RUSSIAN CORPORATE GOVERNANCE ROUNDTABLE

Enforcement of Corporate Governance Rules and Corporate Governance of State-Owned Enterprises

2 - 3 June, 2005

Moscow
Russian Federation

SYNTHESIS NOTE

WITH THE SUPPORT OF
THE EUROPEAN UNION UNDER ITS TACIS PROGRAMME AND
THE GLOBAL CORPORATE GOVERNANCE FORUM

© OECD

TABLE OF CONTENTS

I. Introduction 1

II. Enforcement of Corporate Governance Requirements 3

A. Supervision and regulatory enforcement 3
B. Enforcement by the Courts 6

1. Civil proceedings 6
2. Prosecutions 7

III. Corporate Governance of State-Owned Enterprises 7

A. Overview 7
B. Boards of directors 9
C. State ownership policy 9
D. Transparency and disclosure 10

© OECD

I. Introduction

Purpose: This note summarises the Russian Corporate Governance Roundtable's discussion on enforcement of corporate governance rules and corporate governance of state-owned enterprises (SOEs), held in Moscow on 2-3 June, 2005. This Introduction briefly summarises the key findings, outlines the Roundtable's next steps and provides some reasons for its recent focus. Parts Two and Three of this note will describe in more detail the Roundtable's discussions about enforcement-related issues and SOEs, respectively.

The meeting: The meeting was organised by the Organisation for Economic Cooperation and Development (OECD)[1] and co-hosted by the Russian Federal Service for Financial Markets (FSFM) and the Russian Ministry of Economic Development and Trade (MEDT) with support from the Supreme Arbitrazh Court of Russia. The discussion brought together policy makers, regulators, judges, business leaders and other experts from Russia and OECD countries to identify bottlenecks to effective enforcement of corporate governance rules and priorities for improving corporate governance of SOEs in Russia.

Overview of key findings: Although Russia has made significant advances in designing the appropriate legal/regulatory architecture for corporate governance, it continues to face considerable challenges in implementing good corporate governance standards. One challenge is providing incentives for improving the private sector's understanding of how to implement good governance practices. Another challenge involves sequencing essential reforms intended to strengthen institutions involved in the **oversight and enforcement** of corporate governance standards. For example, the FSFM lacks some of the essential powers, tools and resources to effectively monitor and enforce existing standards. Furthermore, commercial courts face their own challenges in handling heavy case-loads, largely as a result of insufficient capacity, independence, efficiency, accountability and enforcement ability. A key conclusion arising from the discussion is that, in such circumstances, there are few disincentives for breaching corporate governance requirements.

Russia also faces considerable challenges to improve **corporate governance of SOEs**. Acknowledging these challenges, the Russian government has an ambitious privatisation programme over the medium term (2005-2008) with the underlying principle that the State remains an owner in enterprises only when necessary to fulfil state policies. This mid-term plan provides an opportunity to assess state ownership policies and introduce important changes in corporate governance practices of SOEs. In order to benefit these reform objectives, participants identified the following priorities: improving the effectiveness of SOE boards, raising transparency both of individual SOEs and of the state's ownership policies, as well as facilitating equitable treatment of shareholders.

Next steps: The Roundtable agreed to create an *ad hoc* Task Force on **Enforcement** to develop policy options for effective, even-handed enforcement of corporate governance rules in Russia. The Task Force will take into account the Roundtable's lively debate about how to strike the appropriate balance between public (*e.g.* regulatory) and private (*e.g.* disclosure, market discipline and privately initiated litigation) enforcement mechanisms in Russia to create a culture of compliance and strengthen disincentives for non-compliance, without exacerbating conditions that might lead to excessive regulatory interventions, high regulatory costs and/or a climate that fosters distrust between the business community and regulators.

1. The meeting was co-financed by the European Union under its TACIS programme and the Global Corporate Governance Forum.

