REPORT

ENFORCEMENT POWERS OF THE FFMS OF RUSSIA IN THE AREA OF SHAREHOLDER RIGHTS PROTECTION (IN THE AREA OF CORPORATE GOVERNANCE) *

Reporters:

Tatiana Medvedeva - Senior Advisor for Legal Issues of the CCMD Foundation

Alexey Timofeev - Technical Advisor for Legal Issues of the CCMD Foundation

* This paper has been prepared in the framework of the Russian Corporate Governance Roundtable. The project is co-financed by the European Union under its TACIS program and the Global Corporate Governance Forum.

Enforcement powers of the FFMS of Russia in the area of shareholder rights protection (in the area of corporate governance)

The enforcement powers of the FFMS of Russia in the area of protection of shareholders' rights are determined by a range of questions within the FFMS competence. In accordance with the Law on Securities Market the FFMS exercises control over compliance by issuers with the Russian securities legislation, as well as standards and requirements approved by the federal executive body for securities market[1]. In this connection the enforcement powers of the FFMS shall make it possible to exercise control over compliance by issuers of the specified requirements.

On the basis of the Law on the Securities Market one can distinguish the following issues on which the FFMS exercises control over issuers:

1) compliance with the rules of securities issue and information disclosure in the course of issue;

2) information disclosure in the course of prospectus registration;

3) disclosure of periodic information and material facts;

4) maintaining the register of owners of securities.

The following enforcement powers of the FFMS exercised within the control over issuers are considered in this report:

1) conducting inspections;

2) issuing orders;

3) bringing to administrative responsibility;

4) sending materials to law enforcement agencies for bringing to criminal responsibility;

5) making claims on issues within the competence of the federal executive body for securities market (including invalidity of securities transactions).

1. Conducting inspections of issuers

Right of the FFMS to conduct inspections of issuers is set in the Law on the Securities Market[2]. This law authorizes the FFMS to establish procedure for inspections of issuers, to conduct inspections of issuers' activity, either independently or in cooperation with the federal executive bodies, to appoint and recall inspectors for control over an issuer.

The right of the FFMS to conduct an inspection and to receive required information is based on criminal liability. However, effectiveness of inspection powers in certain cases is ensured not so much by criminal penalty as by other administrative capabilities of the FFMS. For example, obstacles to inspection in the course of securities issue may result in refusal to register the securities issue or declaration the issue invalid. These circumstances promote cooperation of issuers and their officials with the FFMS.

1.1. Conducting inspections in the course of registration of securities issues and securities prospectuses

[1] Para 10 of article 42 of the Law on the Securities Market.

[2] Para 6 of article 44 of the Law on the Securities Market.

The most common reason for conducting inspections by the FFMS is registration of securities issues and securities prospectuses.

In accordance with the Russian legislation each issue of securities (including shares and bonds) is subject to state registration[3]. Such registration may be accompanied by registration of securities prospectus or may not.

Registration and disclosure of securities prospectus is required for their public placement and circulation. In the event of issuing securities by open subscription (public offering) or closed subscription (private offering) among more than 500 persons registration of issue prospectus is obligatory. In this case registration of prospectus is performed in parallel with registration of securities issue.[4] If registration of securities issue was not accompanied by registration of prospectus (for example, in the event of closed subscription) the issuer can register prospectus later in order to ensure public circulation of issued securities (for example, for listing of securities)[5].

In accordance with the Law on Securities Market the FFMS of Russia is responsible for completeness of the information contained in the documents submitted for state registration of securities issue[6]. In the meantime, the Law entitles the FFMS to verify the reliability of data contained in the above documents[7]. Monitoring of compliance with legislative requirements to the securities issue is closely connected with such inspection - the FFMS verifies the reliability of information on performing actions necessary for securities issue according to law.

Though the FFMS is not obliged to verify the reliability of data contained in the documents submitted for the state registration of securities issue, in practice it performs verifications on a selective basis. There are also specific reasons for the FFMS to verify the reliability of this information. Usually the reasons are internal contradictions in the submitted documents and obtaining by the FFMS of information on possible unreliability of information. In the last case the most frequent source of information are complaints received by the FFMS until the moment of registration of a securities issue.

As a rule, in case of appearance of the reasons for conducting inspections the FFMS suspends registration of the securities issue for the period of inspection but according to law for no more than 30 days[8].

The power to verify the reliability of information rests on the other power of the FFMS - the right to request from the issuers to submit documents needed for the settlement of the questions coming under its jurisdiction[9]. Using this right the FFMS performs verifications by requesting documents from the issuers and their analysis.

The Law envisages consequences of non-submission of the documents by request of the FFMS - if these documents are not submitted within 30 days it shall be one of the reasons for refusal to register the securities issue (additional issue)[10].

