5.3.1

ETHICS

Ethics is about doing what is right, not only what is required. The law and the corporate governance code set the minimum standards; ethics is the standard the company sets for itself, and the one by which its Board, management and people are judged when the rules are silent or inconvenient. Every company has an ethical standard in practice, whether or not it is written down. The question for the Board is whether that standard is chosen deliberately and upheld consistently, or left to emerge from habit and pressure.

This sub-chapter deals with the ethical standard itself and the Board's responsibility for it. Corporate culture and tone at the top are covered in sub-chapter 5.1.2; compliance, whistleblowing, conflicts of interest and related party transactions in sub-chapters 5.3.2 to 5.3.5; and the duty of loyalty of each Board member in sub-chapter 4.1.

Most corporate scandals begin not with an illegal act but with a series of lawful decisions that no one was willing to call wrong. Ethical failures destroy trust faster than financial ones. In the Baltic states, where markets are small and business and political networks overlap, the cost of an ethical lapse is high, and for state-owned and municipally owned enterprises public trust in the company is also public trust in its owner.

The role of the Board

The Board is the guardian of the company's ethical standard. It cannot delegate this role to a compliance function or a lawyer, because ethics is ultimately a matter of judgement, and the Board's judgement sets the ceiling for everyone else's. The Board's contribution has four parts. It defines the standard, by approving the code of ethics and the company's position on the dilemmas that matter in its business. It embodies the standard, by applying the same rules to itself and by the way it takes decisions. It tests the standard, by asking about the ethical dimension of what it approves and by refusing lawful but improper proposals. And it protects the standard, by ensuring that systems are in place to detect and correct breaches, and that consequences apply regardless of seniority.

Management runs the ethics programme: it drafts the code, designs training, handles day-to-day questions and investigates most incidents. The Board does not do this work, but it approves the framework, receives the evidence and holds management to account for the results. Where a Board committee exists, the audit committee or a dedicated ethics and compliance committee will usually prepare the

materials and proposals for the Board; the responsibility, however, remains with the full Board.

What the Board should do

1. **Own the ethical standard.** Approve a code of ethics (or code of conduct) that expresses the company's values in concrete terms, states what is expected of everyone from the Board down, and explains how to raise concerns. Keep it short and specific to the company; review it at least every three years and whenever the business changes materially.
2. **Apply the standard to the Board first.** Adopt Board-level rules on gifts and hospitality, outside interests, use of company information and dealings with shareholders, and record in the minutes that they are observed. A Board that exempts itself from the code cannot demand that management follows it.
3. **Make ethics a criterion in decisions, not an afterthought.** Require that major proposals to the Board (transactions, market entries, restructurings, incentive schemes and similar) address the ethical and reputational dimension explicitly: who is affected, what could go wrong, and how the decision would look if made public. Where a decision is lawful but questionable, the Board should be prepared to say no.
4. **Assign clear ownership.** Designate who is responsible for the ethics programme (an ethics or compliance officer, the company secretary or a committee) with direct access to the Board or its audit committee, adequate resources and the authority to investigate. In smaller companies the role can be combined with another function, provided the reporting line to the Board is preserved.
5. **Insist on training that is practical.** Ensure that all employees, and the Board itself, receive training built around real dilemmas the company faces, in the languages people actually speak, rather than a generic annual e-learning module. Ask to see the dilemmas used, not only the completion rates.
6. **Review ethical performance at least annually.** Receive a report covering incidents and how they were handled, questions raised with the ethics function, results of employee surveys on trust and pressure, and the disciplinary consequences applied at all levels. Treat this review with the same seriousness as the review of financial results.
7. **Verify consistency across the company, its group and the value chain.** Ensure that subsidiaries, agents, distributors and major suppliers are bound by equivalent standards, particularly where the company operates in markets or sectors with a higher risk of corruption, sanctions breaches or human rights violations.

Warning signs

- The code of ethics has not been revised for years and nobody on the Board can recall its main provisions.
- Ethical questions are referred to the legal department, and the answer is always “it is legal”.
- Board papers on major transactions or incentive schemes contain no reference to reputational or ethical risk.
- Reported incidents are few and always minor, while the company operates in a high-risk sector or market.
- Senior managers accept invitations, gifts or side engagements that would not be tolerated at lower levels.
- Employees describe the values as “what we say to customers” rather than “how we work”.
- Pressure from a shareholder, including a public owner, to take a decision the Board considers improper is accepted without a recorded discussion.

