

Russian corporate governance Roundtable

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*BENEFICIAL OWNERSHIP INFORMATION DISCLOSURE

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CONTENTS

CONTENTS	1
INTRODUCTION.....	2
1. BENEFICIAL OWNERSHIP: STANDARD DEFINITIONS AND MODERN APPROACHES	2
2. SPECIFICS OF BENEFICIAL OWNERSHIP IN RUSSIA.....	4
2.1. Motives.....	5
2.2. Empirical Data.....	6
2.3. Typical Patterns.....	10
3. PARTICULARS OF BENEFICIAL OWNERSHIP IN RUSSIA: LEGAL REGULATION	13
3.1. Notion of Beneficiary and Beneficial Owner in RF Law	13
3.2. Legal Regulation of Stockholders Information Disclosure in Russia.....	14
(A) Information disclosure by nominee stockholders on beneficial owners whose shares are in nominee ownership	14
(B) Information disclosure by beneficial owners on their ownership of underwritten stocks	14
(C) Information disclosure by the issuing entity on beneficial owners of its stocks	16
(D) Responsibility	18
3.3. Beneficial Owner in the System of Trusts.....	19
3.4. Legal Collision of Different Jurisdictions	19
3.5. Antimonopoly Regulation and Beneficial Ownership Information Disclosure	21
3.6. Law against Legalization (Laundering) Illicit Profits and Information Disclosure on Beneficial Owners	22
CONCLUSIONS AND RECOMMENDATIONS	24

* The views expressed in this paper are those of the author and do not necessarily represent the opinions of the OECD or its member countries.

¹ Legal aspects with respect to Russia are covered with the participation of I. Mezheraups (IET).

INTRODUCTION

1. The transparency of a modern corporation is one of the cornerstones of the company law reforming. The driving force of the modern corporate governance legislation reform that has swept practically all countries objectively includes the processes of economic globalization, internationalization, and competition, the emergence of new economic sectors, development of financial markets and new technologies, rapid growth in the number of shareholders and changes in their composition².

2. A considerable number of national and international corporate governance codes that appeared in the 1990s – early 2000s, reflect this tendency and increasingly influence traditional law³. The significance of this problem is emphasized by the fact that matters relating to corporate governance reform have exceeded the national limits and become the target of OECD attention (Principles of Corporate Governance, 1999), EC (setting up expert groups on company legislation, 2001), G8 meetings (2002), and other international entities. Although there are indisputable national characteristics of models, it is commonly recognized that *responsibility, accountability, honesty (legality), and transparency are truly universal standards for all corporate governance regimes*⁴. Within this context, the problem of beneficial ownership information disclosure acquires great importance. The beneficial ownership information disclosure problem is also acute in Russia, as in particular a considerable percent of shares of many Russian companies have been transferred to offshore companies and trusts. It is also necessary to make a distinction between two aspects of the problem: (1) identification of true proprietors – beneficial owners from the point of view of protection of shareholders’ and investors’ rights (the corporate governance context); and (2) using beneficial confidentiality and complex legal structures for legitimate tax planning and illicit export (concealment) of capital (the context of taxation, capital flight and money laundering). This paper focuses primarily on the first aspect, although the interconnection is obvious.

1. BENEFICIAL OWNERSHIP: STANDARD DEFINITIONS AND MODERN APPROACHES

3. Given the widest approach, a “beneficial owner” means any person who is the ultimate beneficiary (the recipient of profit and other benefits), even if the title to property is registered in someone else’s name⁵. In other words, *the discussion of beneficial ownership is expedient only when there is a formal separation (“splitting”) of a certain set of rights between different entities: management (administration) and receiving profits and all other benefits*.