© OECD

This work will benefit from the OECD Principles of Corporate Governance, which since their 2004 revision now include more guidance on enforcement. The Principles stress that the corporate governance framework should: *(i)* promote transparent and efficient markets through enforceable laws, *(ii)* be consistent with the rule of law, thereby ensuring integrity, and *(iii)* clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities.

The Roundtable has agreed to create an **SOE Corporate Governance** Task Force to develop mid- to long-term priorities and recommendations for improving SOE corporate governance in Russia. The main focus will be on Russian listed partially state-owned enterprises where the state remains a controlling shareholder. Good corporate governance practices in these companies, demonstrating in particular the equitable treatment of shareholders, would provide credibility and set an important example for improving corporate governance practices in all listed companies. This work will benefit from the recently issued OECD Guidelines on Corporate Governance of State-Owned Enterprises (April 2005), the first international benchmark in this area to help governments assess and improve the way they exercise their ownership function. The Russian Ministry of Economy has requested that these Guidelines be used as a reference in the OECD – Russia dialogue on corporate governance.

How the Roundtable evolved to focus on (i) enforcement and (ii) corporate governance of SOEs.

In 2002[2], the Russian Corporate Governance Roundtable issued its *White Paper on Corporate Governance in Russia*, which summarised in an operational way common policy objectives and reform priorities. Since 2003, the Roundtable has entered a new phase of work in order to strengthen support for the implementation and enforcement of corporate governance reforms, as agreed in the White Paper. Based on this successful track record, at its November 2004 meeting the Roundtable agreed to focus on two priorities for strengthening confidence in the Russian business climate (and in particular, the protection of property rights): *(i)* improving enforcement of corporate governance rules; and *(ii)* corporate governance of SOEs.

Improving the protection of property rights cannot be achieved without building sound institutions and conditions for the market economy. Strengthening the framework for **enforcing** corporate and securities laws, through administrative enforcement actions by the FSFM, prosecutions by the Prosecutor's Office and civil proceedings (*e.g.* investor-initiated litigation to obtain remedies in the commercial courts) is critical to re-assuring investors that their rights will be protected in an even-handed manner. Also, ensuring that the FSFM and the courts have the resources, capacity, and independent status to fulfil their responsibilities effectively and efficiently, together with sufficient transparency with respect to their operations to promote confidence in their actions are key objectives.

Indeed, the Roundtable's action plan is timely since the FSFM is seeking to have its powers extended to encompass jurisdiction over certain other financial sectors[3] and the stock exchanges have begun to monitor implementation of the Russian Code on Corporate Governance. In the area of civil enforcement, clarifying the circumstances in which directors and officers should be held liable to companies and their shareholders would support the Supreme Arbitrazh Court's desire to provide more guidance to judges who are dealing with allegations that shareholder rights have been violated.

2. For more background information about the Roundtable, which was established in 1999, please refer to *http://www.oecd.org/daf/corporate-affairs/roundtables*.

3. It is proposing to assume responsibility for the regulation of the insurance industry, pension funds and the distribution of certain other financial instruments and, at a later stage, to assume responsibility for the regulation of the banking sector.

© OECD

Given the Russian government's objectives to promote economic growth, establish a level-playing field for investment and improve its corporate governance framework, it is only natural that improving **corporate governance practices of state-owned enterprises** should be another high priority. The size of SOEs in the Russian economy is still significant. The largest listed firms are partially state-owned with SOEs present in key sectors of the economy, including oil and gas, electricity, and telecoms. The reform of these sectors is critical for Russia's long-term growth. Also, in view of how important these companies are to the economy, improvements in the largest Russian SOEs would have a potential positive impact on overall market practices.

The remainder of this note describes in more detail the issues discussed during the Roundtable meeting

II. Enforcement of Corporate Governance Requirements

A. Supervision and regulatory enforcement

In Russia, the FSFM is the principal regulator dealing with enforcement of corporate governance rules. The Securities Market Law[4] and Investor Protection Law[5] give it powers over companies, registrars, and other professional securities market participants.