Common pitfalls and drawbacks

The first pitfall is confusing ethics with compliance: assuming that because the lawyers have cleared a decision, the ethical question has been answered. It has not; the law is the floor, and many of the decisions that later prove most damaging were perfectly lawful. The second is the aspirational code: a document full of fine words that gives no guidance on the three or four dilemmas that actually arise in the company’s business, such as gifts from suppliers, pressure from a large customer or shareholder, or cutting corners to meet a deadline. The third is the exception for the important: tolerating behaviour from a founder, a star salesperson or a politically connected manager that would end the career of a junior employee. Nothing tells the organisation more clearly what the real standard is. The fourth is treating ethics as a reporting line rather than a Board responsibility, so that the Board hears about it once a year in a slide on training completion. Boards should also be aware of the opposite risk: an ethics programme so heavy with policies, declarations and campaigns that people stop reading and start ticking boxes. A short code, honest examples and visible consequences work better than volume.

Guidance for other governance professionals

The company secretary should ensure that the code of ethics is formally approved and periodically reviewed by the Board, that ethics appears on the Board’s annual calendar, that Board members’ own declarations are collected and minuted, and that new directors are inducted into the company’s ethical standards and the

dilemmas specific to its business. The ethics or compliance officer should keep the code short and usable, build training around real cases, maintain a record of the questions and incidents raised, and report to the Board on patterns and root causes rather than on activity. Internal audit should test whether the standard is applied in practice, for example by reviewing gifts and hospitality registers, procurement decisions and the handling of past incidents, and should state in its findings where a control was bypassed for reasons of culture rather than capability. Human resources should ensure that ethical conduct is assessed in performance reviews and promotion decisions, and that disciplinary outcomes are consistent across levels. General counsel should advise on what the law requires, but should also be willing to tell the Board when a lawful course of action is nonetheless unwise.

KEY TAKEAWAYS

A. Ethics is about doing what is right beyond what the law requires. Compliance sets the floor; ethics sets the standard by which the company, its Board and its people are judged.

B. The Board is the guardian of the ethical standard. It approves and reviews the code of ethics, applies the code to itself first, and treats ethical and reputational considerations as a criterion in every major decision.

C. An ethical standard needs an infrastructure: clear ownership with a reporting line to the Board, practical training built on the company's real dilemmas, a safe channel for raising concerns (sub-chapter 5.3.3), and consistent consequences at all levels.

D. Ethics must be reviewed at least annually on the basis of evidence – incidents, questions raised, survey results and disciplinary outcomes – with the same rigour as financial performance

E. In the Baltic context, small markets, close personal networks and, in SOEs and MOEs, political pressure create specific ethical risks. The Board should name them openly and set rules for them, rather than assume goodwill.

F. Ethics extends beyond the company's own staff to subsidiaries, agents, distributors and suppliers, particularly in higher-risk markets and sectors.

QUESTIONS FOR THE BOARD

1. *Do we have a code of ethics that is specific to our company, approved and reviewed by the Board, and would it tell a new employee what to do in the three situations most likely to arise in our business?*
2. *Does the Board apply to itself the rules on gifts, hospitality, outside interests and confidential information that it expects management to follow, and have we, as directors, declared our own?*
3. *Is ethical and reputational risk assessed explicitly in the papers for major decisions, and which decision in the last year did we take, or refuse, mainly on ethical grounds?*
4. *Who owns the ethics programme, do they have the resources and authority to investigate, and do they report directly to the Board or its audit committee?*
5. *Who in this company would tell the Board that management has crossed an ethical line, and would they feel safe doing so?*
6. *Do our remuneration and promotion decisions reward the way results are achieved, or only the results, and are consequences for misconduct applied consistently regardless of seniority or performance?*
7. *What evidence did the Board review in the last year on ethical performance – incidents, questions raised, survey results, disciplinary outcomes – and what did it decide as a result?*
8. *What do our subsidiaries, agents, distributors and key suppliers know about our ethical standards, and how would we find out if they breached them?*
9. *For SOEs and MOEs: how does the Board handle requests from the owner that it considers improper, and is that handling recorded?*