If any violations of legal requirements in the process of issuance or unreliable information are uncovered as a result of inspection, the FFMS, subject to the type of violation,

[3] Para 1 of article 19 of the Law on the Securities Market.
[4] Para 2 of article 19 of the Law on the Securities Market.
[5] Para 3 of article 19 of the Law on the Securities Market.
[6] Para 5 of article 20 of the Law on the Securities Market.
[7] Para 3 of article 20 of the Law on the Securities Market.
[8] Para 3 of article 20 of the Law on the Securities Market.
[9] Para 7 of article 44 of the Law on the Securities Market.
[10] Article 21 of the Law on the Securities Market.

can suspend an issue or refuse to register it. The Law on the Securities Market[11] has the following provision:

"The issue of securities may be suspended or recognized as void, if the registration body finds out the following violations:

violations by the issuer of the requirements of the RF legislation in the process of issuance;

detection of unreliable information in the documents on the basis of which the securities issue was registered".

For the above reasons the FFMS can refuse to register the securities issue, for example if data on the adopted decision on issuance, as well as information on officials, structure of bodies and stock capital of the issuer was found untruthful.

The same rules are applied when a securities prospectus is registered not in parallel with a securities issue but afterwards. Unfortunately, in this case the law does not provide for extension of the common thirty-day period of registration of the securities prospectus, that impedes conducting inspection[12]. In this case the FFMS can use its right to suspend the issue.

1.2. Conducting inspections of issuers in the course of securities placement

The FFMS has a right to conduct inspections on any stage of the issue including the stage of securities placement. As a rule such an inspection is conducted if upon completion of securities placement complaints were made on violations during the prior stages or in the course of securities placement. If the above violations are detected the FFMS has a right to suspend the securities issue until their elimination.

1.3. Conducting inspections of issuers in connection with registration of the report on the results of the issue

In accordance with the Law on Securities Market the last stage of the procedure of securities issue is state registration of the report on the results of the securities issue[13]. According to this Law[14] within 30 days after completion of placement of issued securities the issuer shall be obliged to submit its report about the results of the issue (additional issue) of securities to the registration body, as well as documents proving the issuer's compliance with the requirements to be observed in the course of placing the securities.

Thus, the main objective of supervision on the stage of registration of the report on the results of the securities issue is to control the compliance with the requirements for securities placement after registration of the issue. Meanwhile, violations of the procedure of the securities issue on the previous stages and unreliable information in the documents submitted before can be detected on this stage also.

The FFMS of Russia is responsible for the completeness of the registered report on the results of the issue, however performs selective verifications of the reliability of information contained in the documents submitted for registration of the above report. The specific reasons for verifications can be, as it was mentioned, internal contradictions in the submitted documents,

[11] Article 26 of the Law on the Securities Market.
[12] Para 3 of article 19 of the Law on the Securities Market.
[13] Para 1of article 19 of the Law on the Securities Market.
[14] Article 25 of the Law on the Securities Market.

including those submitted before, as well as complaints about violations, which are not evident from the submitted documents.

The most frequent reasons for conducting inspections are complaints about violations of preferential rights of shareholders, non-compliance in the course of the issue with the rules of concluding interested party transactions, violation of the rules of price determination, etc.

If violations are detected, the FFMS has a right to refuse the registration of the report on the results of the issue. It means that the securities issue is recognized as void and the parties are returned into initial state[15].

According to the Law the registration body shall consider the report on the results of the issue of securities within two weeks and extension of this period for conducting inspections is not provided as for registration of the securities issue. It is obviously that this period is not enough for conducting inspection, and in practice the FFMS uses its right to suspend the securities issue in order to conduct an appropriate inspection.

1.4. Conducting of inspections of issuers in connection with information disclosure

One more reason for conducting inspection is information disclosure by an issuer. The FFMS controls both the fact of discharge of the issuers' obligation to disclose information and reliability, as well as completeness of the information disclosed.

The Russian law sets disclosure requirements for information that an issuer is obliged to disclose in the form of quarterly reports and messages on the material facts.

In each quarterly report an issuer has to disclose information on the same items as in the securities prospectus.

The quarterly report is submitted to the FFMS no later than 45 days after the end of the reporting quarter. The quarterly report shall be submitted in hardcopy or electronic form.

In addition, within 45 days after the end of the reporting quarter the issuer has to publish the text of the quarterly report in the Internet. The text of the quarterly report has to be available in the Internet during no less than 6 months after its publication or until the issuer's report for the next quarter is published in the Internet.

Information disclosure in the form of messages on the material facts is aimed at operational disclosure of the events, which can be of importance for the securities market participants. Message on the material fact shall be published in the news line no latter than 1 day, in the Internet no latter than 3 days, and in periodical no latter than 5 days after the entry is made in personal account of a person registered in the share register of the issuer. The text of message on the material fact shall be available in the Internet during no less than 6 months after its publication.

Besides, the above messages shall be sent to the FFMS in hardcopy or electronic form.

The fact of information disclosure is usually verified relating to messages on the material facts. As regards disclosure of the quarterly reports, fact of their non-disclosure in time is evident and does not require a special verification. In the event of messaging on the material facts subject of verification will be the fact in respect to which the message should be disclosed.

