

# ALL EYES ON ROMANIAN CORPORATE GOVERNANCE

*February 2019*

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## EXECUTIVE SUMMARY

This research paper from the Capital Markets and Corporate Governance Committees of the American Chamber of Commerce in Romania (AmCham Romania) aims to assess the corporate governance of major Romanian publicly listed companies, to show how the market is performing in corporate governance and where the opportunities for improvement lie. The paper has been developed using the Corporate Governance scoring methodology of Sustainalytics, an AmCham Romania member company.

A comprehensive corporate governance research was conducted on the 25 companies (seven of which are state-owned enterprises (SOEs)), included in the Bucharest Stock Exchange's BET-XT index (which tracks the 25 most traded companies), and found some notable patterns related to their supervision and management. The findings of the analysis are benchmarked against WIG20 (an index that tracks Poland's 20 most liquid companies) and, as a measure of best practices, against US 25 most traded companies. **The most pressing and impactful areas of improvement for corporate governance in Romania relate to transparent communications with the market, with a view on general disclosure, executive remuneration disclosure, and related party transactions approval process.**

A robust corporate governance framework provides appropriate accountability to shareholders, increases efficiency through the presence of self-regulating mechanisms, and can contribute to value creation at the company. **The strengthening of corporate governance processes therefore represents an opportunity for Romanian listed companies to bolster their attractiveness to investors and other stakeholders.**

From a broader perspective, good corporate governance will contribute to the development of the Romanian capital market. Increased transparency around listed companies' corporate governance practices would provide added incentive for foreign institutional investment, ultimately increasing the liquidity of the local capital market. **Liquidity in the market is often cited as a critical need in the case for Romania to move up from "Frontier" to "Emerging Market" status; the other critical factor being better corporate governance.**

In particular, disclosure can be improved through implementation of the Bucharest Stock Exchange Code of Governance ("BVB CG Code") recommendations or through a point-by-point explanation of any deviations.

This paper identifies:

- the importance of general disclosure, executive remuneration disclosure and related party transaction approval process;
- current market practice among Romanian companies compared with BVB CG Code recommendations;
- conclusions and practical steps for Romanian companies to improve corporate governance.

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## WHY IT MATTERS?

### *General disclosure*

General disclosure, and complete English disclosure in particular, may increase access to international investors and visibility by ratings agencies, as transparency is usually an indicator of good corporate governance practice. Investors require sufficient information on the companies' corporate governance practices to make informed investment decisions, such as casting votes on board proposals and director nominees, evaluating the quality of the board of directors and the remuneration policy. Strong disclosure improves the perception that the directors and managers are high quality, trustworthy, and respecting their duties.

### *Related party transactions approval process*

Transparency on related party transactions approval process may mitigate risks related to conflict of interest cases and abusive transactions. Investors need to know that directors and managers are acting in the best interests of the company and its shareholders. The existence of related party transactions is not unusual, but ambiguity around them raises questions and concerns. Ultimately, an investor needs to be assured that the oversight process is robust and independent enough to mitigate its doubts.

### *Executive remuneration disclosure*

In the last years, executive remuneration has been a very important topic internationally, and remains a contentious point at Shareholder Meetings between managers and shareholders. Similarly, the topic has caught the interest of the media and the public, which now regularly reports studies of the highest paid CEO's. Executive remuneration represents an important tool to align management objectives with shareholders' interests, increase accountability and thereby define the strategic direction of the company. The disclosure of individual remuneration amounts paid to executives, together with the design and overall remuneration philosophy help investors understand the effectiveness of executive pay. An adequate level of remuneration disclosure builds credibility by allowing investors to assess if executive incentives are linked to the creation of long-term shareholder value.

## GENERAL DISCLOSURE

The BVB CG Code recommends that companies publish “the most important information” in Romanian, as well as in English, in order to assure a fair access to information to both local and foreign investors. Therefore, the companies should have a dedicated investor relations section on their corporate website, both in Romanian and English. In addition, companies should provide a series of legal and governance documents, such as the articles of association, shareholders’ meeting materials, director election policies, and candidates’ professional biographies.

**As noted below, we highlight and recognize the complete English disclosure in the majority of BET - XT corporate documents as a positive feature**, especially given the fact that 25% of the companies from the broader Standard Tier do not provide any relevant English disclosure for their investors.

