

Russian corporate governance Roundtable

WORKSHOP : IMPLEMENTATION AND ENFORCEMENT OF DISCLOSURE RULES¹ Moscow, 2-3 October 2003

Synthesis Note

Background

As part of an ongoing effort to strengthen corporate governance in Russia, policy-makers and business practitioners from Russia and OECD countries launched a new phase of work under the auspices of the Russian Corporate Governance Roundtable. This follows the Roundtable's publication last year of a White Paper on Russian Corporate Governance. The Roundtable, established in 1999 and co-organised by the OECD and the World Bank Group, is part of a larger effort to include Russia in the OECD-led international policy dialogue on corporate governance. As financial markets become increasingly global, the Roundtable provides a forum within which Russian decision-makers can exchange experiences with their international counterparts on challenges to reform and options for policy design. Multilateral dialogue enables Russian policy makers to take international circumstances and expectations into account in designing national policies.

The meeting

The October workshop was co-hosted by the Russian Ministry of Economic Development and Trade and the Russian Securities Commission, with the support of the Global Corporate Governance Forum. Participants took stock of international corporate governance developments and focused their discussions on disclosure standards and abusive related party transactions (agenda attached).

Main conclusions

A practical outcome of the meeting was an agreement to provide (a) A possible framework for transition to international financial reporting standards and (b) Viable policy options for tackling abusive related party transactions and disclosure of beneficial ownership. This work will be carried out by two separate task forces and reported on in the form of policy briefs. The policy briefs will contain an analysis of the main issues in Russia, distil real world experience, and provide an assessment of policy options for Russia.

To ensure sustainability, each task force would consist essentially of the same participants who were involved in the particular October workshop session. Most of the work would be organised electronically. A consultative meeting will be held in Paris in late February 2004 and the final policy brief will be discussed in Moscow in early June 2004. The OECD will serve as the Secretariat, with support possibly provided by the IFC.

Also, the following topics were proposed for a plenary workshop later in 2004:

- (1) The role of regulation and self-regulation, in particular the role of stock exchanges and self-regulatory organizations in the regulatory infrastructure. Also, to avoid over-regulation and unintentional consequences, it has been suggested that policy makers should advance their understanding and capacity to assess the regulatory impact of various provisions. Consistency and clarity in the institutional framework and the division of responsibilities between different supervisory authorities were also proposed as important issues for further work.
- (2) Participants also discussed the current debate with respect to the independence and professionalism of boards, and the questions arising from that discussion could include board evaluation and a clear definition of responsibilities.

(3) Finally, it was noted that corporate governance in groups of corporations should receive special attention.

Summary of discussions by issue

The discussion on **international corporate governance developments** considered policy responses from some jurisdictions, notably the United States and European Commission, to corporate governance challenges and their possible implications for Russia. The process to review the OECD Principles of Corporate Governance was presented and key issues highlighted, including the integrity of the disclosure process, as well as conflicts of interest, shareholder participation, implementation and enforcement. One of the lessons learned is the need to re-examine the fundamental roles, responsibilities and interaction among company organs, i.e. the annual general meeting, the board of directors, and managers.

The discussion on the **Russian Code on Corporate Conduct**, issued in 2002 by the Securities Commission, reviewed preliminary experience in compliance by joint stock companies. It also examined the channels through which disclosure is being made and new requirements for companies. This includes new securities regulations, listing requirements by stock exchanges, obligations for state-owned firms, and the role of intermediaries. The discussion provided a useful basis for monitoring progress on compliance with the Code and exploring methods for improvement. The Securities Commission is expected to report to the government latter this year on compliance with the Code, including recommended changes based on practical experience.

The session on **key corporate governance trends** in Russia provided a snap shot of the evolving corporate governance landscape. Ownership is increasingly concentrated, re-organisations are on the rise including through false bankruptcy and forced take-overs, and companies are relying more on self-financing. The government is therefore focused on providing the appropriate incentives for good corporate governance practices. Priorities include information disclosure, the role of the board of directors, balance between regulation and self-regulation including differentiating rules for publicly traded companies and essentially private joint-stock companies.