5.3.2

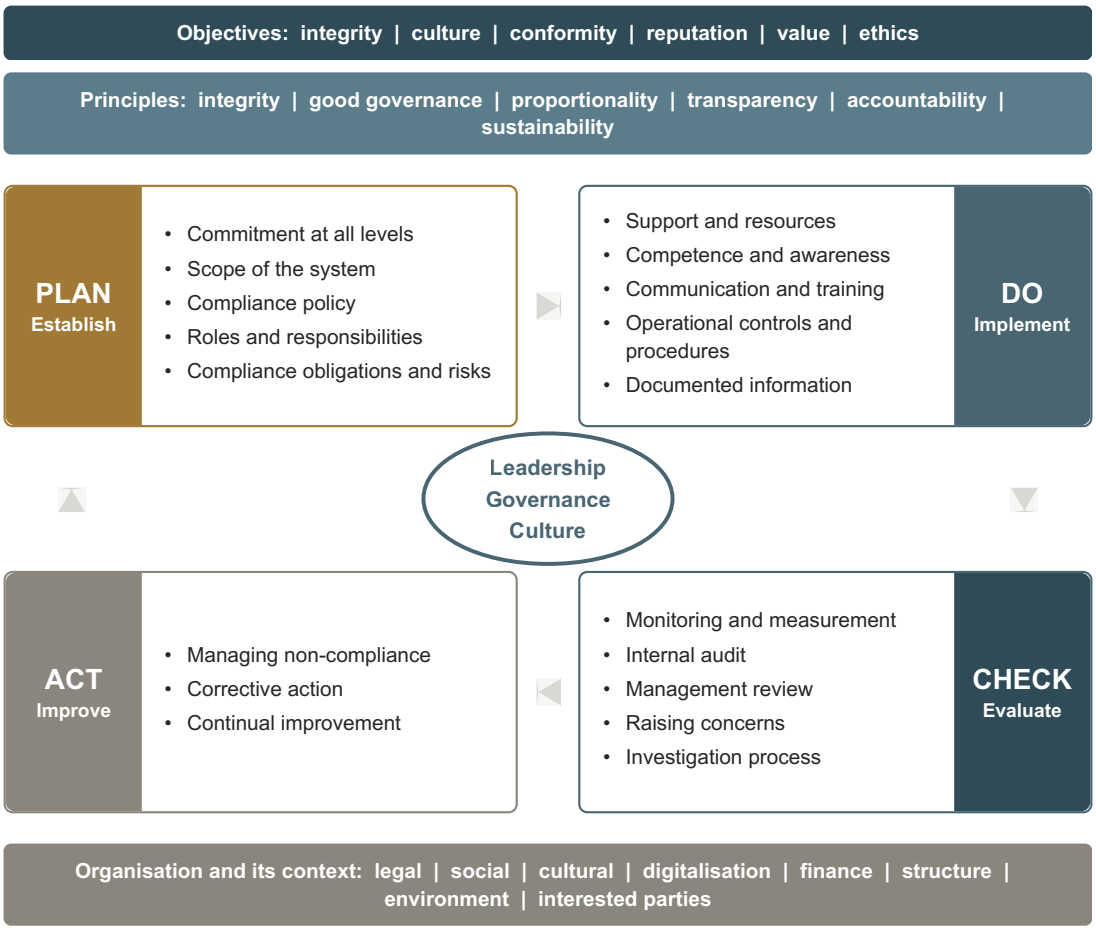
COMPLIANCE

With ever-evolving regulatory requirements, compliance risk is one of the key risks that every company, irrespective of its type, size or other characteristics, faces daily. Compliance risk is the risk of legal or regulatory sanctions, material financial loss or loss of reputation that a company may suffer as a result of its failure to comply with laws, regulations, rules, self-regulatory standards and codes of conduct.

To manage compliance risk, every company should maintain an effective compliance management system. For the system to be effective, it should not only implement policies and procedures to prevent and detect violations of the law, but also promote an organisational culture that encourages ethical conduct and a commitment to compliance with applicable laws, good governance and ethical standards.

The diagram below shows the main elements of a compliance management system as set out in the ISO 37301:2021 standard.

Figure 5.6 **Main elements of a compliance management system**



Source: BICG, based on the structure of ISO 37301:2021, Compliance management systems – Requirements with guidance for use.

A **compliance management system follows the plan - do - check - act cycle**. The company:

1. **plans the system** by securing commitment at all levels, defining its scope, adopting a compliance policy, allocating roles and responsibilities and identifying its obligations and compliance risks;
2. **puts the system into operation** through support, competence, communication, training, controls, procedures and documentation;
3. **checks the system** through monitoring and measurement, internal audit, management review, channels for raising concerns and an investigation process; and
4. **acts on the results** by managing non-compliance and improving continually. Leadership, governance and culture sit at the centre of the cycle, and the whole system is shaped by the company's objectives, its principles and its context.

Compliance is the outcome of a company meeting its obligations. Policies and procedures to achieve compliance should be integrated into all aspects of how the company operates. Compliance should not be treated as a stand-alone activity: it should be aligned with the company's overall strategic objectives and, while maintaining its independence, integrated with the company's financial, risk, quality, environmental and health and safety management systems and its operational procedures.

A company's approach to compliance should be shaped by its leadership, applying the company's core values and generally accepted governance, ethical and community standards.

In essence, compliance is a threefold duty covering:

1. the personal duty of Board members and employees to behave in accordance with the law and the company's rules;
2. the organisational duty of the governing bodies to set up and maintain a system that ensures that the company and its employees act in accordance with the law and the company's principles, and that breaches are discovered in a timely and efficient manner;
3. the duty of the members of the corporate bodies to pre-empt breaches and to avoid the resulting damage to the company's value.