The FSFM has a right to conduct **investigations** about activities affecting companies in the following four cases: *(i)* when registering securities prospectuses, *(ii)* in the course of securities placements, *(iii)* when a report is registered on the results of a securities issuance, and *(iv)* in connection with companies' publications of quarterly reports and disclosures of material changes in their affairs.

If a violation is identified during an investigation, the FSFM has the right to issue an "**order**" *prima facie* that is binding on the company and its officers. In some cases, an order can be issued prior to an investigation if the violation is clearly established by the regulator. The objective is to prevent, stop or remedy violations. Going a step further, the FSFM has the right to initiate a case/claim in order to protect shareholder rights or the public interest.

While the FSFM noted that a key impediment to its enforcement efforts is insufficient authority to carry out investigations and low sanctions for non-compliance, investors called for more aggressive enforcement by the securities regulator within the existing framework, using administrative tools such as suspending trading. Participants noted that establishing an effective mixture of public and private enforcement will also depend much on the private sector's willingness to initiate cases where there have been securities law/regulation violations. If it is too difficult to access the judicial system, limit

4. The Securities Market Law provides the FSFM powers to: suspend or revoke licenses of professional market participants in cases of violations of the securities legislation; seek the liquidation of a company that has violated securities legislation and to impose penalties; assist other law-enforcement agencies, including by sending them information and filing law suits with the FSFM's authority (such as the nullification of securities transactions). In case of a criminal offence, the FSFM submits its findings to the Prosecutor's Office; hear allegations of certain administrative offences committed in the securities market, directly or indirectly related to the protection of shareholder rights.

5. This includes the ability to be a party to court proceedings when pursuing its duties to protect the rights of individual investors and public interest. For example, the FSFM can file a claim with a court to invalidate a securities transaction, cancel a share issue, liquidate a legal entity or terminate operations of professional securities market participants.

 © OECD

the incentives for violators or obtain a remedy, then the regulatory authority needs to play a more active role.

Roundtable participants considered a range of different approaches to improving legal enforcement. The costs and benefits of employing different enforcement methods by securities regulators used in the UK, Australia and Europe were discussed in terms of the four areas mentioned above. It was noted, moreover, that the European Commission's Action Plan relies more on "soft law" and market-based measures, instead of more costly regulatory mechanisms used in some jurisdictions. The importance of international co-operation was also stressed, particularly with respect to information-sharing and in some cases joint investigations.

Main challenges discussed:

1. Russian participants at the Roundtable noted that the **sanctions** that are used to penalise parties for administrative offences[6] in the area of corporate governance are not sufficient, given the level of harm to serve as a credible deterrent to violations. The 1999 Investor Protection Law provided for maximum fines of EUR 580 (RUB 20 000) for company officers and EUR 29 000 (RUB 1 million) for companies. Since the adoption of the Code of Administrative Offences in 2002, the maximum fines have been reduced significantly to EUR 145 (RUB 5 000) for company officers and EUR 1 450 (RUB 50 000) for companies. The number of violations between 2002 and 2004 almost tripled, growing from 1 367 to 4 276 violations. This is typically the case where the probability and magnitude of sanctions are not sufficient to create a positive expectation that liable parties will be penalised. Thus, while the FSFM can impose other administrative sanctions such as refusing to register or suspend a securities issue or recognise a transaction as null and void (and thereby reduce the risk of harm to investors and potential investors), the exercise of such powers does not seem sufficient to deter inappropriate behaviour.