4. For example, the institution of trust (which is crucial for the understanding of the mechanisms behind beneficial ownership), where a trustee manages (administers) the property and a beneficiary profits from this property, is based exactly on the “splitting” of certain property rights. As we know, trust, having first emerged in the 13-14th centuries in Britain, has firmly slotted into the legal systems of a number of countries of Continental Europe, Latin America, and Japan. In most developed jurisdictions that have the institution of trust, this legislative sphere is quite meticulously regulated. Nevertheless, using the aforementioned trust arrangements, it is rather difficult to obtain information on the

² See Hopt K. Modern Company Law Problems: A European Perspective: - In: Company Law Reform in OECD Countries. A Comparative Outlook of Current Trends. Stockholm, Sweden, 7-8 December 2000; Hopt K.J., H.Kanda, M.J.Roe, E.Wymeersch, S.Prigge, eds. Comparative Corporate Governance – The State of the Art and Emerging Research. Oxford, 1998.

³ Gregory H. The globalisation of corporate governance. Weil, Gotshal and Manges LLP, 2001.

⁴ See: Fremond O., M.Capaul (2002): Corporate Governance: One Size Fits All? – http://rru.worldbank.Org/Hot_Topics_Fremond_Capaul.asp

⁵ Some authors use the term “fiduciary ownership” or “trust ownership” (usually when discussing trusts).

true owner of some or other property, considering the confidentiality regime granted by domestic offshore laws to information on beneficiaries. Another example see Box 1.

Box 1. A certain holding company A is owned 100% by one natural person. This holding company A owns 30% of shares of company X. From the point of view of management, the owner of these 30% of shares is holding company A. However, from the point of view of beneficial ownership, holding company A is not a beneficiary. Formally, it receives dividends, but all profits belong to a natural person – the owner of 100% shares of holding company A, the true beneficiary.

5. *A new* – much more ample – meaning has been imparted to the notion of beneficial ownership over the past 5-7 years. The specifics of the modern approach consists, firstly, **in the beneficial owner’s motives**. Apparently, these motives can be both legal and lying beyond legal frameworks (see section 2.1). Nevertheless, growing attention of governments of the leading countries of the world and international organizations to the problem of beneficial ownership is connected, above all, with such motives as *laundering illegal profits, financing terrorism, evading taxes, corruption, concealing property from creditors, deals with related parties, assets withdrawal, market manipulation, insider deals, etc.*⁶

6. Secondly, practically **the entire spectrum of the existing mechanisms** can be used to implement the above motives. The OECD report on beneficial ownership (2001)⁷ highlights the following mechanisms:

- corporations (private and public limited liability companies with unquoted shares, offshore international business companies (IBCs) and exempt companies);
- trusts (as a means of separating the legal owner from the beneficiary);
- foundations (foundations can be regarded as the closets equivalent of a trust in the civil law, as it has no owners or shareholders, but holds certain property for the purpose of achieving certain objectives);
- partnerships (limited and limited liability).

7. It is necessary to mention special mechanisms used for attaining anonymity: bearer shares, nominee shareholders, nominee and “corporate” directors, complex company “chains” and other mechanisms, intermediaries (participants in the company creation process, trusts, attorneys, notaries, trustees, and other professionals).⁸

8. In the end, **three main principles of determining the beneficial owner** – the ultimate beneficiary behind complex legal structures – have been formed in international practice:

- the person who gains the ultimate profit (*the place where the profit ends up*) from property (regardless of whether he manages it or not) is the beneficial owner, or beneficiary. In other words, beneficial interest – profit, benefits, or other proceeds from the contract or use of property (unlike the legal right to property ownership or participation in a contract) – is particularly important for identifying the beneficiary;
- *beneficiaries should be known* (not a single “reasonable” bank in a “reasonable” jurisdiction is entitled or would agree to deal with a company whose beneficial owner is unknown, i.e., banks must obligatorily receive information on the beneficiary of an account);

⁶ Broader issues of international campaigning against money laundering, offshore regulation, FATF activities, etc., including in relation to Russia, are not specially discussed herein.

⁷ Behind the Corporate Veil. Using corporate entities for illicit purposes. Paris, OECD, 2001. it is important to say that the companies primarily addressed by the OECD report are private firms.

