{1}{10}$, $\frac{1}{5}$, $\frac{1}{4}$, $\frac{1}{3}$, $\frac{1}{2}$, $\frac{2}{3}$, or $\frac{3}{4}$ of all the votes under the LPTS. Failure to disclose leads to loss of voting rights of the shares exceeding the limits for two years after disclosure is made. All decisions adopted in the period between the acquisition of a block of shares and the time of disclosure may be annulled if management has been changed or property or non-property rights of shareholders have been violated by the decisions.

The new SML authorizes the LSC to grant exceptions to notification requirements regarding acquisitions or disposals of blocks of shares. Exemption may be granted to intermediaries, if they dispose of the acquired securities within 30 days and do not exercise the right to vote. The LSC may also waive the requirement to notify, if disclosure of such information might harm the issuer and failure to disclose would not mislead the investors .

Tender offer rules under the LPTS provide for voluntary and mandatory tender offers. A person or a group of related persons acquiring more than 50 percent of votes in a company shall be obliged to make a mandatory tender offer to buy the remaining shares. The price is the weighted average price of shares acquired by the offeror(s) during the 12 preceding months. The Supervisory Board of the target must publish an opinion on the bid; members of the Supervisory and Management Boards cannot act in any way to prevent shareholders from deciding on the bid.

The experience with these rules has been that they are not very effective in protecting minority shareholders rights. Acquirers of a majority interest often, before exceeding the 50 percent limit,

had effective control over the company, and were able to artificially reduce the price of shares acquired during the preceding 12 months by taking advantage of market illiquidity. The new SML introduces more stringent mandatory offer rules by lowering the threshold trigger to 40 percent and requiring the tender offer price to be the highest price of acquisition of shares during preceding 12 months . This is in line with the general trend in Europe aimed at protecting minority shareholders. The threshold in European countries varies, but is generally 50 percent or lower. In the other Baltic countries, the threshold is 50 percent but has already been reduced in some Scandinavian countries.

Tender offers, mostly mandatory offers, have been relatively frequent in Lithuania. During the period 1998-2001 there were a total of 142 tender offers registered with the LSC. Of these tender offers 133 were mandatory and nine were voluntary offers. The response of shareholders to these offers has varied. In case of the by far largest (mandatory) tender offer for the remaining shares of the largest commercial bank, Vilniaus Bank, by its Swedish parent bank, the overwhelming majority of shareholders tendered their shares. On the other hand, of the 35 tender offers in 2000, in the case of 19 of them – mainly by domestic investors - no shares were offered for sale. The price offered was too low to attract any interest. Tender offers during 1998-2001 amounted to LTL 788 million with LTL 487 million, or 62 percent actually being sold.

The proposed limit for mandatory tender offers in Lithuania is considered adequate to protect the rights of minority shareholders. Unlike the situation in some EU countries, Lithuanian shareholders with relatively small holdings (10-20 percent) do not dominate the company.

On the other hand, mandatory offers to buy out remaining shares have the effect of reducing available investment opportunities in an already very small market; these companies are taken private. And although small shareholders have no obligation to sell their shares, there is often, in practice, no alternative, due to the risk of otherwise being left with unlisted, difficult-to-sell shares. In small, transitional markets, there are thus arguments also in favor of relatively high limits for mandatory tender offers.

B4 Participation in corporate decisions

The Law on Companies provides the right for shareholders to vote at AGMs. Decisions on key issues must be made by $\frac{2}{3}$ majority (or $\frac{3}{4}$ majority in case of waiving pre-emptive rights) of the shares represented at the shareholders' meeting (rather than a minimum percentage of outstanding share capital). The company statutes may stipulate a higher qualified majority required for adoption of certain resolutions .

The AGM elects the members of the Supervisory Board for a period of up to four years. Supervisory Boards must have at least three members. The Supervisory Board appoints Management Board members for a maximum term of four years, although the terms may be renewed indefinitely . In addition, shareholders with $\frac{1}{20}$ or more of shares may propose candidates for the Supervisory Board and the voting for such candidates must be conducted before votes for the individuals. Cumulative voting for electing members of Supervisory Boards is mandatory.