2. Part of the problem with imposing sanctions is the difficulty that the authorities face in identifying and penalising liable parties in a given case. For example, it may be hard to prove guilt or there may be ambiguity in the regulations. Poor enforcement also results from the absence or insignificance of **liability of directors and company officers** for a given violation. A number of shareholder rights violations do not clearly impose responsibility on wrongdoers, for example, when violations involve nominating candidates to the board of directors or placing items on the annual shareholder meeting agenda. Also, the FSFM cannot sanction companies, directors or officers for failing to advise shareholders of changes to their share of authorised capital. If 'interested parties' and 'affiliated parties' involved in related party transactions fail to notify the company, they are not subject to administrative liability. There is also ambiguity with respect to the liability of directors and company officers in cases of shareholder rights violations during annual general shareholder meetings. Finally, market intermediaries and auditors are not subject to administrative sanctions, even though the Securities Market Law prevents them from using insider information.

3. The **procedure for obtaining an administrative sanction** is problematic. The limitation period for commencing a proceeding is two months from the date of the violation. However, this period is considered too short for the FSFM to detect a violation. Also, given the low level of

6. The following corporate governance violations are covered by the Code of Administrative Offences: unfair issue of securities; violation of information disclosure rights; preventing a shareholder from exercising their rights; violation of rules maintaining the shareholder register; not transferring the shareholder register to a professional registrar for maintenance; use of confidential/insider information on the securities market; not executing an official legal order (resolution, decision) on time; and non-disclosure of data and information to the regulator.

 © OECD

sanctions, it may be too costly for the FSFM to identify a violation as well as begin an action within the limitation period. Experience in some OECD countries indicates a period of closer to five years from the date of the violation or two years from when the violation was detected. In addition, the procedure for obtaining an administrative sanction requires the FSFM to draw up a protocol on the administrative offence, which should be submitted two days after the violation is detected and must be signed by the violator. This procedure imposes significant limitations on the FSFM's enforcement powers, since the violator might not be reachable by the FSFM or its regional offices.

4. The FSFM also lacks the **authority to investigate cases** involving the failure to submit information (or failure to submit on a timely basis) to the FSFM or the failure to implement an "order" on time. These cases can only be investigated by judges.

5. FSFM faces **capacity constraints** in terms of resources. Also, there are restrictions on the allocation of scarce resources. As in other countries, the FSFM finds that it has insufficient human resources to pursue effective enforcement. For example, the FSFM's enforcement department has a total of 165 employees to supervise approximately 150-180 000 joint stock companies. About 80% of investigations concern shareholder rights abuse and corporate-governance related violations.

The discussion stressed the importance of prioritising scarce regulatory resources when imposing sanctions. For instance, actions in Australia are based on strategic decisions that can send a strong message to the financial markets. Preventative measures are also critical, such as surveillance powers. In order to avoid time-consuming and costly litigation, regulators can focus on publicising, persuading and publicly shaming companies. The regulator in Australia can also try to find out-of-court-settlements which take the form of enforceable undertakings, infringement notices and negotiated settlements. Conversely, UK companies are asked to impose their own sanction by creating a remedial programme. The UK approach of self-sanctioning tends to lower enforcement costs as regulators spend less time and resources imposing sanctions. Most of the costs of imposing sanctions will be borne by the sanctioned companies themselves. If companies are unwilling to devise sanction schemes themselves, the regulator will impose sanctions.

It was proposed that, in order to strengthen capacity, the FSFM needs to develop a watchdog/monitoring system, work more closely with the judiciary and strengthen co-operation with the international community, including through the exchange of information and training.

6. Traditionally, stock exchanges in Russia have not played a major role in enforcing corporate governance rules as is the case in some OECD countries. The Russian Trading System (RTS) and the Moscow Interbank Currency Exchange (MICEX) will, however, require issuers to comply with the Corporate Governance Code or their own company codes enacted in accordance with the Code, as part of listing rules. This requirement is supposed to come into force beginning of 2006. Stock exchanges can also stop certain kinds of corporate misconduct, for example, by suspending trading and de-listing securities. In practice, however, no issuers have been de-listed. There is a concern that stock exchanges may be reluctant to exercise their enforcement powers, since they might lose their company clients if they are too rigorous in the exercise of their powers. The perception is that exchanges may relax their standards rather than lose companies to competing exchanges.