The FFMS has a right to verify the reliability of the information disclosed both with respect to quarterly report and messages on the material facts.

2. Issuing orders for issuers

[15] Article 26 of the Law on the Securities Market.

In accordance with the Law on Securities Market the FFMS has a right to send orders binding for execution to the issuers and to request submission of documents needed for the settlement of the questions coming under its jurisdiction[16].

The Law on Protection of Rights and Lawful Interests on Securities Market specifies that the orders of the federal executive body for securities market are binding for execution by profit and non-profit organizations and their officials, entrepreneurs, individuals on the territory of the Russian Federation, they are issued on the questions covered by this Law, other federal laws and regulations of the Russian Federation with a view to stop and prevent violations on securities market, as well as other questions within the competence of the federal executive body for securities market[17].

An order in itself expresses the will of an oversight body based on authoritative powers, the way it sees for getting over the negative factors, which the addressee has to follow. This ensured that an order is a useful and universal instrument for solution of several tasks at a time. As evident from the Law the orders can be issued with a view to prevent, to stop violation or to remove its consequences.

Usually, when a violation is of continuing character, an order is issued on its elimination. Sometimes it is impossible to eliminate violation as it has already occurred. In this case the FFMS can issue an order on removal of negative consequences of such violation.

Among the orders aimed at prevention of violations there are the orders to suspend operations - in case the violation is detected which can result in other violations the FFMS has a right to suspend operations which can lead to it. In the context of this report such orders can be issue with respect to maintaining the shareholder register and operations with the issuer's securities. In this case operations are resumed after elimination of the violation.

Power to issue orders is widely used by the FFMS. Last year only the central office of the FFMS issued more than 200 orders, the third of which had respect to corporate governance.

Issue of an order is often the result of inspection conducted - if violation is detected in the course of inspection the FFMS issues an order. However, sometimes when the fact of violation is evident (in case of violation of the rules of disclosure of quarterly reports) an order can be issued without conducting inspection.

Efficiency of an order is ensured by administrative penalty. Orders are often issued together with bringing to administrative responsibility for the relevant violation.

2.1. Orders on securities issue

On the basis of the general provisions on right of the FFMS to issue orders on the questions within its competence[18], as well as special provisions of the Law[19] the FFMS issues orders in case of detection of violations in the course of securities issue. Such orders can be issued during the registration of the securities issue or afterwards and have respect, for example, to securities prospectus change. In this case the FFMS can even use its right to suspend the securities issue until elimination of the violations.

2.2. Orders on information disclosure

[16] Para 7 of article 44 of the Law on the Securities Market.
[17] Para 1 and 2 of article 11 of the Law on Protection of Rights and Lawful Interests on the Securities Market.
[18] Para 7 of article 44 of the Law on the Securities Market.
[19] Para 3 of article 51 of the Law on the Securities Market.

Considering the FFMS functions the orders on information disclosure - quarterly reports and messages on the material facts - are quite frequent. Orders on information disclosure are also issued in respect to disclosure of information on affiliated persons by the open joint stock companies[20].

If information was not disclosed within the specified period the FFMS has a right to order that an issuer disclose information, and if it was detected that disclosed information is incomplete or unreliable - to order to eliminate these violations. At the same time, if it concerns the issuers of publicly circulated securities the FFMS can order that trade operators and other securities market professional participants suspend the public circulation of securities of these issuers. This is based on the right of the FFMS provided by the Law on Protection of Rights and Lawful Interests of Investors on Securities Market[21]. Such an order is aimed at elimination of the risk of making investment decisions without proper information.

2.3. Orders on disclosure of information to shareholders

Unlike cases when according to the Law on Securities Market information is disclosed to all securities market participants, the Law on Joint Stock Companies provides disclosure of certain information to shareholders.

The Law on Joint Stock Companies provides obligation of a joint stock company to provide its shareholders with certain documents and information[22]. These are the founding documents of the joint stock company, its internal documents, annual reports, accounting documents and financial reports, minutes of the company general meeting of shareholders, meetings of the Board of Directors, Inspection Commission (Inspector), and collective executive body of the company, voting bulletins, as well as power of attorney for participation in the general meeting of shareholders, reports of independent appraisers, lists of the company's affiliated persons, lists of the general meetings participants, persons having right for dividends, etc.

These documents shall be submitted to the shareholders for reading in premises of the company's executive body within seven days after the request. Besides, the joint stock company shall provide copies of the above documents upon request of shareholders.

The Law on Joint Stock Companies envisages other cases when the company is obliged to disclose documents and information to shareholders - for example, for the general meeting of shareholders[23].

Situation when shareholders send complaints to the FFMS about refusal to disclose information specified by the law is common. The FFMS has a right to issue orders on provision of this information.

2.4. Orders on maintaining of a register

One more common case of issuing orders is issue of orders on maintaining a shareholder register. Taking into account that the resister can be maintained by a specialized registrar or an issuer either can be an addressee of such orders.