Shareholders have the right to vote by proxy (which must be notarized for natural persons in some cases). The proxy must be appointed in writing and the proxy card delivered to the company. There are no restrictions as to who may be appointed proxy . As a general rule, a shareholder may withdraw his proxy by notifying the agent and the company in writing, however shareholder agreements may limit such proxy withdrawals. Voting by mail is permitted only if authorized in the company statutes. After the general ballot has been sent or handed in to the shareholder, the ballot may not be changed. The general ballot signed by the shareholder (his proxy) shall be delivered to the company not later than one day before the General Meeting. As a general rule, the general ballot signed by the shareholder (his proxy) and delivered to the company is irrevocable .

B5 Equitable treatment and statutory remedies

Abuses of the minority shareholders rights in the period of post voucher privatization, including non-dividend payment of the company funds to the controlling shareholders, used to happen. Although there is no systemized information on this matter, but the presence of the violations was noticeable. The legislator has reacted to this situation by adopting the amendments to the Law on Companies. In that respect the amendments of 1998 have to be mentioned as they increased protection of the minority shareholders' interests by expanding their rights in relation to general meetings of shareholders, expanded possibilities to challenge decisions of the managing bodies and claim damages, specified procedure of receiving information from the company. This amendment also strengthened the stakeholders participation in corporate governance, by introducing the special shares and providing direct recourse of creditors in relation to the reorganization of the company. The recent improvement of the law of corporations is related to introduction of the conflict of interest rules, clear fiduciary duties of the members of the managing bodies and wider disclosure requirements in the new Civil Code and Law on Companies, which came into effect on July 1, 2001.

All shareholders who are in the same position (i.e. shareholders owning shares of the same type and class, of the same nominal value, which are fully paid up or not paid up, etc.) have equal rights and duties. If all the voting shares of the company are of the same nominal value, all shares carry one vote at the AGM. Special shares may grant greater rights to state or municipal holders (for the rights of special shares, see C2 below). Further, where voting shares have different nominal values, one share of the lowest nominal value shall give its holder one vote, and the number of votes granted by other shares shall be equal to their nominal value divided by the smallest nominal value of a share . On the other hand, the Law on Companies requires that ordinary shares, which constitute the bulk of the authorized capital , must have the same nominal value.

The rights of ordinary shareholders to dividends or a share in the assets of the company upon liquidation are subordinated to the satisfaction of claims of the holders of preference shares. Only the ordinary shareholders have pre-emptive rights. The company statutes must specify a fixed amount of dividend (cumulative or non-cumulative) attributable to the preferred shares . Preferred shares may be voting but this must be specified in the company statutes.

Shareholders have a number of statutory remedies:

A. Preventive action. Shareholders can ask the court to prohibit the managing bodies of the company from entering into transactions violating the purposes of the company or which exceed the managing body's authority. This remedy is important in the light of Art. 2.83 Par. 1 of the Civil Code which provides that transactions entered into by the managing bodies of a company which exceed their authority (i.e. are ultra vires) shall be binding to the company unless the other contracting party has acted in bad faith.

B. In addition to actions for invalidation of resolutions of general meetings described under B2, any shareholder has the right to bring an action before the court, requesting that a resolution of the AGM be annulled where it:

- contradicts the company statutes or Lithuanian law;
- is detrimental to the company.

C. Parties to a shareholders agreement can also initiate court proceedings concerning resolutions of the AGM which contradict the shareholders agreement. In such case the remedy is a recalculation of the votes based on the terms of the shareholders agreement or an annulment of the resolution itself.

D. Any shareholder may appeal decisions of the Supervisory Board, the Management Board or the Chief Executive Officer. Such appeals must be based on grounds of contradiction with imperative rules of law, company statutes or principles of reasonability, honesty or fairness.

E. One or several shareholders may claim compensation for damage caused to the shareholders. This provision, which may be comparable to providing class action rights, is new to Lithuanian legal system and is as yet untried.

F. A derivative action is also available to the Supervisory Board to represent the interests of the company in disputes with management. Similarly, any shareholder may claim compensation on behalf of the company in case a violation of conflict of interest rules by members of management bodies.

G. The LSC has authority by law to exercise remedies available to investors, including shareholders, if in the public interest.

H. The new Civil Code provides for two new remedies: investigation of activity of an entity and forced sale of shares. These provisions are as yet untried.