7. There are two main securities market self regulatory organisations (SROs) in Russia, the Professional Association of Registrars and Depositaries (PARTAD) and the National Association of Securities Market Participants (NAUFOR).[7] During the Roundtable discussion, both PARTAD and

7. Both SROs were originally registered by the FSFM, however, PARTAD has is now the only registered SRO.

 © OECD

NAUFOR expressed their willingness to support regulatory enforcement by assisting in monitoring efforts through collecting information from their members. Their leverage is mostly based on reputation risk. They also seek to develop a balanced partnership with the securities regulator. Roundtable participants welcomed the SROs' interest in facilitating implementation of good corporate governance but noted that recent financial scandals have called into question the effectiveness of relying too heavily on SROs that are not subject to robust public interest oversight.

8. There was a lively discussion on **implementing corporate governance codes in EU countries** and, in particular, which bodies (*e.g.* regulators, prosecutors, shareholders, stock exchanges, SROs, the media, rating agencies) are best-positioned to monitor compliance. It was suggested that the trend toward de-mutualisation of stock exchanges has intensified concerns about the potential conflicts of interest they face in monitoring compliance with their corporate governance standards, so that greater reliance is being placed on monitoring by shareholders, the media and rating agencies. Some countries, such as the UK, Germany and Netherlands have included in the law an obligation for companies to comply or explain why they are not complying with national corporate governance codes. Another way to give corporate governance codes "teeth" might be to require companies to submit their own Codes to their shareholders for approval at the annual general meeting. It was suggested that a systematic approach to Code enforcement would be helpful, supported by a comparative study of enforcement regimes around the world.

B. Enforcement by the Courts

1. Civil proceedings

As indicated in the Russian White Paper on Corporate Governance in 2002, there is still a need to strengthen the judicial system's capacity to deal effectively with company disputes. A solid and predictable judiciary is a key pre-requisite for a credible corporate governance system and a well-functioning business sector. Participants commented that additional resources for better compensation of judges would help improve the quality of recruitment and help retrain experienced professionals. They also discussed the importance of raising the expertise and competence of judges to respond to demands of complex commercial cases. In this regard, the European Commission's training and awareness-raising programmes for Arbitrazh Court judges are very welcome.

Another issue raised in the White Paper that has still not been entirely resolved and is detrimental to enforcement is clarifying the Arbitrazh Court's jurisdiction so that their judges become fully specialised in handling commercial law cases. Two types of courts normally enforce shareholder rights in Russia: arbitration courts[8] and courts of general jurisdiction[9]. The new Arbitration Procedure Code and Civil Procedure Code adopted in 2002 provided for a significant reduction in the role of courts of general jurisdiction in company disputes. In practice, however, these courts of general jurisdiction still consider corporate cases in some regions, although they are not supposed to.

Private commercial arbitration of company disputes has been proposed in some countries as an alternative to enforcement in the regular court system. Arbitration has been used in Russia as a means of alternative dispute resolution. However, since the Arbitration Procedural Code's adoption in 2002,

---

8. These courts have jurisdiction over disputes between companies and shareholders, considering all commercial cases and other cases relating to business and economic activities, involving individuals, legal entities or individual entrepreneurs.

9. When several related claims cannot be separated and some need to be tried by a general court of jurisdiction, the latter considers the complaint as a whole.

 © OECD

there has been a strong trend away from using commercial arbitration in company disputes. This might be because the Arbitration Procedural Code indicates that cases between shareholders and companies are to fall "under the special jurisdiction" of the State's arbitrazh courts. This has raised questions as to whether private arbitration tribunals can still be used. Another problem with using private commercial arbitration is that an arbitral tribunal would not normally have jurisdiction or the ability to 'undo' a corporate resolution (e.g. decisions by boards of directors). Arbitral tribunals can grant monetary damages, but not a rapid annulment of the corporate decision/resolution that was taken in violation of corporate governance requirements.