Participants discussed Russia's transition to **international financial reporting standards** (IFRS) and reviewed the new Russian government plan to accelerate transition, including progress to-date, future planning schedules and challenges encountered. Some recommendations were proposed to help with implementation, including the legal and regulatory changes that need to be made, new institution(s) that may be required, a timetable, the coordination of existing institutions and possible benchmarks to work on and how to maintain long-term continuity and oversight. The priority is to achieve a consensus among the responsible government agencies on the appropriate course of action.

While most **related party transactions** may be legitimate, their obvious potential for abuse means that controls on these transactions are essential. Participants examined current disclosure practices of related party transactions in Russia and recent proposed changes to legislation, which includes broadening the definition of who is considered a related party. The discussion identified the obstacles to overcome such as improving internal company controls, particularly to clarify the decision-making process for approval of related party transactions as well as disclosure practices. Another problem is that there are no sanctions or liability for violations. Also under-developed judicial practice with these cases is problematic from the enforcement stand-point and protection of shareholder rights. Finally, rules on related party transactions between groups of corporations should be given special attention.

The session on **disclosure of beneficial ownership** explored current practices on disclosure of this critical component of non-financial information. A lack of transparency, particularly of beneficial ownership, contributes to tunnelling by concealing related party transactions. This opacity comes at a real economic

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cost. Participants considered to what extent and through which channels information on beneficial ownership is provided to the company, shareholders and the market in Russia. The main disincentives to disclosure of such information in Russia were considered, including fear that this information will be misused. Recommendations were made on how to realistically encourage and facilitate such disclosure by individual owners, companies as well as the roles of other agencies and intermediaries, particularly depositories. It was suggested that enforcement could be improved by providing a clear definition of beneficial ownership in Russian law and introducing sanctions for violations.

The discussion on **insider trading** revealed that there are practically no measures designed to prevent the use of privileged information and insider trading in Russia. Therefore, it is almost impossible to identify a violation or even define it as such. Trading on privileged information significantly undermines confidence in capital markets. It is reasonable for investors to expect that the abuse of insider information be prohibited, as far as these practices violate the principle of equitable treatment and therefore are a breach of sound corporate governance. Participants examined existing rules in the Securities Law that have a broader focus on proprietary information and draft legislation that attempts to specifically define, restrict or prohibit insider trading in Russia. The discussion focused on potential obstacles to implementing the regulations, and on actions that would prevent the use of privileged information. It was acknowledged that enforcement of insider trading violations is extremely difficult, even in countries with more developed securities markets.

Other outcomes

Russian leadership: The Russian co-hosts of the event, the Ministry for Economic Development and Trade and the Federal Commission for the Securities Market (FCSM), truly demonstrated their leadership in the corporate governance debate in Russia. Both institutions provided invaluable inputs to the preparation of the workshop agenda and most importantly, assured senior and pro-active participation during the workshop discussion. The issues they put on the agenda indeed proved to be top priorities in order for the Russian corporate governance framework and practices to improve. In addition, active participation by Duma deputies, representatives of the private sector including companies, rating agencies, investment banks, director and investor associations, and non-governmental organisations demonstrates the importance these institutions attach to moving the corporate governance agenda ahead.

Peer discussion: The active participation by members of the OECD Steering Group on Corporate Governance and other OECD Member country experts in discussions with their counterparts in Russia testifies to the true two-way dialogue on corporate governance that the Roundtable represents. It is clear that the dialogue has come a long way since the White Paper on Corporate Governance was launched by the Roundtable in April 2002. The focus now is on concrete policy design in order to achieve priority outcomes. The sharing of experience with practitioners from OECD countries is now more valuable than ever.

Increasing role of the business community: The National Council on Corporate Governance, led by the Russian holding company Interros, has requested the Secretary General and the OECD to play an active role in a June 2004 international conference in Moscow on Corporate Governance and Economic Growth. It is an encouraging sign to see the business community take leadership in promoting better corporate governance practices. The Secretariat met with Interros representatives to confirm interest in their efforts.

Cooperation with international organisations: The Roundtable once again served as a hub for other bilateral and international bodies active in Russia on corporate governance. These include the EBRD, European Commission, World Bank, IFC, UNCTAD, the Canadian Development Agency and CIPE. Also,

the OECD Secretariat together with the main Roundtable partners participated in discussions on corporate governance at a World Economic Forum meeting in Moscow. This provided an opportunity to disseminate key priorities in the White Paper, outline main conclusions from the Roundtable workshop as well as build further support for future work.