

OECD WORK ON CORPORATE GOVERNANCE IN RUSSIA

This note was prepared as background to a meeting of the OECD-Russia Liaison Committee meeting, to take place in Moscow on 20 June 2005.

I. Main Achievements and Challenges

1. Output results delivered under the 2003-04 work programme, and during first half of 2005

During 2003-2004, the Russian Corporate Governance Roundtable entered a new phase of work in order to strengthen support for implementation and enforcement of corporate governance reforms as agreed in the Roundtable's **White Paper on Corporate Governance in Russia**. The Roundtable has provided the framework for all co-operation between Russia and the OECD on corporate governance issues since 1999. At its October, 2003 meeting, the Roundtable identified as a particular priority the need to improve transparency and disclosure, recognising it as a critically important element of improving investor confidence and lowering the cost of accessing capital for Russian companies. The Roundtable therefore decided to create two task forces to focus on two key elements of better transparency and disclosure: i) transitioning to International Financial Reporting Standards (IFRS), and ii) better identifying the corporate ownership and control structures and interests of all parties involved in company transactions through improved disclosure of related party transactions.

- The task force met in March and June 2004 to develop a policy brief setting out policy options and recommendations for Russian policy-makers called, **“25 Recommendations to Facilitate Transition to IFRS.”** The task force report recognises the importance of accurate and reliable information to enable shareholders and investors to take well-considered investment decisions, and provides concrete recommendations for facilitating the transition to internationally agreed accounting standards. The report notes that such actions will be particularly useful in supporting company efforts to raise money from external investors. Financial statements conforming to IFRS standards will be easier for investors to understand and have confidence in. For management, the new standards will make the economics of the company more transparent. For policy-makers, it could help strengthen Russia's capital market, and regulators could benefit from improved regulatory oversight and enforcement. More broadly, other stakeholders would benefit from overall improved transparency of company accounts.
- The second task force met in March and November 2004 to develop a policy brief on **“Improving Transparency of Related Party Transactions.”** It concluded that improving reporting and transparency of related party transactions is a critical aspect of protecting shareholder rights and enhancing public confidence in the Russian capital market. Protection of investor rights and improved corporate governance requires that the controlling shareholders and control arrangements of publicly listed companies be disclosed. It also requires a mandatory disclosure regime that effectively regulates related party transactions, clarifying the responsibilities of board members and management for disclosing such transactions. To curb abuse, transparency of ownership and control structures and the nature of transactions is essential. Both task force reports were published in the first half of 2005, following a November 2004 Roundtable discussion.

As a direct follow-up to the White Paper, Standard & Poor's issued a **progress report on implementation of each of the 41 recommendations in the Russian White Paper** in 2004. It concluded that while overall, “only moderate progress has been made”, some progress had been made in both of the areas that the Roundtable task forces have focused on. The report was presented to Russian media and used as a means for encouraging policy-makers to take further steps to improve corporate governance.

The Roundtable will meet on 2-3 June, 2005 in Moscow to take on **two issues of growing priority identified by the Russian authorities: corporate governance of state-owned enterprises and enforcement of corporate governance rules**. The June 2005 plenary will identify the main road blocks and the most critical issues to address. The objective is to work on issues where maximum impact can be achieved to support reform efforts. These priorities are further discussed in the concluding section of this paper.

2. Assessment

Summary of impacts: The two task force reports highlighted above are being given close consideration by Russian policy-makers. Most recently, the paper on transition to IFRS was included in the Russian Ministry of Finance's own strategy paper on financial reporting reform and endorsed by the Ministry of Economy and Federal Service for Financial Markets (FSFM). Minister of Finance A.L. Kudrin stated, "For the first time, Russian and international experts have developed realistic, practical and sustainable recommendations based on a deep understanding of the economic situation in Russia. The experts have managed to adapt the best international practices to the conditions existing in Russia. That makes this document prepared by the Roundtable very important and valuable."

The Ministry of Economy and FSFM have indicated their intention to use the policy options paper on transparency of related party transactions in their legal reform efforts. More broadly, the Roundtable's impacts during this period include increased awareness of corporate governance issues, widespread use of the OECD Principles of Corporate Governance and the White Paper, including in the Russian Corporate Governance Code as well as in many company codes and other international assistance programmes, and development of a corporate governance culture in the private sector and associations.

Tangible Results

Since its inception in 1999, the Russian Corporate Governance Roundtable has played an important role in building momentum and establishing a coalition for reform in Russia. This is demonstrated by the following tangible results:

Raising high level visibility. Economics Minister German Gref stated in 2004, "The need to improve corporate governance is one of the key challenges faced by Russian business today. Better corporate governance, in addition to improved economic performance, allows companies to reduce their financial and operational risks, and significantly raises their attractiveness to investors." Mr. Gref also noted the publication in 2002 of two important documents, the Russian Corporate Governance Code and the White Paper. "The White Paper on Corporate Governance, published by the OECD together with the Russian Ministry of Economics, offers an overview of existing state of corporate governance in the country and presents recommendations for policy makers and legislators, as well as best practice for the private sector..."