A practical first step is to identify and map the compliance areas most relevant to the company and to establish, and keep up to date, a register of the external legal requirements and internal rules with which the company must comply.

The role of the Board

The Board approves the compliance policy and the appointment of a compliance officer or function with the independence, resources and authority to do the job, and with a direct reporting line to the Board or its audit committee. It sets risk-based priorities, receives regular reports on compliance risks, breaches, contacts with regulators and remediation, and ensures that the compliance function is integrated with risk management and internal audit under the Three Lines Model and operates effectively. In smaller companies the role may be combined with another function, provided that its independence and access to the Board are preserved.[AJ1.1]

Board roles and responsibilities

The Board is ultimately accountable for the company's compliance with law and ethical standards. This cannot be fully delegated - management implements, but the Board oversees and is responsible.

The Board's specific responsibilities include:

(i) Set the tone - demonstrate commitment to ethical behavior and compliance, including zero tolerance for corruption and misconduct.

(ii) Approve key policies - Code of Ethics, Anti-Corruption Policy, and Whistleblower Policy should be board-approved documents.

(iii) Engage in compliance risk oversight - understand the company's material compliance risks, satisfy themselves that appropriate mitigation measures are in place, and challenge management where controls appear inadequate.

(iv) Oversee compliance performance - receive and critically review periodic compliance reports and risk assessments; ask probing questions; and escalate concerns where red flags are not adequately addressed.

(v) Foster a compliance culture - actively promote company's culture in which ethical conduct is expected, reported concerns are taken seriously, and non-retaliation is guaranteed.

(vi) Ensure adequate resources - satisfy themselves that a competent, sufficiently independent compliance function (or Compliance Officer) exists with an adequate budget and clear reporting lines to the board.

(vii) Personal conduct - each board member must comply with conflict of interest obligations, insider trading rules (if applicable), confidentiality duties, and all other duties to which they are subject in their capacity as board members, including expected conduct under the Code of Ethics.

(viii) Incident oversight - serious compliance incidents and material whistleblower cases must be reported to the board, which should oversee investigation and remediation.

(ix) Board-level liability - directors may incur personal criminal or administrative liability for compliance failures. Ignorance of compliance obligations is not a defence — board members are expected to be and remain informed.

KEY TAKEAWAYS

A. Compliance risk is the risk of sanctions, financial loss or reputational damage from failing to comply with laws, regulations, self-regulatory standards and codes of conduct. Every company faces it daily, whatever its size or sector.

B. An effective compliance management system combines policies and procedures to prevent and detect breaches with a culture that encourages ethical conduct. ISO 37301:2021 provides a recognised reference model.

C. Compliance is a threefold duty: the personal duty of every Board member and employee to comply, the organisational duty of the governing bodies to set up a system that ensures compliance and detects breaches, and the duty to pre-empt breaches and avoid damage to the company.

D. Compliance is integrated into the way the company operates, aligned with its strategy and linked to its risk, quality, environmental and health and safety systems, while keeping the independence of the compliance function.

E. The Board approves the compliance policy, ensures that the compliance function has independence, resources and a direct line to the Board or its committee, and receives regular reporting on compliance risks, breaches and remediation.

QUESTIONS FOR THE BOARD

1. *Which laws, regulations and internal rules matter most for our business, and do we maintain an up-to-date register of them with named owners?*
2. *Has the Board approved regularly reviews a compliance policy and appointed a compliance officer with adequate resources, independence and direct access to the Board or its audit committee?*
3. *Does the compliance system prevent and detect breaches in practice, and what were the most significant compliance incidents, regulatory contacts and remediation actions in the last year?*
4. *Is compliance risk part of the risk register and risk appetite, and how does the Board satisfy itself that the compliance function is effective and not only documented?*
5. *Do Board members and management set the example in complying with the company's rules, and how does the company keep track of regulatory change?*

5.3.3

WHISTLEBLOWING

A whistleblowing mechanism is the structured, formal system that a company puts in place to allow employees, customers, suppliers, contractors and other stakeholders to report misconduct, illegal activities or unethical behaviour safely.

Whistleblowing addresses matters that affect the public interest or the integrity of the company. To distinguish whistleblowing from personal employment grievances, a whistleblowing framework applies to actions that threaten the company's integrity or the public interest, such as:

- Fraud, corruption, bribery or money laundering.
- Financial malpractice or deliberate breach of accounting controls.
- Breaches of environmental, health and safety regulations.
- Cover-ups or destruction of evidence related to any of the above.