(i) Investigation: Shareholders holding at least $\frac{1}{10}$ of the authorized capital of the company (or less, if so provided by the company statutes) have the right to request the court to appoint experts to investigate if the company, managing bodies of the company or members of the managing bodies have acted properly. If, on the basis of such investigation, the court determines that there has been improper action, one of the following measures may be applied:

- annulment of decisions of the managing bodies of the company;

- suspension or dismissal of any member of a managing body;
- appointment of temporary managing bodies of the company;
- authorization to disregard certain provisions of company statutes;
- order to change certain provisions of the company statutes;
- transfer of the voting rights in the managing bodies of the company to another persons for a limited period of time;
- order the company to perform or abstain from certain actions;
- liquidation of the company and appointment of a liquidator.

(ii) Private companies have the right to request the court to order that the shares of a person whose actions contradict the objectives of the company (and there is reason to believe that such behavior will not change in the future), are sold to the shareholders instituting the action.

On December 17, 2001, a Law on Insurance of Obligations of Banks and Financial Brokerage Companies to Investors was passed and comes into effect on July 1, 2002. The purpose of the law is to protect individuals, particularly small investors, in case of failure of broker-dealers. The scheme is similar to the existing deposit insurance scheme and will be administered by the same institution, the Deposit Insurance Fund.

B6 Insider trading and self-dealing

Under the LPTS, issuers must report the occurrence of material events within five days to the LSC and the NSEL. In practice, however, the LSC has been requiring listed companies to disclose such events immediately. The new SML aligns the legal framework with this practice, requiring all listed companies to disclose material events immediately, while giving unlisted companies five days to do so. Insider trading and market manipulation are prohibited and subject to both fines and imprisonment. The LPTS prohibits insiders from taking advantage of undisclosed information to trade securities and from divulging such information to third parties. Executives of the issuer must notify the LSC of trades in their company's shares. The restrictions against market manipulation include the prohibition against spreading false information to influence the price of securities

The LSC maintains an enforcement department of 4 full-time staff members. In addition, the NSEL monitors suspicious trading and forwards cases to the LSC. During 2001, the LSC carried out 190 inspections, of which 35 were routine, full-scope inspections and 155 were reviews of cases of suspected violations. In 42 of these cases, LSC administrative sanctions were imposed, mostly for failure to submit required periodical information and failure to open individual securities accounts. During 2001, five cases of suspected violations of the securities law were referred to the prosecutor-general for review, three of which involved broker-dealer and client matters and two cases concerned public companies. There were a few cases of suspected insider trading and price manipulation, one (on price manipulation) of which resulted in sanctions.

C The Role of Stakeholders in Corporate Governance

C1 Legal rights and redress for violation of rights

289. The Law on Companies requires that the Supervisory Board (as well as the Management Board and the Chief Executive Officer) act in the best interests of the shareholders and the company. Failure to conduct the operations in the manner required subjects board members to both civil and criminal penalties. Members of the Management Board are also jointly and severally liable for actions that cause damage to the company.

There are no voluntary codes of best practice of corporate governance developed by business organizations or non-governmental organizations. Through the public reference facilities of the LSC and the commercial registers, the same financial information available to shareholders is also publicly available to other stakeholders.

In a broader sense, corporate decisions are influenced by labor law requirements, consumer protection and environmental legislation. Enforcement of these laws is also sufficiently effective to ensure that the relevant requirements are taken into consideration when adopting corporate decisions. However, particular rights and redress for violation of rights are established for creditors under both the Civil Code and the Law on Companies.

A. Creditors whose rights and legitimate interests are neglected by the AGM or management bodies of the debtor may request court-ordered annulment of such decisions. The grounds are violation of mandatory legislative provisions or company statutes or conflict with principles of reasonability, honesty or fairness.

B. A company which is in default with respect to debts in excess of $\frac{1}{20}$ of the company's share capital must obtain the creditor's written consent before investing assets in another enterprise.

C. Creditors may ask the court to convene an extraordinary general meeting of shareholders, when certain capital requirements are not met. At the meeting, the shareholders may decide to (i) reduce the share capital of the company by an amount equal to the deficiency; (ii) liquidate the company; or (iii) contribute additional capital to make up the deficiency. If the shareholders fail to take the required action, the Management Board is obliged to apply to the court for a reduction of capital .