One of the benefits and opportunities from improved disclosure is more shareholder engagement. Engagement can bring in expertise and support to grow the company. Concerning the overall investor communications, **our findings suggest a limited reach on the part of the companies’ shareholder engagement programmes**. Therefore, Romanian companies might miss value creation opportunities implicit in this partnership with their shareowners.

However, the methodology used evaluates disclosure one step further; to the assessment of transparency in relation to tools that facilitate the effectiveness of the supervision and management. Examples include independence, committee membership, stock ownership, and a director skill matrix for the selection of board members.

In particular, **we highlight that Romania is significantly lagging on board diversity policy disclosure, despite an investor-driven push worldwide**. The lack of formal policies related to diversity, as to gender, education, age, and experience is a weakness. Only 1 company in the BET-XT publishes a diversity policy for board membership.

The presence of a skills matrix and disclosure on how this is integrated in the nominating process is another great example, which give investors assurance that the members of the board bring the skills and experience necessary to oversee the company's management. A good skills matrix maps the key skills, knowledge and experience needed for directors against the attributes of the directors themselves. Investors are able to clearly see that the company has thought about what it needs in a board, and has deliberately recruited for these needs.

Of the 25 BET – XT companies:

PRACTICE	Romania	Poland (WIG20)	US (25 most traded)
Have an IR section in English, and disclosure the following documents in English: annual report, AGM materials, vote results, board member CVs, and compliance with the BVB CG Code	100%	100%	100%
Provide information on calls and/or meetings with shareholders	68%	100%	100%
Disclose an IR contact person	48%	95%	100%
Publish a diversity policy for board membership	4%	60%	60%
Provide specific board-required set of skills*	12%	10%	64%

\* beyond disclosure related to legal requirements.

## RELATED PARTY TRANSACTIONS APPROVAL PROCESS

BVB CG Code recommends that the members of the board of directors declare any exposure to existent or potential conflict of interest. Also, an interested director shall not take part in the discussions concerning the issue which is subject to such conflict of interest. Moreover, the audit committee shall review transactions with related parties, while a policy should be adopted to ensure that transactions carried on with “companies with which it has close relations”, valued at a minimum of 5% of the company’s net assets, are approved by the board, after the audit committee’s review.

The research also focuses on identifying related party transactions that are material and, on the approval, and valuation process. The qualitative analysis assesses if the identified related party transactions raise concerns about value leakage or self-dealing and whether outside shareholders’ rights were respected during that process.

The findings **indicate a low degree of information accessibility, while the lack of disclosure regarding the approval of the related party transactions creates potential for concern as regards the existence of mechanisms set up to protect minority shareholders from abusive transactions.**

Of particular note, under one of the companies’ related party transactions policy, the CEO approves transactions valued at up to EUR 3 million, above which board approval is necessary. This is excessively high. For comparison, Government Ordinance no. 109/2011 requires board approval for transactions valued at more than EUR 50,000.

As regards the actual practice, of the 25 BET – XT companies:

PRACTICE	Romania	Poland (WIG20)	US (25 most traded)
<b>Disclose a policy on related party transactions*</b>	28%	30%	100%
<b>Disclose the approving body (e.g. the board of directors) for such transactions</b>	28%	30%	100%
<b>Provide the value threshold for which this approval is needed</b>	24%	0%	88%

\*for the purpose of this research, we evaluated as relevant a policy that clearly defines a related party and/or provides specific steps for the approval process, including materiality thresholds

## EXECUTIVE REMUNERATION DISCLOSURE

BVB CG Code recommends companies follow specific principles to ensure transparency in relation to remuneration procedures. The companies are encouraged to publish on their website a remuneration policy, which should provide a description of the decision-making process, present each component of the executive compensation (e.g. salaries, bonuses, and equity-based compensation) and any attached performance conditions. Moreover, the annual report should include an update on the implementation of this policy during the annual period under review.

Poor compliance to this code was found, as demonstrated by **poor disclosure levels for individual executive remuneration**. Romania lags behind Poland, where 100% of companies in a comparable index provide disclosure. The **limited disclosure provided by the concerned companies on compensation decisions does not allow investors to ascertain the company's use of funds, or whether executive incentivisation is sufficiently aligned with corporate strategy**. For example, are pay decisions discretionary? Is pay commensurate with company performance? Without relevant information, an accurate assessment of the executive remuneration structure cannot be completed. Furthermore, a distinction should be drawn between SOE and non-SOE remuneration reporting. The former report on executive remuneration pursuant to the specific provisions of the Ordinance 109/2011, while the latter typically provide far more limited disclosure on their remuneration practices.