The core goals of a whistleblowing mechanism are:

- Early detection. To act as an early-warning system that uncovers fraud, bribery and compliance breaches before they grow into corporate crises.
- Psychological safety. To create a "speak-up" culture where employees feel safe to voice concerns without fear of workplace bullying, demotion, or dismissal.
- Stakeholder trust. To build mutual trust by giving external stakeholders a transparent mechanism for identifying systemic risks, preventing ethical breaches and safeguarding the interests of investors, partners and the community.
- Accountability. To bypass traditional hierarchies so that misconduct at the executive or management level cannot be concealed.

The strategic benefits for the company are:

- Financial protection. Research consistently shows that occupational fraud is most frequently detected through tips. Early detection greatly reduces financial losses and helps to avoid regulatory fines.
- Reputational safeguarding. Handling issues internally and correcting them proactively reduces the risk of damaging leaks to the media or regulators.
- Improved culture. An active, trusted whistleblowing system signals to employees that management values integrity, boosting morale, trust and talent retention.

– Competitive advantage. Institutional investors increasingly treat robust environmental, social and governance (ESG) frameworks, including whistleblowing mechanisms, as a criterion in allocating capital.

The role of the Board and Management

The roles and responsibilities of the Board in whistleblowing:

1. Setting the tone at the top. The Board should publicly champion the whistleblowing system, making it clear that raising concerns is an act of loyalty to the company.
2. Whistleblowing policy. The Board approves and regularly reviews a whistleblowing policy establishing a formal infrastructure: secure reporting channels (hotlines, web platforms), independent investigators (where appropriate, external service providers) and strict non-retaliation rules.
3. Ensuring independent reporting lines. The Board (typically through its audit committee) should ensure that the whistleblowing process is functionally independent of executive management, to prevent conflicts of interest.
4. Direct escalation route. The policy should provide fast-track reporting for high-risk cases: a report concerning senior management goes directly to the Chair of the Board or the audit committee, so that the subjects of an investigation can never oversee it.
5. System monitoring and key indicators. The Board (with the help of its audit committee) regularly reviews anonymised metrics on the reporting system (number of reports, categories of misconduct, investigation closure rates). A complete absence of reports should be challenged by the Board as a possible sign of a culture of fear.
6. Protecting the whistleblower. The Board safeguards the speak-up culture by holding management responsible for the well-being of those who report, and verifies that protection measures are effective and that any retaliation is met with immediate corrective action.

The roles and responsibilities of management in whistleblowing:

1. Establishing accessible channels. Management provides secure, accessible and easy-to-use channels (such as external 24/7 hotlines or encrypted web platforms) that allow anonymous or strictly confidential reporting.
2. Drafting and enforcing procedures. Management creates clear, transparent written procedures detailing how reports are received, how investigations are conducted and how feedback is given to the reporter.

3. Appointing competent case handlers. Management designates and empowers impartial, trained individuals or functions (such as compliance) to handle incoming reports objectively. It is recommended to appoint an independent third-party provider to host the intake hotline or digital platform; this significantly increases employee trust and ensures that reporting data cannot be traced by the internal IT department and that reports are investigated independently.
4. Awareness and training. Management is responsible for continuously training staff on how to use the system and for educating managers on how to react appropriately when an employee raises a concern.
5. Taking corrective action. When an investigation confirms wrongdoing, management takes appropriate disciplinary action and updates internal controls to prevent recurrence.
6. Reporting to the Board and its audit committee. Management provides regular anonymised reports that allow the Board to fulfil its oversight duty.

The core conditions for whistleblowing to succeed are:

- Confidentiality and anonymity. The identity of the whistleblower must remain strictly confidential and be shared only on a need-to-know basis with those conducting the investigation. Anonymous reporting must be fully supported.
- Impartiality. Every report must be assessed objectively by a trained professional who has no personal or professional conflict of interest with the subject of the report.
- Timely feedback. The system must acknowledge receipt of reports promptly and provide the reporter with status updates within a reasonable, predefined timeframe.
- Actionable outcomes. Whistleblowing must yield tangible results; management must follow through with concrete disciplinary actions when wrongdoing is proven.
- Transparency. The whistleblowing policy and the reporting channel or form should be freely available on the company's external website (reachable from its home page). This demonstrates transparency to all stakeholders and ensures that external parties and former employees can easily access the channels.
- Tone in the middle. While the Board sets the tone at the top, management must ensure that middle managers and supervisors support the policy, translating ethical values into daily operational behaviour so that employees feel safe raising issues at departmental level.

Compliance with EU rules

When establishing or improving a whistleblowing framework, companies must ensure that it complies with the EU Whistleblowing Directive, as transposed in Estonia, Latvia and Lithuania, and with the GDPR, so that reports are handled lawfully and personal data are protected. The Directive requires companies with 50 or more employees to establish internal reporting channels and procedures.[21]

KEY TAKEAWAYS

A. A whistleblowing mechanism is a formal system that allows employees and external stakeholders to report misconduct, illegal activity or unethical behaviour safely. Its purpose is early detection, a speak-up culture, stakeholder trust and accountability that bypasses hierarchy.