Contributing to Russian policy-making. In 2004, the Ministry of Economy set up a corporate governance experts group to formulate priorities for corporate governance reform, using the White Paper as a basis. In early 2005, the FSFM is creating its own corporate governance experts group which will consider as its priority a review of the Roundtable task force paper on "Improving Transparency of Related Party Transactions". The Duma formed a Working Group on Improving Corporate Governance in Russia, led by the Duma Committee on Property, encouraging synergies with the Roundtable's work. These efforts now also include the Supreme Arbitrazh Court.

Guiding technical assistance programmes to help prioritise. Technical assistance projects on corporate governance managed by the European Commission, the UK, USAID, Canada and the IFC are using the

OECD Principles of Corporate Governance, the White Paper and other Roundtable materials.

3. Medium Term Challenges

The objectives of OECD's co-operation with Russia remain:

- To facilitate Russian participation in international policy dialogue on the basis of the OECD Principles on Corporate Governance, the White Paper on Corporate Governance in Russia and the Russian Corporate Governance Code.
- Provide a forum in which Russian policymakers and experts can strengthen and develop contacts with their peers in OECD countries and facilitate exchange of experience.
- Evaluate how the corporate governance rules in Russia relate to international best practices.
- Support reform by advancing analysis and understanding of viable policy-options as well as implementation and enforcement mechanisms in the area of corporate governance.

Recent press reports and analysis by investor groups have raised questions about Russia's commitment to better corporate governance. During the past 5 years, overall improvements in the Russian corporate governance framework and practices are evident. However, highly selective enforcement in the "Yukos case" followed by the effective re-nationalisation of Yukos' main production arm, Yugansneftegaz, and tighter control of state-owned assets has recently dampened companies' motivation to improve corporate governance and lowered investor confidence.

Russian authorities have expressed interest in addressing this challenge through the Russian Roundtable, by focusing on i) corporate governance of state-owned enterprises and ii) enforcement of corporate governance rules. This is an opportune time to make a difference on these issues – as improvements should have positive repercussions on the market.

- Corporate governance of state-owned enterprises is a major issue in OECD countries. Russian authorities have expressed a strong interest in benefiting from the OECD's emerging work in this area. In Russia today, federal, regional, and local authorities continue to hold stakes in privatised companies. Indeed, they still control approximately 24% of the equity market, or \$56.8 billion worth of assets. At the same time, the government is also the key regulator of Russia's capital markets. Because of these two responsibilities, as owner and regulator, the government has a great interest in improved corporate governance practices. The key challenges include (1) defining an effective state ownership policy, (2) improving protection of minority shareholders (3) increasing the effectiveness of board of directors and (4) increasing transparency and quality of disclosure. The recently issued OECD Guidelines on Corporate Governance of State-Owned Enterprises will provide a useful platform for this work.
- Enforcement of corporate governance rules is undoubtedly a central challenge in Russia. Improvement in the quality of legislation has not yet been matched by improvements in the quality of institutions that implement the law or those that resolve legal disputes and enforce the law. Without effective, impartial third-party enforcement of the law, property rights are likely to be insecure and arm's-length contracting will involve much high transaction costs. The Federal Service for Financial Markets (FSFM) is keen to address institutional issues concerning investigative power and sanctions as well as capacity issues. This is also timely as the FSFM seeks to increase its status to a "Mega-regulator" with stronger enforcement powers. The stock exchanges and self-regulatory organisations of market participants are weak in monitoring or

enforcing corporate governance standards. At the same time, any improvements in regulatory enforcement need to go hand-in-hand with reform in the judiciary. The Supreme Arbitrazh Court has agreed to work with the OECD to bring more transparency to the decision-making process on commercial cases and examine criminal and civil enforcement as well as the infrastructure.

Benefiting from its June 2005 discussion, the Roundtable will convene working groups to review and propose policy options/recommendations on corporate governance of state-owned enterprises and enforcement of corporate governance rules in Russia. The Roundtable will consider the initial results of this work in 2006 and how to take it forward in the 2007-2008 work programme.

A comprehensive report on progress against the White Paper will also help to define the future agenda, to meet the demand by Russian policymakers, regulators and practitioners for focused policy work and active participation in the international policy dialogue. Depending on resources, more targeted assistance could be provided to Russian institutions engaged in reform efforts.

II. Russia's Participation in the OECD Steering Group on Corporate Governance

The OECD Steering Group on Corporate Governance does not have any non-member observers. However, Russia has actively contributed to the Steering Group's work through its participation in consultations in 2003 undertaken for the review and revision of the OECD Principles of Corporate Governance, and participation in the 2004 consultations of the Working Group on Privatisation and Corporate Governance of State-Owned Assets in the development of the new OECD Guidelines on Corporate Governance of State Owned Enterprises.

Contact: Fianna Jesover