---

[20] Para 1 of article 92 of the Federal Law "On Joint Stock Companies" and Resolution of the FCSM of Russia No 03-19/ps issued on 01.04.2003 "On disclosure of information on affiliated persons of the open joint stock companies".

[21] Para 2 of article 11 of the Law on Protection of Rights and Lawful Interests of Investors on the Securities Market.

[22] Article 91 of the Law on Joint Stock Companies.

[23] Para 3 of article 52 of the Law on Joint Stock Companies.

The FFMS issues orders to transfer the register to a registrar for its maintenance in accordance with the established rules, to provide information from the register, and others.

The above types of orders on maintaining a register are accompanied by the orders on suspension of certain operations for the period up to 6 months[24].

3. Making claims

In order to protect investors the FFMS has a right to make the following claims:

claims demanding that securities issue is declared null and void after registration of the report on the results of the issue if unfair issue involved significant misleading of shareholders, or if the issue objectives are in conflict with the rule of law and morality[25];

claims demanding that assets are returned to holders of securities if the issue is deemed invalid[26];

claims demanding recovery of money received by the issuer unjustly in case of issuing securities over and above the quantity stated in the decision, if during two months the issuer does not redeem and repaid the extra securities [27];

claims demanding that transactions are deemed invalid if they affect interests of investors - shareholders;

other claims if they are aimed at protection of lawful interests of investors.

According to part 1 of article 46 of the Civil Procedural Code of the RF in cases provided for in the law public authorities can make claims demanding protection of rights, freedoms and lawful interests of other persons upon their request or protection of rights, freedoms and lawful interests of the public. Part 1 of article 53 of the Code of Arbitration Procedure of the RF contains similar provision on claims and applications demanding protection of public interests.

When making a claim in arbitration court the FFMS shall specify the violation of public interests which gave occasion to legal recourse[28].

Thus, the FFMS can initiate a case to protect a certain investor or to protect rights and lawful interests of investors at large, or public interests.

According to article 46 of the Civil Procedural Code of the RF making claim in court of general jurisdiction to protect a certain investor is possible only on the ground of request of this investor with the exception of cases when claims are made to protect incapable persons or minors.

4. Bringing to administrative responsibility

Application of administrative sanctions in general and in the area of corporate governance in particular is one of the most effective instruments of protecting interests of securities market participants. However, minimum three requisitions are needed: presence of constituent elements of administrative offence in the Code of Administrative Offences, clear and quick procedures of application of administrative sanctions, proportionality of administrative sanctions.

---

[24] Para 2 of article 11 of the Law on Protection of Rights and Lawful Interests of Investors on the Securities Market.
[25] Article 14 of the Law on Protection of Rights and Lawful Interests of Investors, Article 51
[26] Article 26 of the Law on the Securities Market.
[27] Article 26 of the Law on the Securities Market.
[28] Para 2 of article 53 of the Arbitration Procedural Code

The Code of Administrative Offences specifies a special type of administrative offences - violations in the area of finances, taxes and duties, securities market[29]. This group includes several offences relating to protection of shareholder interests in the area of corporate governance. These are:

1) Unfair issue of securities[30];

2) Violation of legal requirements regarding information disclosure on securities market[31];

3) Preventing an investor (shareholder) from exercising rights on company management[32];

4) Violation of the rules of maintaining the register of shareholders[33];

5) Evasion from transfer of the shareholder register to a registrar for its maintenance[34];

6) Use of official information on securities market[35];

7) Non-execution in time of a legal order (resolution, decision) of a regulatory body (official)[36];

8) Non-disclosure of data and information to a regulator[37].

4.1. Unfair issue of securities

In accordance with the Law on Securities Market[38] the issue shall be deemed unfair if the actions involved are expressed in the violation of the procedure of issue, established by the Law, and are the grounds for the refusal of the registration body to register the issue of securities (additional issue), for the recognition of the issue of securities as void, and for the suspension of the issue of securities.

The most frequent violations of the issue procedure are violations of the legislative requirements to the procedure of securities placement, violations of issue terms set in the decision on the issue, violations of the rules of information disclosure in the course of securities issue.

For the above offences the Code provides for imposition of fines that range from 4 thousand to 5 thousand rubles for the issuer's officials and from 40 thousand to 50 thousand rubles for the issuer.

4.2. Violation of legal requirements regarding information disclosure on securities market

This offence can be expressed in one of the following actions (inactions):

1) non-disclosure of legally provided information by an issuer to a shareholder upon his request. For example:

[29] Section 15 of the Code of Administrative Offences.
[30] Article 15.17 of the Code of Administrative Offences.
[31] Article 15.19 of the Code of Administrative Offences.
[32] Article 15.20 of the Code of Administrative Offences.
[33] Article 15.22 of the Code of Administrative Offences.
[34] Article 15.23 of the Code of Administrative Offences.
[35] Article 15.21 of the Code of Administrative Offences.
[36] Article 19.5 of the Code of Administrative Offences.
[37] Article 19.7 of the Code of Administrative Offences.
[38] Article 26 of the Law on the Securities Market.

non-submission to shareholders of documents and information for the general meeting[39];

refusal of the issuer to disclose documents to shareholders in accordance with articles 91 and 92 of the Law on Joint Stock Companies[40].