D. In connection with any reduction of capital, each creditor must be notified. In certain circumstances, a creditor may request additional security.

E. In connection with a reorganization, for example, by merger, a company is obliged to notify each creditor and may be required to provide additional security.

F. In connection with liquidation of a company, creditors must be notified and may have the right to review annual financial statements and the statements produced at liquidation.

G. Creditors may initiate bankruptcy and restructuring proceedings under the Law on Enterprise Bankruptcy and the Law on Restructuring of Enterprises, respectively.

C2 Performance-enhancing mechanisms for stakeholder participation

Companies may issue employees' shares which are registered shares sold on preferential terms or otherwise transferred to employees of the company. The company statutes may restrict the transfer of employees' shares, but the period of restriction may not be longer than three years after which the share is converted to an ordinary registered share. Employees' shares are primarily used as a staff performance incentive.

D Financial and Non-Financial Disclosure

D1 Disclosure of material information

Rules concerning disclosure are included in the Law on Companies, the LPTS and accounting legislation.

Public companies (as well as larger private companies) must make their annual report, together with the auditor's opinion, available to the public. Upon the request of any person, the company must provide access, at the company's registered office, to the report and the auditor's opinion or present a copy of the above documents.

The LPTS requires issuers to prepare and submit to the LSC and the NSEL annual reports , prospectuses and other periodic reports, (which include financial statements). The LSC establishes the content and reporting period for the disclosure. For example, companies listed on the Official List must prepare quarterly reports in addition to the semi-annual reports provided by companies listed on the Current List.

Under the LPTS, issuers must notify the LSC, the NSEL, and media of all material events within five business days. In practice, however, the LSC has been requiring immediate disclosure of such events by listed companies. In comparison with the existing law, the new SML requires such notice to be given immediately for listed companies and within five days for unlisted companies. In addition to notifying the LSC and the NSEL, issuers must provide the information to at least two information agencies or daily newspapers.

Under a new Accounting Law that was adopted by parliament in November 2001 and became effective on January 1, 2002, beginning January 1, 2004, all listed companies are obliged to prepare their financial statements in accordance with International Accounting Standards (IAS) . In the meantime, Rules on Periodic Disclosure of Information about Activities of Issuers and their Securities of LSC require that financial statements of companies listed on the Official List be prepared according to IAS and audited pursuant to International Standards of Audit.

Financial information for traded companies is available without charge (both in hard copy and online) from the public reference facilities of the LSC. Copies of the company statutes are generally available from the company or from the Register of Enterprises.

D2 External audit

All public companies (as well as certain larger private companies) must have their annual financial accounts audited by an independent auditor. Auditors have to be licensed in accordance with the provisions of the Law on Audit. The Supervisory Board (which is described in E1 below), as well as shareholders, may also initiate a specific independent audit of the activities and accounting records of the company. The costs of an audit commissioned by shareholders must be covered by the shareholders who engaged the auditors. If the auditors confirm the facts stated in the shareholders' application, the company is obliged to reimburse the shareholders the auditing costs, up to a certain amount.

The Management Board and the Chief Executive Officer are responsible for making all documents of the company necessary for audit available to the auditor.

There are no requirements that Supervisory Boards have audit committees. The Lithuanian Chamber of Auditors is responsible for auditing standards and practices, but has no authority to impose fines or other economic sanctions. There have been no legal actions against auditors, but the Chamber of auditors has recently withdrawn the licenses of 22 auditors. Such withdrawals have been mainly on the basis of failure to perform audits for some period of time or failure to take part in training arranged for auditors.

D3 Major share ownership

Shareholders of both private and public companies are entitled to receive the shareholder list from the company. In order to provide this information to a shareholder, a public company can request the list of its shareholders from the CSDL, which in turn collects the information from broker-dealers.

Private companies have very limited public disclosure obligations. The acquisition of all the shares of a company by one person must be noted in the Enterprise Register. The transfer by a holder of all the shares in a company to other persons must also be noted.

As far as disclosure of ownership of public companies is concerned, the LPTS requires notification to the LSC concerning acquisitions and disposals of blocks of shares. Another source of information on the owners of public companies may be periodic reports and prospectuses of issuers. The Rules of the LSC on Periodic Disclosure of Information about the Issuers Activities and their Securities requires, on a periodic basis (quarterly, semi-annually or annually depending on the listing of the securities, number of holders of the securities and the capital of the issuer) to disclose the shareholders possessing five percent or more of the issuer's share capital.