Participants also noted that since Russian judges traditionally have followed very closely the strict language of legislation, they find it difficult to apply broad legal concepts. This means, for example, that applying concepts about "acting with due care", "acting in good faith" and "acting in the best interests of the company" present significant challenges for these judgments. It was suggested that future work could be focused on a few isolated cases and analysed in-depth, in order to raise awareness for judges.

Other key challenges identified by Russian judges in applying Russian Company Law provisions about the liability of company officers and directors specifically include: *(i)* inconsistency of legal terminology and requirements in different statutes, including Company Law and other federal laws (such as the labour code); *(ii)* refining the relationship between company management and the company as well as the nature of obligations; *(iii)* defining the jurisdiction of general courts and commercial courts in the claims for damages; *(iv)* proving guilt of a company officer or board member; and *(v)* evaluating claims to invalidate transactions as an alternative to claims for damages.

2. *Prosecutions*[10]

In addition to the courts, the Prosecutor's Office has enforcement powers, which involve both civil and criminal litigation related to corporate governance. A prosecutor is entitled to file a claim for invalidation of transactions made by legal entities with an arbitration court. While prosecutors have the right to file an application, they are not generally authorised to participate in suits among shareholders, companies and their management. Prosecutors can also initiate administrative proceedings if they discover a breach of a law that gives rise to administrative sanctions. The Prosecutor's Office plays an important role in criminal litigation. All criminal cases are considered in courts of general jurisdiction. The following criminal offences related to corporate governance: disclosure of information; issuance of securities; bankruptcy related; and offences of management authority. Although criminal offences related to corporate governance are investigated by the Ministry of Interior (*i.e.* policy investigators), the role of the prosecutor's office is significant. In terms of corporate practice, the "cooperation" of law-enforcement bodies, and especially the investigators, is often sought by corporate raiders in the course of illegal takeover campaigns.[11]

III. Corporate Governance of State-Owned Enterprises

A. Overview

A background report on the corporate governance of SOEs in Russia was presented; it was prepared by Russian experts with input from the Ministry of Economy. The policy in 1998-2003 was

10. The Roundtable discussion focused on civil proceedings rather than prosecution. However it is important to understand how the latter fits into the overall enforcement process.

11. The Russia Corporate Governance Manual by IFC and US Department of Commerce (2004).

© OECD

to retain a large state share in strategically important enterprises while selling shares in companies where the state does not want to take responsibility in a given sector. The report emphasizes the significant number of remaining SOEs in the Russian economy, with roughly 30% of industrial output and 37% of assets in the banking sector in 2004. As in many OECD countries, SOEs are present in key sectors of the economy (including oil and gas, electricity, telecoms, railways, etc.), where reforms, particularly in the gas industry, have been identified as critical for Russia's long-term growth prospects.[12] Moreover, the largest Russian listed companies are partially state-owned (Gazprom, RAO UES, Tatneft) or subsidiaries of SOEs (for example Svyazinvest, etc.). Consequently, an improvement of corporate governance in these large Russian SOEs could have a potentially positive impact on overall market practices in Russia.

The representative from the World Bank discussed the case of Gazprom in the introductory session. A number of challenges to reforming Gazprom could be overcome by improving their corporate governance practices and further improvements in this regard could have a positive impact on medium and long term economic growth.

While the discussion was focused on partially state-owned listed companies, a presentation of current corporate governance reforms in the fully state-owned RDZ (the Russian Railways Company) also underlined the complexity of the issues in the Russian context as well as the necessity to follow up this discussion in the coming years. The company is developing a Corporate Governance Code, which has been drafted using the *OECD Guidelines on Corporate Governance of SOEs* as a reference.

In the introductory session, the representative from the Ministry of Economic Development and Trade stated that the current government has an ambitious privatization programme in 2005-2008, where the underlying principle is that the State should remain an owner in enterprises only when they are necessary from a state policy perspective. The objective of this privatization programme is to positively impact on the competitive environment, and enhance the transparency and efficiency of management in order to ultimately raise economic growth.