Commission of the above offence entails imposition of fines that range from 2 thousand to 3 thousand rubles for the issuer's officials and from 20 thousand to 30 thousand rubles for the issuer;

2) submission of unreliable information by an issuer. This offence involves submission of information which doesn't correspond to reality to a shareholder without regard to where it contains - in documents directly submitted to the shareholder or in published or otherwise disclosed information, including disclosure in the Internet.

Commission of the above offence entails imposition of fines that range from 2 thousand to 3 thousand rubles for the issuer's officials and from 20 thousand to 30 thousand rubles for the issuer;

3) violation by an issuer or a person providing services on public presentation of disclosed information of the procedure of disclosure of information on securities market, which shall be disclosed according to the legislation. For example: non-submission of quarterly report, non-disclosure by an issuer of publicly circulated securities of messages on material facts and other material information which can affect the securities price, absence of information to be disclosed to shareholders on the issuer's web-site.

Commission of the above offence entails imposition of fines that range from 3 thousand to 4 thousand rubles for the issuer's officials and from 30 thousand to 40 thousand rubles for the issuer;

4.3. Preventing an investor (shareholder) from exercising rights on company management

This offence is the most serious as a shareholder loses one of his basic rights - right for company management.

It covers a number of actions and inactions resulting in violation of a shareholder's right to participate in company's management.

One of the examples of preventing a shareholder from participation in the general meeting is denial of registration of the shareholder or his representative. Quite often it happens so that the guard does not let the above persons to enter the premises where the meeting is held. It sometimes leads to open conflict between various groups of shareholders. It is fair to say that such methods became rare in occurrence but they are still in the arsenal of instruments used in corporate conflicts.

The other example of preventing shareholders from exercising their rights on company management are violations of rights of shareholders in the course of preparation to the general meeting. The grossest violation is failure to notify a shareholder about an impeding general meeting. However, in terms of proving it is the most complex, as in this case the old trick with "empty sheets of paper" is used - a registered letter is sent to the shareholder, but empty sheets

[39] According to the Law on Joint Stock Companies (article 52) such documents and information shall be provided within 20 days, in some cases within 30 days.

[40] In accordance with article 91 of the Law on Joint Stock Companies a company shall provide upon request of shareholders its founding documents, internal documents, annual reports, accounting documents and financial reports, minutes of the company general meeting of shareholders, meetings of the Board of Directors, Inspection Commission (Inspector) and collective executive body of the company, voting bulletins, as well as power of attorney for participation in the general meeting of shareholders, reports of independent appraisers, lists of the company's affiliated persons, lists of the general meetings participants, persons having right for dividends, and some other documents.

are put in an envelope. The common methods are refusal to accept a letter of attorney of a representative due to "defects found in it", change of time or place of holding the general meeting.

Commission of the above offence entails imposition of fines that range from 4 thousand to 5 thousand rubles for officials and from 40 thousand to 50 thousand rubles for legal entities.

4.4. Violation of the rules of maintaining the register of shareholders

Violation of the rules of maintaining the register of shareholders may consist in:
illegal refusal or evasion from making entries in a share register;
registration of inaccurate data due to fault of a register's holder;
breach of periods for issuing statements from a share register;
non-execution or improper execution by a register's holder of requests of a shareholder, a person acting on his behalf, as well as a nominal shareholder.

Thus, this offence covers almost all violations connected with maintenance of a shareholder register except evasion from transfer of the register, which is a separate type of offence.

The amount of fine set for this offence ranges from 1 thousand to 2 thousand rubles for officials and from 10 thousand to 20 thousand rubles for legal entities.

4.5. Evasion from transfer of the shareholder register to a registrar for its maintenance

Evasion from transfer of the shareholder register to a registrar for its maintenance consists in non-execution of an issuer with more than 50 shareholders of an obligation to conclude a contact with a registrar or evasion of an issuer from transfer of information and documents comprising the system of share register.

The amount of fine set for this offence ranges from 1 thousand to 2 thousand rubles for officials and from 10 thousand to 20 thousand rubles for legal entities.

4.6. Use of official information on securities market

Administrative liability is envisaged for making transactions with the use of official information on securities market by persons possessing such information by virtue of their official status, labor duties or the agreement concluded with the issuer, and for transfer of official information to the third persons for making transactions. Actually it is liability for illegal use of insider information for the purpose of making securities transactions or sharing it with a third person to make securities transactions.

Only officials possessing official information can be offenders. The Law on Securities Market contains the list of these officials: general director, members of management bodies of the issuer or professional participants having an agreement with the issuer, employees of state bodies who have access to such information by virtue of their control, supervisory and other powers[41].