B. The Board sets the tone, approves the whistleblowing policy, ensures the process is independent of executive management, provides a direct escalation route to the Chair or the audit committee for cases involving senior management, reviews anonymised metrics and protects those who report.

C. Management provides accessible and secure channels, clear procedures, impartial and trained case handlers (preferably with an independent external provider for intake), training, corrective action and regular reporting to the Board.

D. Whistleblowing succeeds only with confidentiality and anonymity, impartiality, timely feedback, actionable outcomes, transparency of the policy and channels, and support from middle management.

E. In the EU, the framework must comply with the Whistleblowing Directive, as transposed nationally, and with the GDPR; companies with 50 or more employees must have internal reporting channels.

21 Directive (EU) 2019/1937 on the protection of persons who report breaches of Union law (the Whistleblowing Directive).

QUESTIONS FOR THE BOARD

1. *Do we have a Board-approved whistleblowing policy and secure channels that are known to employees and accessible to external stakeholders, including through our website?*
2. *Is the process independent of executive management, and would a report concerning the CEO or a Board member reach the Chair or the audit committee directly?*
3. *What did the last year's anonymised metrics show (number of reports, categories, closure times), and if there were no reports, why?*
4. *How do we know that whistleblowers are protected from retaliation, and what happened in the last case where someone raised a concern?*
5. *Do our channels and procedures comply with the national law transposing the EU Whistleblowing Directive and with the GDPR, and when were they last reviewed?*
6. *Does management, including middle management, treat raising concerns as an act of loyalty, and how does the Board know?*

5.3.4

CONFLICT OF INTEREST

A conflict of interest (***COI***) is a situation in which two or more parties have competing interests which may, actually or potentially, improperly influence a decision-making process and make it difficult for those involved to fulfil their duties fairly. In general terms, a COI exists where the interests of two parties collide, so that satisfying one is at the expense of the other.

In the context of Board work, a COI is a situation in which a Board member's personal, financial or other interests interfere, or could interfere, with their duty to act in the best interests of the company, thus compromising, or appearing to compromise, their ability to make impartial decisions on the company's behalf.

A conflict of interest typically arises when personal interests are placed above those of the company, and it usually materialises in the decision-making process. It may involve one party being able to take a decision affecting another, or holding or having access to information about another, where the decision or the information can benefit or harm the deciding or receiving party or a person related to it, and generally carries a risk of violating the rights of the other party.

Conflicts of interest are not in themselves illegal or prohibited. To ensure that they do not lead to corrupt practices, which may be subject to investigation and prosecution with serious legal, financial and reputational consequences, they must be disclosed, prevented, mitigated or managed.

Types of conflict of interest

A COI can be (i) actual, (ii) potential or (iii) perceived, and can arise in a wide variety of ways:

Actual COI: the person is influenced by a conflict of interest

An actual COI is a situation in which the circumstances clearly constitute a conflict: a Board member or another person related to the company faces a real and existing conflict of interest. For instance, the following situations constitute an actual COI:

- Serving on the Board of the company while also serving on the Board of a competitor or of a service provider of the company;
- The company entering into a transaction with a Board member or their related party;
- Hiring or supervising a relative, spouse, cohabitee or close friend;

- Using company assets for private benefit;
- Close personal relationships influencing decisions taken as part of the Board role;
- Using confidential information obtained in the role for one's own benefit.

Potential COI: the person could be influenced by a conflict of interest

A potential COI is a situation that does not yet constitute a conflict but where there is a reasonable possibility of an actual or apparent conflict arising. For instance:

- A person serves on the Boards of two companies that have no business relationship; a COI may arise if the two companies plan to do business together;
- Serving on several Boards, within or outside the group, which takes up a significant amount of time and raises the question whether the person can fulfil all of their duties and, if not, which will be prioritised;
- A Board member is a former official of a public authority; a COI could arise if the company becomes subject to an investigation by that authority;
- A Board member of company A also serves on the Board of company B, a client of company A; a COI could arise if company B were to file a complaint against company A.

Perceived COI: the person could appear to be influenced by a conflict of interest

A perceived conflict is a situation in which a person appears to have a COI even though this is not the case. For instance, the company hires a new employee who has the same surname as the CEO although they are not related.

Managing conflicts of interest

In performing their duties, Board members must act fairly and reasonably and be loyal to the company, without preference for the interests of any shareholder or group of shareholders, even if the Board member was nominated and appointed by that shareholder or group.

Proper management of conflicts of interest involves at least the following:

1. **Effective COI policy and processes.** The Board is responsible for ensuring that the company has effective procedures to identify, evaluate, prevent and mitigate conflicts of interest. The Board should approve the COI policy, regularly revise it and oversee its implementation. The policy should be reviewed at least every three years and whenever it becomes apparent that the processes it establishes are not effective.