Participants noted that progress has been achieved in rising revenues and asset values of listed SOEs. However, they agreed that further improvement in the corporate governance of large Russian SOEs would bring substantial benefits to the Russian economy and the development of capital markets. Improvements in the governance of SOEs are expected to promote growth through better decision making and supervision processes in SOEs, leading to better managerial performance. If fully implemented, they should lead to a more transparent allocation of resources and will also facilitate SOEs' access to capital (both debt and equity). Finally, better corporate governance of SOEs will improve the competitive process in those sectors open to entry by the private sector, where price controls have been lifted or reformed, and where the state's regulatory and ownership functions are separated.

In order to ensure that efforts to improve the corporate governance of SOEs in Russia are effective and fruitful, participants suggested that clear support by the Russian government at a high political level will be essential. This will send a strong signal of the Russian state's willingness to reform and will ensure adequate participation in the discussion of the most relevant players, particularly from the state itself (including Rosimuschestvo).

12. *OECD, Economic Survey of the Russian Federation, 2004.*

 © OECD

B. *Boards of directors*

An increasing number of OECD countries have undertaken important reforms to professionalize and empower SOE boards. In doing so, they seek to limit day-to-day *ad hoc* political interference and to increase the independence and competence of SOE boards through building up structured and skill based nomination processes and developing more systematic evaluation processes. A key element is also to restore SOE boards' responsibility in monitoring management and overseeing the strategy of the company. Remuneration practices are also gradually evolving to reflect more adequately the responsibilities and work load involved. In a number of OECD countries SOE boards still tend to be too large, excessively staggered with too many "state representatives" lacking business perspective and often independence. The Russian Ministry of Economy as well as representatives from business including the Russian Institute of Independent Directors noted that Russia faces similar challenges in this regard and needs to improve the functioning of its partially state-owned listed enterprise boards.[13]

Under the current organization of the ownership function, Rosimuchetsvo exercises the ownership rights on behalf of the state. It *de facto* chooses its representatives within SOE boards (even if they are *de jure* elected by the AGM), and provides them with detailed instructions on how to vote on all agenda items. This "instruction system" was strongly criticized by a number of Roundtable participants describing it as reducing board efficiency in partially state-owned listed enterprises. Firstly, agreement within the government and the administration on the instructions is time consuming and is subject to cumbersome procedures, giving rise to turf battles and sometimes ending up in not having instructions on time, which leads to the most strategic issues not being discussed. Secondly, the actual discussion may diverge from the initial path, making the instruction irrelevant. Moreover, and more fundamentally, this instruction system is not coherent with the duty of board members to act in the interest of all shareholders. This serious contradiction triggered a lively debate between state and business representatives. There is still a strong need to clarify and strengthen the understanding of the role and fiduciary duty of board members, especially in the context of Russian SOEs.

In the same vein, the role of independent directors needs to be clarified as there seems to be a significant reluctance by the State to include at least some independent directors even in the boards of the largest partially state-owned listed enterprises. This reluctance is perceived as even more problematic as it results in some of the largest listed Russian companies not implementing the Code of Corporate Conduct. Deriving directly from this absence of independent board members, the growing number of audit committees within SOE boards is chaired by non-independent directors, which greatly undermines their credibility. More generally, the nomination of state representatives is far from being transparent, with a great deal of direct interference by a number of government agencies. A number of Ministers or their deputies sit on the boards of the largest SOEs, which does raise the possibility of conflict between their ownership and regulatory responsibilities. These state representatives are not evaluated, nor liable for inefficiency (which can also be attributed to the instruction system).

Thus, key suggestions advanced for improving SOE boards in Russia are to: *(i)* improve the nomination process, and more precisely to remove politicians from SOE boards; *(ii)* withdraw the instruction system; *(iii)* allow SOE boards to nominate CEOs and/or management boards. These priorities accurately reflect the spirit of the OECD Guidelines.

