WOULD INSURANCE COVERAGE OF D&O'S BRING MORE INVESTORS TO STOCK EXCHANGE?

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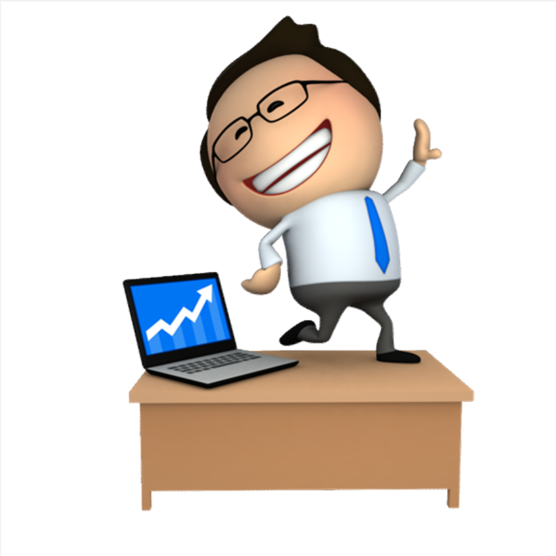
Nasdaq



D&O

- Corporate Governance
- Board Independence
- US context & facts
- Comply or Explain
- Estonian case

CORPORATE GOVERNANCE – DEFINITION

Corporate governance *involves a set of relationships between a company's management, its board, its shareholders and other stakeholders.*

Corporate governance *also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined.*

[*G20 / OECD Principles of Corporate Governance*]

CORPORATE GOVERNANCE – INDEPENDENCE

The board should be able to exercise objective independent judgement on corporate affairs.

*Boards should consider assigning a **sufficient number** of **non-executive board members** capable of exercising **independent** judgement to tasks where there is a potential for conflict of interest.*

[*G20 / OECD Principles of Corporate Governance, VI The responsibilities of the board*]

CORPORATE GOVERNANCE – HISTORY

1992 – UK takes a lead in developing a code for listed companies.

1999 – G20 / OECD issue Principles of Corporate Governance with the focus on publicly traded companies.

2002 – US stock exchanges (Nasdaq, NYSE) improve corporate governance requirements for listed companies.

2005 – Commission publishes recommendation on the role of non-executive supervisory directors of listed companies.

2005 – Tallinn Stock Exchange publishes Corporate Governance Recommendations.

2006 – Obligation for all listed EU companies to publish annual corporate governance statement starting from 2008.

US CONTEXT – NASDAQ

The company's board of directors is required to have a majority (more than 50%) of independent directors.

D&O - SURVEYS

- D&Os believe that **D&O insurance** is **indispensable -** 87% rank D&O insurance as an **important** condition before agreeing to join a board.
- After a company files for an **IPO**, the issuer typically purchases **D&O insurance policy** for the first time:
    - 85% of companies had not previously paid D&O premiums prior to going public.
    - 97,2% of companies going public purchased a D&O liability insurance policy.

SCIENTISTS SAY – PROS

- Corporate transparence increases for firms that increase board size by adding new independent directors *.

- D&O insurance coverage improves the value of large increases in capital expenditure for firms with better internal and external governance **.

[**C. S. Armstrong, J. E. Core, W. R. Guay "Do independent directors cause improvements in firm transparency?", Journal of Financial Economics, 113 (2014)*]

[***C. Lin, M. S. Officer, R. Wang, H. Zou "Directors' and officers liability insurance and loan spreads", Journal of Financial Economics, 110 (2013)*]

SCIENTISTS SAY – CONS

- D&O insurance increases a firm's cost of equity by providing incentives for D&Os to*:
  - Lower care;
  - Vigilance in financial reporting / disclosure;
  - Take more risks.
- Greater use of D&O insurance increases the cost of debt**.

*[*Z. Chen, O. Z. Li, H. Zou "Directors' and officers liability insurance and the cost of equity", Journal of Accounting and Economics, 61 (2016)]*

*[**C. Lin, M. S. Officer, R. Wang, H. Zou "Directors' and officers liability insurance and loan spreads", Journal of Financial Economics, 110 (2013)]*

COMPLY OR EXPLAIN

Listed company is required either to comply with corporate governance principles or explain the principles it chooses to depart and the reasons for doing so.

NASDAQ TALLINN CORPORATE GOVERNANCE RECOMMENDATIONS - INDEPENDENCE

*At least **half of the members of the Supervisory Board** of the Issuer shall be **independent**. If the Supervisory Board has an odd number of members, then there may be one independent member less than the number dependent members.*

*An **independent member** is a person, who has no such business, family or other ties with the Issuer, a company controlled by the Issuer, a controlling shareholder of the Issuer, a company belonging to the Issuer's group or a member of a directing body of these companies, that can affect their decisions by the existence of conflict of interests.*

[*Nasdaq Tallinn Corporate Governance Recommendations, III Supervisory Council, 3.2.2*]

NASDAQ TALLINN CORPORATE GOVERNANCE RECOMMENDATIONS - COMPLIANCE

*The Management Board and the Supervisory Board shall **describe** the management practices of the Issuer including their **compliance** with these **Corporate Governance Recommendations** in the annual report presented to General Meeting.*

*If the management of the Issuer deviates from the management structure described in these Corporate Governance Recommendations the Management Board and Supervisory Board shall **justify the deviation**.*

[*Nasdaq Tallinn Corporate Governance Recommendations, V Publication of Information, 5.4.*]

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LISTED COMPANIES ON NASDAQ TALLINN

2015

73% (11/15) – at least one independent member

47% (7/15) – at least half of independent members

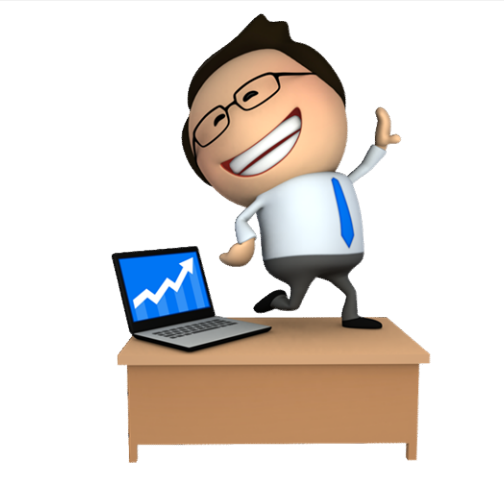
2016

88% (14/16) – at least one independent member

44% (7/16) – at least half of independent members

CHALLENGES

- Lack of professional independent board members.
- Difficult to ensure independence.
- D&O insurance market in the Baltics is immature.



Corporate Governance Requirements

- ✓ …
- ✓ *Independent Board Members*
- ✓ …

D&O

THANK YOU!

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