The amount of fine set for this offence ranges from 2 thousand to 3 thousand rubles.

4.7. Non-execution in time of a legal order (resolution, decision) of a regulatory body (official)

[41] Article 32 of the Law on the Securities Market.

The issuers are liable for non-execution of orders of the FFMS in time set in an order. The amount of fine set for this offence ranges from 500 to 1 thousand rubles for officials and from 5 thousand to 10 thousand rubles for legal entities.

4.8. Non-disclosure of data (information) required for the regulator to perform its activity

This administrative offence consists in non-submission or undue submission to the FFMS of data (information) submission of which is provided by law and is required for this body to perform its activities, or submission of incomplete or inaccurate data (information). The issuer can be held liable for this offence in case of conducting inspections on the basis of complaints of shareholders about violations of their rights.

The amount of fine set for this offence ranges from 100 to 300 rubles for citizens, from 300 to 500 rubles for officials and from 3 thousand to 5 thousand rubles for legal entities.

*5. S*ending materials to the law enforcement agencies for bringing to criminal responsibility

The Criminal Code provides for liability for the following offences:

1) Abuses in the course of securities issue[42];

2) Malicious evasion from disclosure of information specified by securities legislation of the RF to the investor or the controlling body[43];

3) Abuse of powers[44];

4) Commercial bribery[45].

Having detected elements of the above offences the FFMS has a right to send materials to the law enforcement agencies.

5.1. Abuses in the course of securities issue

Unlike the offence provided by article 15.17 of the Code of Administrative Offences establishing liability for unfair issue, the Criminal Code (CC) provides for certain violations in the course of the issue which may lead to criminal liability. In accordance with it the following actions shall be deemed as criminal offences: entering of consciously inaccurate information to the prospectus of securities issue, approval of issue prospectus or report on the results of the issue containing patently inaccurate information, as well as placement of issued securities which issue was not registered. The requisition for bringing to criminal responsibility is infliction of major damage[46]. Thus, depending on the character of offence and gravity of its consequences an offender may be brought to administrative or criminal liability.

The CC provides penalty in the form of criminal fine ranging from 100 thousand to 300 thousand rubles or in the amount of salary or other income of the offender for the period from one year to two years, or compulsory work for the term ranging from 180 to 240 hours, or corrective labor for the term ranging from 1 year to 2 years. If these actions were committed by a

[42] Article 185 of the Criminal Code.
[43] Article 185.1 of the Criminal Code.
[44] Article 201 of the Criminal Code.
[45] Article 204 of the Criminal Code.
[46] Major damage in this case shall be damage, which exceeds 1 million rubles.

group of persons by previous concert or an organized group the penalty is the fine ranging from 100 thousand to 500 thousand rubles or in the amount of salary or other income for the period from 1 year to 3 years, or imprisonment with maximum term of 3 years.

5.2. Malicious evasion from disclosure of information specified by securities legislation of the RF to the investor or the controlling body

As a rule the issuer is obliged to provide investors with information. At the same time this obligation is sometimes imposed on the other persons, for example on a registrar, a person who disclose information under the agreement with the issuer.

Malicious evasion as a criminal offence is similar to the administrative offence provided by article 15.19 of the Code of Administrative Offences. If an offence is of malicious character or major damage was caused and offender may be brought not to administrative but criminal liability.

This criminal offence has the following forms:

malicious evasion from disclosure of information containing data about the issuer, its financial and economic activity and securities, transactions and other operations with securities, by a person who is obliged to provide investor with such information;

submission of patently incomplete information;

submission of patently false information.

These offences may occur in all cases when there is an obligation to disclose information - in securities prospectus, quarterly report, massages on material facts, etc. For example, repeated groundless refusal to submit information to investor can be deemed as is malicious evasion from disclosure of information.

Submission of incomplete information can be expressed in concealment of a part of important information, and submission of patently false information - in forging information.

Besides, article 185.1 provides criminal liability for malicious evasion from disclosure of information to controlling body. This offence covers all bodies, which like the FFMS exercise control over legal entities - issuers. Its elements are similar to the elements of the administrative offence provided by article 19.7 of the Code of Administrative Offences, but implies more strict penalty if similar actions are of malicious character. It is obvious that a person who not once failed to submit information upon request of the FFMS can be brought to criminal liability.

Criminal sanction for this offence is criminal fine up to 300 thousand rubles or in the amount of salary for the period up to 2 years, or compulsory work for the term ranging from 180 to 240 hours, or corrective labor for the term up to 1 year.

5.3. Abuse of powers

According to the CC abuse of powers takes place when a person performing management functions in a profit organization uses his powers against the lawful interests of this organization and for the purpose of obtaining benefits and advantages for himself or other persons or inflicting harm to other persons, if this action seriously affected rights and lawful interests of citizens or organizations, or state interests.