⁸ See for more detail, for example: Apel A., Gunko B., Sokolov I. Cash Withdrawal and Offshore Business in Diagrams. St.Petersburg, PITER, 2002 (in Russian); Kabir L.S. Organizing Offshore Business. M., Finansy i Statistika, 2002 (in Russian); Ushakov D.L. Offshore Zones in the Russian Taxpayers’ Practice. M., Yurist, 1999 (in Russian).

- the beneficial owner of company X can, in the end, only be a real natural person or publicly traded company.

9. Ideally this approach should be applied to all banking transactions (in the banking world) to trace money laundering, evasion of taxes, etc. Any illicit (criminal) transaction must be traced, and the evidence of any financial transaction cannot end at an anonymously owned company. When necessary, any bank must disclose beneficial ownership data through a court order.

10. As far as corporate governance is concerned, the OECD Principles of Corporate Governance⁹ offer some recommendations. Effective control and strategic management by the major shareholder are not things undesirable for a company. Nevertheless, *the structures of property and control should be transparent in all circumstances*. This is necessary because outsider shareholders need an opportunity to have a clear picture of the way control is exercised in order to assess their own position and interest in financing the company.

11. Finally, for purposes of this paper, let us try to formulate the following definition: a beneficial owner is a natural person (group of persons) or a company which via (complex) legal entities and their combinations (offshore companies, trusts, foundations, nominee shareholders, holdings, contract corporate groups, bearer shares, shareholder's agreements, shadow directors, etc.) intentionally conceals (minimizes, delegates) his/her (its) property title and ability to control while retaining the rights to profits and other benefits resulting from this property, as well as informal property management (control) rights. This is precisely the content of "beneficial ownership" notion used in further discussion.

2. SPECIFICS OF BENEFICIAL OWNERSHIP IN RUSSIA

12. First of all, it is necessary to point to the objective common factors of forming the Russian national corporate governance model connected to the problem of beneficial ownership: a relatively high property concentration level, actually "closed" nature of most companies (formally open joint stock companies), organizing business in the form of company groups, combining the functions of management and ownership, self-financing, in-house boards of directors, lack or inefficiency of external mechanisms, and some others.¹⁰

13. The problem of non-transparency of the Russian companies' corporate capital was briefly discussed at Round Table sessions as early as 2000. In particular, it was stated that joint stock companies often use complex cross-shareholding schemes involving financial institutions, with the formation of financial-industrial groups. Shareholders often conceal their property by acquiring shares via one or several "mailbox" offshore companies formally not connected with the beneficial owner. Regulatory authorities are unable to "reach" those owners, even though offshore corporations arouse loads of suspicions as centers of corruption. Another method of rearranging control over shareholders' property, risks, and official rights are inter-shareholder agreements. According to the existing rules, no one shall be obliged to disclose information on such agreements, even if they can damage minority interests. A characteristic Russian problem in this respect is the role of the state as a major shareholder.¹¹

⁹ OECD Principles of Corporate Governance. Paris, OECD, 1999.

¹⁰ See details in: Radygin A. Corporate Governance in Russia: Restrictions and Perspectives. – *Voprosy Ekonomiki*, 2002, No. 1, p.101-124 (in Russian); Radygin A., Shmeleva N. Main Corporate Governance Mechanisms and Their Specific Features in Russia. – In: *The Economics of Russian Transition*. Ed. By Y.Gaidar. Foreword by S.Fischer. The MIT Press, Cambridge, Massachusetts, 2003, Chapter 15, pp.461-510.

¹¹ See: Nestor St., Jesover F. OECD Principles of Corporate Governance in Shareholder Rights and Equality: Their Acuteness for the Russian Federation. – Round Table on Corporate Governance for Russia. OECD, World Bank. Moscow, February 24-25, 2000.

14. Nevertheless, the problem of beneficial ownership has so far been nearly totally neglected in Russia. The White Paper¹² prepared on results of the Round Table on corporate governance in Russia accentuates this situation and maps out the necessity of amendments.

2.1. Motives

15. As already stated above, one of the dominating **motives** of a beneficial owner in concealing information on the real owners of some or other company's shares is protection of assets acquired *recently and far from always completely legally* (i.e., protection against judicial, political, criminal and other exposures, corporate blackmail, danger of confiscation, recognizing privatization deals null and void, etc.).