2. **Training.** The company should organise initial training (on induction) and regular refresher training on conflicts of interest for the Board and employees, so that everyone is reminded of their obligation to identify and manage them and new recruits are informed in a timely manner.
3. **Declaration of interests.** Board members, senior management and key personnel must (i) declare their related parties (close family members and entities in which they or their close family members have a material holding, votes or influence), other positions and employments held currently or during the last three to five years, and any other material interests and affiliations that could influence their independence of mind in performing their duties; and (ii) update this information regularly (quarterly or annually) and whenever changes occur.
4. **Declaration of a COI.** Where a COI may arise in a specific situation (for example, the company intends to sign a contract with an entity controlled by a Board member), the Board member must declare the existence and nature of the potential conflict to the Chair and the Board without delay upon becoming aware of it. Best practice is to declare it as soon as the member learns that the matter is on the Board's agenda and before the Board materials on the matter are distributed.
5. **Checking for a COI.** Management preparing an agenda item, and the corporate secretary checking the materials before the Board pack is distributed, should check against the declarations of interests whether a COI may exist and, if so, advise the Chair accordingly. At the beginning of each meeting the Chair asks whether any member may have a COI in respect of any agenda item.
6. **Decision on the existence of a COI.** Upon declaration or identification of a possible COI, the Board evaluates the nature and circumstances of the situation and the interests disclosed and decides whether a COI exists. If it does, the Board evaluates its materiality and decides on the measures to prevent, mitigate or manage it.
7. **Recusal.** A Board member who has a COI must recuse themselves from the consideration of, and voting on, the agenda item concerned. Recusal means that the information and Board materials on the matter are not shared with the member, that the member does not take part in its consideration (including leaving the meeting while it is discussed), so that the non-conflicted members can discuss it freely and without bias, and that the member does not vote on it.
8. **No influence on the decision.** The Board member must not seek to influence in any other way the decision on the matter in which they have a COI.
9. **Documentation.** The declaration, identification and evaluation of a COI, the decision on its existence and the measures taken to prevent, mitigate or

manage it should be documented. It is also recommended to draw up separate minutes recording the discussion and decision on a matter in which a Board member has a potential COI. Such minutes are reviewed, approved and signed by, and available to, the non-conflicted members; the conflicted member is informed of the decision and has access only to the resolution part of the separate minutes.

10. **COI register.** The company should keep an up-to-date register of conflicts of interest and the measures taken to manage them.
11. **Continuing COI.** *A* COI of a continuing rather than one-off nature, and the measures taken to manage it, should be regularly revisited, re-evaluated and, if necessary, adjusted to ensure that they remain sufficient and effective. A continuing COI may arise, for example, from a long-term service contract between the company and an entity controlled by a Board member's spouse. Where a continuing COI would require the member to recuse themselves from most of the matters discussed by the Board (for example, advising or serving on the Board of a competing business), this should be assessed before the appointment, and the person should not be appointed, since constant recusal would prevent them from performing their duties.

KEY TAKEAWAYS

A. A conflict of interest arises when a Board member's personal, financial or other interests interfere, or could interfere, with their duty to act in the best interests of the company. Conflicts may be actual, potential or perceived, and are not illegal in themselves, but must be disclosed and managed.

B. Board members act loyally to the company and without preference for any shareholder, including the one that nominated them.

C. Managing conflicts requires a Board-approved policy, training, declarations of interests by Board members and key personnel, prompt declaration of a conflict when it arises, checks by management and the corporate secretary before each meeting, and a Board decision on whether a conflict exists and how to manage it.

D. A conflicted member recuses themselves from the materials, discussion and vote and does not seek to influence the decision in any other way; the process and decision are documented, with separate minutes where appropriate, and recorded in a COI register.

E. Continuing conflicts are revisited regularly; a conflict that would require constant recusal should rule out the appointment in the first place.

QUESTIONS FOR THE BOARD

1. *Do we have a Board-approved conflict of interest policy, when was it last reviewed, and are Board members and key personnel trained on it?*
2. *Have all Board members and senior managers submitted declarations of interests, and are they updated regularly and when circumstances change?*
3. *How is each Board agenda checked for potential conflicts before the materials are distributed, and does the Chair ask about conflicts at the start of every meeting?*
4. *When a conflict was last declared, did the member recuse themselves fully, and was the decision documented and recorded in the COI register?*
5. *Do any Board members have continuing conflicts, and are the measures taken to manage them still sufficient?*
6. *Does any Board member act, or appear to act, in the interest of the shareholder that nominated them rather than of the company?*

5.3.5

RELATED PARTY TRANSACTIONS

Related party transactions (RPTs) are one of the situations in which a COI is inherent. RPTs are usually legitimate transactions between the company and a related party. A problem arises where such a transaction allows the related party to extract more value from the company than it would otherwise be entitled to (for example, a majority shareholder being paid above the market price for goods it sells to the company).