The CC[47] has a definition of a person who performs management functions in a profit organization - this is a person who permanently or temporarily or under special power performs

[47] See Note to article 201 of the Criminal Code.

organizational and regulatory or administrative and economic duties in a profit organization despite of the form of ownership. Thus, sole executives of joint stock companies can be deemed as such persons, but it is not clear if members of the Board of Directors and Management Board can be also deemed the same[48].

Elements of this offence are formulated in the CC quite abstractedly, so that many actions (inactions) of the managers, including "stripping assets" can be deemed as abuse of powers.

Abuse of powers is penalized by a criminal fine up to 200 thousand rubles or in the amount of salary or other income of the offender for the period up to 18 months, or compulsory work for the term ranging from 180 to 240 hours, or corrective labor for the term ranging from 1 year to 2 years. If this offence led to grievous consequences the penalty is the fine ranging from 100 thousand to 500 thousand rubles or in the amount of salary or other income for the period from 1 year to 3 years, or arrest for the term from 4 to 6 months, or imprisonment with maximum term of 5 years.

5.4. Commercial bribery

Commercial bribery means illegal transfer of money, securities or other property or illegal rendering of property services to a person who performs management functions in a commercial or other organization in order to make him perform an action (inaction) in favor of the briber in connection with the official position of this person.

Judicial practice in this area formed an attitude of the Supreme Court of the RF. The court studied the practice of concluding paid "services agreements" between shareholders and members of the Board of Directors. These agreements are aimed at formalization of "representation" relations between shareholders and members of the Board of directors, including execution of written directives and their obligation in the course of voting. Such agreements not only contradict to law, but in some cases can be grounds for criminal liability. If these agreements provide for payments to a member of the Board of Directors by a shareholder, the above relations can be qualified as commercial bribery. In the Resolution of the Plenum of the RF Supreme Court of February 10, 2000 No 6 "On judicial practice in hearing cases on commercial bribery and corrupt practice" it is stated that "agents representing state interests in joint stock companies, whose part of shares is in federal ownership ... shall be held liable under article 204 of the CC of the RF in case of illegal receipt of money or use of services for actions (inactions) in favor of the briber in connection with the official position". This interpretation of the Supreme Court may cover other cases of "remuneration" of members of the Board of Directors by certain shareholders.

The CC sets various sanctions for commercial bribery depending on the presence of qualificatory elements (extortion, commission by a group of persons, etc.). The strictest penalty is criminal fine in the amount from 100 thousand to 500 thousand rubles or other income for the period from 1 year to 3 years, or deprivation of right to hold certain positions or perform certain activities for the term up to 5 years, or imprisonment with maximum term of 5 years.

[48] Position of the Supreme Court of the RF in respect of cases on commercial bribery (Resolution of the Plenum of the RF Supreme Court No 6 "On judicial practice in hearing cases on commercial bribery and corrupt practice" of February 10, 2000, speaks in favor of the fact that members of the Board of Directors shall be included in the list of persons performing management functions.

Conclusion

Analysis of the enforcement powers of the FFMS in the area of protection of shareholder rights allows to make a conclusion on their insufficiency.

1. Nowadays enforcement on a number of socially dangerous acts is restrained by lack or insignificance of responsibility. A good example of such acts is use of insider information. The Russian legislation does not provide for criminal liability for the use of insider information, and administrative liability for illegal use of official information is insignificant both from the point of view of its subjects and from the point of view of penalties.

There is no administrative liability for non-disclosure by a shareholder of information on changes of his share in charter capital that could be one of the measures for providing the right of shareholders to get information on the structure of ownership in the company. Administrative liability of affiliated persons for non-submission of information on their affiliated nature, as well as of members of the Board of Directors, executive director, managing director, members of the collective executive body, shareholder owing together with his affiliated persons 20 or more percents of voting shares for non-submission of information provided by the Law on Joint Stock Companies could contribute to detection and prevention of violations when concluding interested party transactions[49].

Gaps in administrative legislation in the area of corporate governance are often caused by the wrong approach to formulation of constituent elements of offences. Their objective aspects are describes, as a rule, specifically through listing of unlawful acts; as a result many violations of rights of shareholders are not offences in terms of administrative law.

The other drawback which leads to narrowing of the scope of effect of provisions of the Code of Administrative Offences is inadequate subject structure of offences. For example, exclusion of management companies, members of the Audit Chamber and the Inspection Commission, and shareholders from the list of subjects of administrative liability is an essential drawback of the existing administrative legislation, as well as ambiguity in respect of members of the Board of Directors and Management Board[50]. In case of a general meeting which can be initiated by the above persons their actions often lead to violation of rights of shareholders to participate in company management. Subject structure of use of official information is also inadequate: legal entities - professional participants and auditors do not bear administrative responsibility, though the Law on Securities Market set a prohibition for them to use official information.

2. In respect of bringing to administrative responsibility one can state that in general it is not effective due to small amount of penalties.