16. Nevertheless, it is apparent that the Russian companies quite frequently use trusts for purposes of optimizing taxation. For example, a beneficial owner located in a country with a high taxation regime transfers the title to his property to a trustee resident of an offshore zone. In this case, the trustee would pay property tax at lower rates, and the beneficial owner, in turn, would pay taxes only on profits gained as a result of using his property.

17. Besides that, trusts are also used for the purpose of withdrawing assets from the company and enacting the transfer pricing mechanism. As the information on beneficial owners in many offshore zones is confidential and may be disclosed only on a relevant court order, major shareholders of Russian companies can easily and legally "pump" assets from their companies.

18. Other acute motives of concealing information on real owners include the following:

- insider deals on the stock market carried out by members of the company managerial bodies or other persons who have access to privileged information (according to estimates of the Moscow Interbank Currency Exchange (MICEX), up to 50% of all transactions are carried out with the use of insider information¹³);
- non-observance of legislative requirements to related transactions and related party transactions;
- non-observance of antimonopoly law;
- non-transfer of shares and parcels of stocks owned by civil servants in trust management for the period of their civil service;
- organizing hostile uptakes or other major acquisitions of stock.

19. For example, the Federal Law "On Joint Stock Companies" sets special requirements to related party transactions, specifically, transactions that pose an interest to a company shareholder who, jointly with affiliated persons, holds 20 percent or more voting shares of this joint stock company. In some cases stipulated by the law decisions approving related transactions are taken by a majority vote of all shareholders who are not interested in the transaction at the general shareholders' meeting. As recognizing the holders of 20 and more percent of the company shares as interested in some or other transaction and, as a consequence, recognizing their shares as non-voting at a relevant shareholders' general meeting, could change the alignment of forces during the ballot, the said shareholders often conceal the facts of ownership of the said percentage of the company shares. Such tactic is particularly often used to carry out numerous transactions to withdraw assets from subsidiaries to the mother company, and vice versa.

20. When such patterns are used, it is practically impossible to identify the interest of some or other company in concluding the transaction, as information on beneficial owners is not subject to disclosure. This situation can be overcome by introducing legal requirements of beneficial ownership information disclosure by offshore companies. However, even such requirement would not solve the problem completely, because, firstly, the laws of foreign

¹² White Paper on Corporate Governance in Russia. OECD, 2002.

¹³ Address of the MICEX representative to the OECD-World Bank Round Table on Corporate Governance in Russia on November 17, 2000.

countries and relevant agreements may require that trustees keep such information confidential and, secondly, the real owner could be “concealed” with the help of a chain of false (front) beneficiaries, trusts, nominee shareholders, and trustees.¹⁴ The only possible way out of this situation is *the introduction of relevant information disclosure regulations on the international level. Another important way – tax policy also based on the system of international standards and agreements.*

21. There is one more important motive. Major blocks of shares of some Russian companies are owned by civil servants. In accordance with Art.11 of the Federal Law “On the Fundamentals of Civil Service in the Russian Federation,”¹⁵ “a civil servant shall transfer for trust management under state guarantee for the period in civil service their shares (blocks of shares) in the charter capital of commercial organizations in the order established by federal law.” Seeking to evade this legal requirement, civil servants prefer to conceal the facts of owning company stocks.

2.2. Empirical Data

22. According to surveys of some “typical” Russian companies (2002), 64% of companies are fully satisfied with the level of information disclosure from the point of view of information presented to shareholders and regulators; 20% of companies said they disclose minimum information on the structure of property and shares of other companies. On the contrary, 32% of companies consider themselves fully transparent in this respect (structure of property), although it is obvious that the point at issue is their officially registered structure. The desire to disclose data on their major shareholders is also weak.¹⁶

23. According to the Standard & Poors 2002 rating (42 companies capitalizing 98% of the market), the most transparent Russian companies are: MTS, Wimm-Bill-Dann, YUKOS, and Vypelkom, whereas motor car construction enterprises have the lowest ratings, with OJSC GAZ slotting in the bottom line of the rating list (which is connected with the general policy of the holding that owns this company). Wimm-Bill-Dann turned out to be the only company disclosing 100% information on the structure of property (according to S&P criteria). The S&P conclusion on the most non-transparent aspects of the company activities coincided with the data of other surveys and ratings: the structure of property, remuneration of management, and relations with investors. The leaders among them are obviously those companies that, firstly, were created from scratch (outside the privatization process) and, secondly, refer to the narrow group of companies publicly drawing investments on the international financial market.