The Board should approve the related party transaction policy, regularly revise it and oversee its implementation.

Related party

Although the definitions in national regulations differ in detail, for the purposes of RPT governance the concept of a related party usually includes at least the following persons:

1. a direct or indirect controlling shareholder of the company, or any other person that, through shareholding or otherwise, has sole or joint control or significant influence over the company;
2. a member of the Board or of the key management personnel of the company or its affiliated entities;
3. close relatives of the persons listed in (1) and (2);
4. the holding, subsidiary and other affiliated entities of the company and of the persons listed in (1) to (3).

Related party transaction

A related party transaction is any arrangement involving a transfer of value (resources, services, rights or obligations) between the company and a related party, irrespective of whether a price is charged.

RPT governance

RPT governance aims to distinguish, and prevent, RPTs that are unfair to the company, to its shareholders generally or to minority shareholders from transactions that benefit the company and enhance its value. Although national regulations differ,

good corporate governance requires at least the following standards in respect of RPTs:

1. **Sufficient information.** Management provides the approving body with sufficient information on the terms and conditions of the proposed transaction.
2. **Audit committee opinion.** The opinion of the Board's audit committee (if the company has one) on the proposed RPT is obtained before the Board approves it. Committee members with a potential COI in respect of the RPT recuse themselves from its consideration and the vote, and follow the other principles of COI management.
3. **Board approval.** The RPT is approved by the Board in accordance with the RPT policy. Board members with a potential COI in respect of the RPT recuse themselves in the same way.
4. **Approval conditions.** When considering and approving an RPT, the audit committee and the Board must ensure that:
    i. the transaction is at *arm's length*; if it is not, the approving body must evaluate and justify that the RPT is *in the best interests* of the company and is *not unfair* to the shareholders unrelated to it. Before approving the RPT, the audit committee or the Board may obtain an independent qualified third-party opinion on the fairness of the transaction (a *"fairness opinion"*);
    ii. **the same internal procedures** have been followed for the evaluation, approval and monitoring of the RPT as for any other third-party transaction;
    iii. continuing RPTs (for example, the provision of services over a period of time, as opposed to one-off purchases) are regularly revisited, including:

    – regular reporting on and monitoring of the performance of the RPT;

    – regular re-evaluation and re-approval of the transaction, to ensure that it continues to be at arm's length, fair and in the best interests of the company; and

    – a change of its terms, or its termination, where it can no longer be justified as fair or as serving the interests of the company.

5. **Disclosure.** RPTs are disclosed in the company's financial statements and annual report.

Transactions with related parties entered into in the ordinary course of business and on market terms, and non-material transactions, are usually excluded from prior evaluation and approval. The permitted exclusions should be defined in the RPT policy and comply with national regulatory requirements, and summary information

on such transactions should be reported regularly to the Board (for example, in the regular compliance reports).

KEY TAKEAWAYS

A. Related party transactions are transfers of value between the company and a related party: a controlling shareholder, a member of the Board or key management, their close relatives, or affiliated entities. They are usually legitimate but carry an inherent conflict of interest.

B. The Board approves an RPT policy, revises it regularly and oversees its implementation. Its purpose is to prevent transactions that are unfair to the company, its shareholders generally or minority shareholders.

C. Before approval, management provides sufficient information, the audit committee gives its opinion, conflicted members recuse themselves, and the Board satisfies itself that the transaction is at arm's length or otherwise justified as being in the company's best interests, if necessary, with an independent fairness opinion.

D. RPTs follow the same procedures as any third-party transaction, continuing RPTs are re-evaluated and re-approved regularly, and RPTs are disclosed in the financial statements and annual report.

E. Ordinary-course, market-terms and non-material transactions may be excluded from prior approval if the policy so provides and the law allows, but summary information on them is still reported to the Board.

QUESTIONS FOR THE BOARD

1. *Do we have a Board-approved related party transaction policy that defines related parties, approval thresholds and permitted exclusions in line with national law?*
2. *Which related party transactions did the Board approve in the last year, and for each, how did it satisfy itself that the terms were at arm's length or otherwise in the company's best interests?*
3. *Did the audit committee give its opinion before approval, and did all conflicted members recuse themselves from the materials, discussion and vote?*
4. *Which continuing related party arrangements exist, when were they last re-evaluated, and are they still fair to the company?*
5. *Are related party transactions fully disclosed in the financial statements and annual report, and does the Board receive summary reporting on the transactions excluded from prior approval?*