Before coming into force of the existing Code of Administrative Offences elements of administrative offences and powers of the regulator of securities market to impose fines were established by article of the Law on Protection of Rights and Lawful Interests of Investors on

[49] In accordance with article 82 of the Law on Joint Stock Companies members of the Board of Directors, sole executive, managing director, members of the collective executive body, shareholder owing together with his affiliated persons 20 or more percents of voting shares shall be obliged to inform the Board of Directors, Inspection Commission and Auditor about companies in which they own 20 or more percent of the voting shares (participatory shares, units); companies in which they hold positions; current or proposed transactions known to them and in which they may be deemed as interested parties.

[50] In accordance with the Code of administrative offences (article 2.4) only managers and other staff members who perform organizational and regulatory or administrative functions shall be deemed officials.

Securities Market[51]. This provision sets maximum amount of fine imposed on officials - 20 thousand rubles[52], for legal entities - 1 million rubles[53]. Nowadays the amount of administrative fine for offences in the area of corporate governance is reduced for officials four times - to 5 thousand rubles[54], and for legal entities 20 times - to 50 thousand rubles[55].

Such liberalization of administrative liability resulted in substantial growth of a number of offences. In 2002 1367 violations were detected, in 2003 – 2882, and in 2004 – 4276 violations. The number of cases of repeated commission of such offences also grows.

The substantial growth of a number of offences can be explained by the fact that sanctions provided for administrative offences in the area of corporate governance are so insignificant that they can not have a serious influence on offenders and prevent further violations. Thus, the administrative fine in the amount up to 40 thousand rubles can be imposed on the issuers or securities market professional participants. At the same time, in accordance with the sample interview of the issuers carried out by the FFMS they spend from 50 thousand to 250 thousand rubles depending on the company's size for preparation and disclosure of quarterly reports, material facts and other information to be disclosed. No wonder that the issuers prefer to pay the fine and thereby to avoid extra expenses.

The other problem is that there are no sanctions of high efficiency in the Russian legislation. Thus, administrative procedure for disqualification which could be applied to the issuer's officials is absent in the area of corporate governance.

3. One more problem of law enforcement is imperfection of the procedure for bringing to administrative responsibility. The limitation period for bringing to administrative responsibility is two months from the date of commission of an offence. This period is insufficient for the FFMS to detect violations. As a result the offenders can escape from responsibility. Besides, the existing procedure of imposing administrative penalty involves drawing up a protocol on administrative offence. This protocol shall be made within two days after the detection of violation and it has to be signed by a violator who can be very far from the FFMS or its regional office.

The above procedure is probably good for bringing to administrative responsibility the traffic offenders but is not effective in case of violations of shareholder rights, which quite often require collection of additional information, obtaining explanations, study of documents and materials required for proof of offence and guilt of offender. Adoption of a new Code of Administrative Offences resulted in reducing the capabilities of the FFMS on imposition of fines, as the nonobservance of the above procedures and periods for drawing up protocols increased the number of revocations of the FFMS decisions on imposition of fines.

4. Another defect of the existing administrative procedure is the absence of the right of the FFMS to investigate cases of administrative offences on non-submission or unduly submission to the FFMS of information, which has to be submitted under the law, as well as for non-execution in time of the orders issued by the FFMS. Nowadays these cases can be investigated only by judges.

The necessity to investigate cases in court reduces the possibility of operational obtaining of required information and application of sanctions for non-execution of the FFMS orders. Operational efficiency of bringing to administrative responsibility of those who committed offenses is a factor that promotes the violators to fulfill the requirements of the state body.

[51] Article 12.
[52] About 570 Euro.
[53] About 28,5 thousand Euro.
[54] About 140 Euro.
[55] About 1,4 thousand Euro.

Moreover, obtaining of information is required for collection of evidences for other administrative offences in the area of corporate governance.

5. In respect to use of enforcement powers it is necessary to mention that effectiveness of sanctions applied to a violator is quite important. It shall be considered both in terms of the benefits which the violator gets as a result of violation and in terms of a social danger of this violation. Efforts and costs connected with detection of an offence and bringing to responsibility are also very important. Taking into account the above factors the FFMS and other regulatory bodies concentrate on those offences which have high social danger, may involve penalty, and this penalty may have disciplinary effect on the offender and other securities market participants. In some instances one has to take into account limitation of resources of a regulatory body. So, if the harm inflicted by the offence is not comparable with the costs for its detection and holding liable for it the body can refuse from prosecution.

One more aspect which shall be taken into consideration is a perspective of bringing to responsibility for an offence. For example, taking into account that issuer's refusal to sign a protocol of offence (that is quite common) excludes the possibility of holding him liable, attempts of prosecution of the issuers are of little promise.

6. The above mentioned problems are of legal character. However, in order to make the mechanisms of enforcement by government agencies more effective the institutional development of the FFMS is necessary, which is not limited to vesting its bodies with powers but is connected with the increase of the number of their employees and improvement of their qualification.