24. The available scarce data on offshore nominee shareholders, the shareholder capital concentration level, alliances and cross-ownership can provide some quantitative characteristics of the problem of beneficial ownership. Practice shows that most companies do not disclose information on offshore companies and trusts that hold their charter capital. Most frequently (as shown in Table 1) companies disclose only nominee shareholders (also see Box 2).

Box 2. The analysis of selected metallurgical enterprises on the basis of the 2001 data shows that 37.5% of enterprises had from 1 to 4 nominee shareholders with fixed 10-50% of the company capital (28.6% on average). For example, 6 offshore companies owned 100% of the OJSC Mtsensk Aluminum charter capital, 2 foreign companies with offshore owners hold 63.79% in OJSC Pikalevskoe Glinozem Association, 6 offshore companies hold 46.41% in OJSC NLMK, 3 offshore companies hold 45.7% in OJSC Chelyabinsk Metallurgical Plant.¹⁷

25. The situation is similar among major Russian companies (holdings), with the exception of the “transparent” share owned by the state. As seen from Table 1, even the largest companies usually disclose information only on nominee shareholders and the share of the state in their charter capital. Some companies (for example, regional communication

¹⁴ The ultimate (controlling) owners of many Russian companies (groups) are well known unofficially, but there are no official accurate data on their actual structure of property and control. As a result, *it is merely stipulated* that, for instance, the V.Alekperov is the owner of LUKOIL, V.Potinin and M.Prokhorov – of Norilsk Nickel, I.Makhmudov – UGMK, R.Abramovich – Sibneft (before the YUKOS transaction), V.Vekselberg – SUAL, M.Fridman and V.Vekselberg – TNK (before the BP transaction), V.Bogdanov – Surgutneftegaz, V.Lisin – NLMK, R.Abramovich and O.Deripaska – Russian Alluminum, O.Deripaska – Basic Element Holding Ltd., K.Bendukidze – OMZ, A.Mordashov – Severstal, etc. The situation is similar with most major private banks (Alpha-Bank, MDM-Bank, etc.).

¹⁵ Federal Law No.119-FZ dated 31 July 1995.

¹⁶ Corporate Governance Policies in Russian Regions. Draft Report. IRG, on the order of IFC, 2003.

¹⁷ See: Mirkin Ya.M. Securities Market in Russia. M., ALPINA, 2002, p.313-314.

companies, electric power companies, etc.) disclose information on the owner of their majority holding (which is quite understandable due to initial public nature of this information – the existence of a majority holding of Svyazinvest, RAO UES Russia, etc.).

Table 1. Practice of Shareholder Information Disclosure by Russian Companies (Examples)¹⁸

Company	Information on the composition of shareholders disclosed by Russian companies
OJSC Aeroflot-Russian Airlines	RF represented by Minimuschestvo – 51.7%; JSC DKK (nominee shareholder (NS) – 30.46%
OJSC LUKOIL	JSC ING Bank (Eurasia) (NS) – 63.2%; LLC GARANT Specialized Depository Company (NS) – 10.7%; JSC NIKoil Depository Company (NS) – 5.2%
OJSC Gazprom	RF represented by Minimuschestvo – 38.37%
RAO UES Russia	RF represented by Minimuschestvo – 52.55%; Noncommercial Partnership National Depository Center (NS) – 11.58%; JSC ING Bank (Eurasia) (NS) – 10.9%; JSC DKK (NS) – 6.7%; Deutsche Bank Trust Company Americas – 6.35%
OJSC YUKOS	OJSC DIB (NS) – 59.21%; OJSC Brunsweek UBS Warbus Nominees (NS) – 13.52%; LLC Deutsche Bank (NS) – 12.99%
OJSC TNK	LLC Deutsche Bank (NS) – 97.07%
OJSC GMK Norilsk Nickel	Joint stock commercial bank Rosbank (NS) – 40.9%; JSC ING Bank (Eurasia) (NS) – 40.51%; JSC DKK (NS) – 6.36%
OJSC Mosenergo	RAO UES Russia – 50.87%
OJSC Rostelekom	OJSC Svyazinvest – 38.005%; JSC ING Bank (Eurasia) OJSC ING Depository IGN Barings