D4 Disclosures relating to corporate control and management

An Enterprise Register is maintained by the Department of Statistics and the Ministry of Economy as well as municipalities acting as local registrars or registrars of certain types of enterprises and includes some 25,000 enterprises, including partnerships and sole proprietorships. The Enterprise Register includes the names of the company's Management and Supervisory Board members, the company statutes and information regarding the share capital of the company. The register also includes the names of the company's founders, but not the names

of current major shareholders (unless the company is owned by one shareholder). This information is not fully centralized. Copies of a company's statutes may be obtained from a particular registrar.

The new Civil Code provides for a unified register of legal entities as well as requirements for disclosure of certain corporate information, including financial statements. The establishment of the register of legal entities, which was scheduled for January 1, 2002, has been delayed.

Periodic reports and prospectuses of issuers contain information concerning managing bodies and contracts concluded by the members of the managing bodies with the issuer, persons related to the issuer, and its business partners. Disclosure of related party transactions (i.e. commercial transactions among affiliated parties) is also required under International Accounting Standards.

E The Governing Body

E1 Structure and independent oversight of management

The Law on Companies provides for an optional two tier board structure comprising a Supervisory Board and a Management Board or a one tier Management Board or Supervisory Board. A public limited liability company is required to have at least one collegial management body - the Supervisory Board or the Management Board.

The Supervisory Board may not include as members anyone on the Management Board or the Chief Executive Officer, thus ensuring that anyone on the Supervisory Board is independent of company management.

The Supervisory Board is entitled to appoint a firm of auditors to audit the accounting documents and financial statements of the company. At the request of the Supervisory Board the company's management must present documents relating to the activities of the company and provide conditions for inspecting the company's assets .

The AGM does not approve the compensation for the Management Board beyond a review of the company's financial statements. Members of the Management Board may have employment contracts with the Company and receive a monthly wage if they perform daily work in the company.

The Management Board (or the Chief Executive Officer, if there is no Management Board) must prepare a report on the company's activities. Activity reports of public companies (and larger private companies meeting certain criteria) must be audited by an independent auditor prior to the AGM. If the AGM does not approve the report on the company's activities or gives the report a negative evaluation, the Management Board (or the Chief Executive Officer, if there is no Management Board) has no further authority to act.

The AGM may also appoint an internal auditor to monitor the company's financial activities.

E2 Key functions

The Supervisory Board has the following basic duties: (1) it elects members of the Management Board (if the Management Board is not formed - the Chief Executive Officer) and removes them from office; if the company is operating at a loss, the Supervisory Board must consider the suitability of the management for their office; (2) it monitors the conduct of the company's business and is authorized to inspect the company's books and internal documents; (3) it makes proposals and comments to the AGM on the company's annual financial statements, the draft of the profit distribution and the report on the company's activities drawn up by the Management Board; (4) it represents the company in court when investigating disputes between the company and a member of the Management Board, the Chief Executive Officer or his deputy.

The Supervisory Board has no right to assign or delegate its functions to the Management Board or the Chief Executive Officer. And in case the Supervisory Board is not formed, its functions may not be delegated to other managing bodies. The Supervisory Board must meet at least four times a year, but there is no requirement for disclosure of attendance records for Supervisory Board members.

The Management Board elects and dismisses the Chief Executive Officer, consents to appointment of his deputies and establishes their remuneration, determines the organizational structure of the company, and carries out all other day-to-day management functions established in the company statutes. Where the Management Board is not formed in the company, its functions, rights, duties and responsibility are attributed to the Chief Executive Officer, save for the rights and duties taken over by the Supervisory Board or the AGM.