In addition to that which is covered by the BVB CG Code, clawback policies are considered an important aspect of the methodology used. Moreover, it rewards the disclosure of a cap on individual payments and that of equity ownership guidelines, as well as the existence of a majority independent remuneration committee, in its assessment of the purpose, principles, and assumptions in a company's executive remuneration.

Both Romania and Poland need to improve the independence of its public companies' remuneration committees; majority independent committees are considered standard market practice in the United States. A lack of a remuneration committee may suggest an overall diminished appetite for hiring and compensating executives according to a systematic long-term strategy.

The analysis showed that, of the 25 BET – XT companies:

PRACTICE	Romania	Poland (WIG20)	US (25 most traded)
Have a remuneration committee*	78%	80%	100%
Have a majority independent remuneration committee.	30%	15%	96%
Disclose individual executive remuneration**	6 SOEs and 3 non-SOEs (36%)	100%	88%
Disclose specific performance indicators under which payments to executives are made	6 SOEs and 5 non-SOEs (44%)	30%	84%
Publish pre-set targets of performance	5 SOEs and 2 non-SOEs (28%)	10%	84%
Have a remuneration plan that includes pre-set goals for performance over a period of two or three years***	0%	5%	84%

\*two Romanian companies are externally managed.

\*\* five of the Romanian companies solely provide the individual compensation received by the executive members of the board and/or the CEO.

\*\*\* stock options plans with multi-year vesting schedule were not considered.

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## CONCLUSIONS

Romanian companies can increase their attractiveness among local and international investors by engaging more with shareholders, improving related party transaction disclosure, and improving executive remuneration disclosure. These simple improvements can go a long way towards a greater degree of investment and an improved market liquidity. Together, better liquidity and better corporate governance appear to be the key ingredients to taking Romania from “Frontier” to “Emerging Market” status.

And if the opportunity and appeal is not enough, European legislative developments will soon enforce action in these areas. The amended European Shareholders' Rights Directive (SRD), which should be implemented by June 2019, stipulates that companies must propose for shareholder vote the remuneration policy and the remuneration report (small and medium companies can opt out). SRD also requires companies to submit for board or shareholder approval material related party transactions, while following specific transparency provisions.

The BET-XT companies provide the English version of the majority of corporate documents, thus facilitating the evaluation of financial progress and corporate governance practices by international investors.

However, as regards the engagement with their investors, half of the companies do not disclose a dedicated investor relations contact person, while one-third of the companies do not inform the public on calls/meetings with shareholders. Therefore, companies might miss opportunities to build a long-term rapport with their owners and address existing or potential concerns from their part.

The communication process with investors can be benefited by a Romanian and English IR section on the website, where regular updates of relevant corporate events and contact details should be published. In addition, access to information may be eased through the setup of an IR officer position, while making sure that this person possesses relevant knowledge and skills.

Furthermore, around two-thirds of the BET-XT companies fail to provide any meaningful disclosure on the approval process of the transactions with related parties, creating a potential concern as regards the management of shareholders' wealth. Moreover, the Romanian companies will have to comply with the amended SRD provisions for related party transactions, under which strict transparency and approval rules have to be followed. Therefore, quantitative ratios shall be set up in order to define the materiality of these transactions, while details such as the identity of parties involved, the type of transaction and value of the transaction must be published.

Finally, the BET-XT companies provide overall poor disclosure of their executive compensation programmes, limiting outside assessment of alignment of pay with performance. As previously noted, the amended SRD brings extended requirements concerning the disclosure of remuneration practices. Firstly, the companies will have to subject to shareholder approval both a remuneration policy (every four years or sooner), as well as a remuneration report (annually). Moreover, high shareholder dissent shall be addressed. Secondly, the format of the remuneration-related disclosure is standardized under the following requirements: a rationale of the remuneration policy, a distinction between fixed and variable components, the key performance indicators used to determine compensation, the conditions of the share-based payments and the enactments of clawback policies.

Throughout this paper, several practical and actionable steps are suggested for Romanian publicly listed companies to improve in these areas. Each item in each table is an example (e.g. disclose an IR contact person). But there are also several ideas explained in the analysis (e.g. board of director skills matrix). Hand in hand with the development of this paper, the American Chamber of Commerce Capital Markets and Corporate Governance Committees offer its support to members and Romanian publicly listed companies to support them on their Corporate Governance journey.