C. *State ownership policy*

The globalization of markets within most industries, technology changes and liberation in many infrastructure sectors has made readjustment and/or restructuring of the state-owned sector often

13. *OECD Comparative Report on Corporate Governance of State-Owned Enterprises*, 2005.

© OECD

necessary. The need to clearly separate state ownership from the regulatory role of the state in competitive sectors, in order to avoid conflicts of interest, and the necessity to put in place more efficient governance structures have been highlighted in many instances. Consequently, a number of OECD countries have undertaken significant reforms in the way they exercise their ownership rights in SOEs and in their corporate governance mechanisms.[14]

Participants noted that Russia is faced with similar but more acute concerns, and could also benefit from reviewing its state ownership policy in order to tackle one of the underlying obstacles to improving corporate governance of SOEs. This would imply discussing in greater depth the separation between the ownership function from other state functions, including regulation and industrial policy. In the current Russian context this separation still appears to be partial, particularly in companies in the energy sector. Adequate separation of the ownership, regulatory and industrial roles of the state would allow the state to create more favorable conditions for SOEs, ensure a level playing field in competitive sectors and competitive conditions conducive to economic growth. In addition, improving transparency of and clarifying the state's objectives will also help reduce or at least manage conflicts of interest faced by SOE board members.

D. *Transparency and disclosure*

Participants noted that transparency and disclosure are even more important for partially state-owned listed enterprises than for other companies since it is important to show that political control is being exercised at arms length to set major policy objectives and to make SOEs' goals clear to the public. By reporting to their ownership entities, the Parliament or the general public, SOEs increase their transparency and accountability. Exposing processes and performance to public scrutiny is a key element for monitoring whether the board is fulfilling its agreed objectives and provides strong incentives for board monitoring and effective use of ownership rights. The availability of information concerning SOEs varies across OECD countries. There is obviously a trade-off between public accountability and commercial confidentiality, or between the costs related to reporting and control, and its benefits. OECD countries are increasingly looking at ways to improve the system of objective setting and performance monitoring.[15]

A background paper prepared by S&P Moscow on SOE transparency and disclosure in Russia highlighted priorities for improving these practices. The paper is based on a survey of the ten largest Russian SOEs' performance in terms of transparency and disclosure, in comparison with a peer group of large privately-owned Russian companies and of comparable foreign SOEs. The results show that Russian SOEs score moderately well in comparison with their private peers, but worse in comparison with their foreign peers.

The strongest score by Russian SOEs was obtained in financial and operational information; however, major shortfalls exist in disclosure of related party transactions. Disclosure of ownership structures and shareholders rights is also a concern. For example, in partially state-owned listed companies little information is provided on the government's goals and policies or on the existing minority stakes. Moreover, reporting on the achievement of government objectives seems to have deteriorated in the last 18 months. There is a lack of disclosure particularly regarding the personal interest of managers and state officials in SOEs or affiliated enterprises, which presents the danger of officials' personal interests interfering with companies' decision making. Disclosure of the composition and practices of the governing bodies as well as director/management remuneration is

14. *OECD Comparative Report on Corporate Governance of State-Owned Enterprises*, 2005.

15. *OECD Comparative Report on Corporate Governance of State-Owned Enterprises*, 2005.

 © OECD

particularly weak. Another critical area is event-driven disclosure. The S&P paper provided a number of examples where Russian SOEs have not provided adequate one-off disclosure about material events, in cases regarding major events with a significant impact on the SOE's value and future prospects. The discussion highlighted that disclosure on material events and on ownership would bring significant benefits to Russia.

Participants also discussed the role of auditors along with the need for improvement in internal audit and risk management in Russia. External audits also provide an important incentive for SOE management and boards to account accurately to the ownership entity and the general public. Increasing attention is being given in OECD countries to the selection of external auditors and to their independence.

© OECD