ANNEX F: NSEL MARKET INFORMATION

Table 1: Number of listed companies on stock exchange and total equities market capitalization

YEAR	NO. OF LISTED COMPANIES	EQUITIES MARKET CAPITALIZATION, LTL MLN.		
		Listed Companies	Unlisted Companies	Total
1997	607	6,824	1,867	8,691
1998	56	4,297	7,537	11,834
1999	54	4,555	8,159	12,714
2000	54	6,349	5,868	12,217
2001	49	4,797	7,019	11,816

Table 2: Number and value of new listings

YEAR	NO. OF NEW LISTINGS	VALUE OF NEW LISTINGS IN LTL MLN.
1997	-	-
1998	62	4,297
1999	3	102.7
2000	4	268.5
First half of 2001	3	322.7

Table 3: Concentration in trading by reporting the share of the most actively traded shares

YEAR	SHARE OF MOST ACTIVELY TRADED STOCK	SHARE OF THREE MOST ACTIVELY TRADED STOCKS	SHARE OF FIVE MOST ACTIVELY TRADED STOCKS	SHARE OF TEN MOST ACTIVELY TRADED STOCKS
1997	18.4	32.3	40.6	55.7
1998	17.6	38.5	49.4	67.8
1999	34.5	61.9	70.6	83.7
2000	51.2	69.2	80.6	88.2
First half year of 2001	16.7	43.5	58.8	75.8

Table 4: Share in annual trading volume accounted for respectively by type of investor including international investors

YEAR	BROKERAGE HOUSES	COMMERCIAL BANKS	INSURANCE COs.	INVESTMENT COs	NATURAL PERSONS	STATE ENTERPRISES	PRIVATE COs.	OTHERS	TOTAL
1997	-	-	-	-	-	-	-	-	100.00
1998	0.4	25.4	-	6.7	26.8	5.5	32.3	2.9	100.00
1999	4.9	46.5	-	7.3	33.8	3.8	-	3.7	100.00
2000	3.2	30.2	-	1.6	15.8	1.9	23.6	23.7	100.00
First half of 2001	1.3	25.7	-	1.3	17.6	2.8	45.7	5.6	100.00

Table 5: Market capitalization of ten largest traded companies on NSEL

Market Capitalization of Ten Largest Traded Companies on NSEL as of June 29, 2001

	Capitalization (USD '000)
Lietuvos Telekomas (telecom)	315,779
Lietuvos Energija (power)	139,177
Mazeikiu Nafta (oil refinery)	126,554
Lietuvos Dujos (gas supply)	119,307
Ekranas (TV tubes)	46,956
Lietuvos Taupomasis Bankas (comm. bank)	39,951
Lietuvos Draudimas (insurance)	29,291
Kalnapolis (brewery)	26,695
Rokiskio Suris (dairy)	21,904
Lietuvos Zemes Ukio Bankas (comm. bank)	21,650
Total	887,264
Total market capitalization	2,953,000
Top ten/total market capitalization	30 percent

Table 6: Turnover of Ten Most Actively Traded Securities on NSEL

Turnover of Ten Most Actively Traded Securities on NSEL in 2000

	Trading volume (USD '000)
Lietuvos Telekomas (telecom)	17,680
Lietuvos Draudimas (insurance)	14,845
Panevezio Pienas (dairy)	8,145
Vilniaus Vingis (electronics)	5,217
Klaipedos Nafta (oil terminal)	3,145
Rokiskio Suris (dairy)	2,493
Lietuvos Energija (power)	2,358
Mazeikiu Nafta (oil refinery)	1,673
LISCO (shipping)	1,632
Ukio Bankas (comm. bank)	1,398
Total	58,586
Total turnover on NSEL	202,195
Top ten/total turnover of traded securities	29 percent

Table 7. Respective ownership ratio of domestic investors (by type) and international investors, end of year, LTL Million.

YEAR	LITHUANIAN INVESTORS									FOREIGN INVESTORS	TOTAL
	Brokerage Houses	Commercial Banks	Insurance Companies	Investment Companies	Natural persons	State Enterprises	Private Companies	Others	Total		
1997	19.1	80.0	4.2	8.7	254.2	18.6	541.2	26.2	952.1	924.0	1,876.1
1998	12.5	79.1	1.9	13.6	278.3	54.3	509.9	5.3	955.0	903.5	1,858.5
1999	11.6	208.0	31.2	12.9	394.7	141.9	512.8	43.7	1,356.8	1,079.0	2,435.8
2000	13.9	52.6	9.8	292.5	360.8	152.1	584.9	17.3	1,483.8	1,804.7	3,288.5
2001	15.2	56.0	13.1	228.2	343.3	135.6	514.8	24.1	1,330.3	1,872.5	3,202.8