¹⁸ Based on data of quarterly company reports presented on the information disclosure server at: www.skrin.ru. Any examples quoted herein are only used to illustrate the *general* problem and do not mean bias towards *concrete* companies.

	(NS) – 18.509%; National Depository Center noncommercial partnership – 9.554%; JSC ING Bank (Eurasia) (NS) – 5.1%; JSC DKK (NS) – 5.029%
OJSC Sibneft	JSC ING Bank (Eurasia) (NS) – 24.1%; OJSC ABN AMRO Bank AO (NS) – 19.7%; OJSC West Siberian Depository (NS) – 19.5%; National Depository Center noncommercial partnership (NS) – 14.9%; LLC Deutsche Bank (NS) – 13.9%

26. The main boom of setting up offshore companies by Russian citizens (companies) fell on 1992-1995. By the end of 1990s the number of Russian offshore companies abroad amounted to tens of thousands (exact data is missing). Some 2,000 companies were being set up annually. In addition to traditional opening of bank accounts, the principal motives were, firstly, to conceal profit and capital, secondly, to optimize taxation, for which purpose a number of well-tested schemes were used, and thirdly, to safeguard assets (also see Box 3). According to available estimates, it is precisely “non-transparency” of the offshore for nonresident’s law-enforcement bodies (i.e. unreliability, according to Financial Stability Forum rating) that is the most important criterion in the choice of jurisdiction.

Box 3. The geography of foreign offshore zones used by the Russian citizens and companies is quite extensive. However, there are indisputable favorites. For instance, in 2002, 8% of the Cyprus GDP accounted for offshore companies, 60% of which were of Russian origin. On the whole, over 52,000 companies are registered in Cyprus, 18,000 – 25,000 of which, according to different estimates, belong to Russian residents (i.e. up to 40%). Besides protection of assets and setting up complex structures for this purpose, the services of Cyprus offshore companies are actively used by participants of the stock market, insurance and trade companies. Many major Russian companies are connected with the offshore companies of Gibraltar, the British Virginia Islands, holdings of Denmark, Luxembourg, the Netherlands, etc. There have also been scandals involving offshore companies set up specially to launder cash (for example, the use of the Gibraltar Lismate Ltd. in 2000 to embezzle funds from JSC Dalvostokugol with the participation of Latvian and US banks).¹⁹

27. It is also quite difficult to make an accurate appraisal of the actual level of concentration of company capital. The achieved level of company property concentration is not as high as in some countries of Eastern Europe. The results of empirical surveys show higher indexes for East Europe of mid-1990s²⁰ than the data revealed by IET sample surveys for Russia in 2000.²¹ However, this process is actively developing (see Box 4).

¹⁹ Information from periodicals (Commerzant, Vedomosti, Finansovaya Rossia, Expert, Rynok Tsennyh Bumag, Zhurnal dlya aktsionerov, etc.) and specialized web-sites.

²⁰ Frydman R., Ch.W.Gray, M.Hessel, A.Rapaczynski: Private Ownership and Corporate Performance: Some Lessons from Transition Economies. The World Bank. Washington D.C. Working paper No.1830. September 1997.

²¹ Radygin A., Arkhipov S. Ownership, Corporate Conflicts, Efficiency (Some Empirical Evaluations). – V.: Voprosy Ekonomiki, 2000, No.11, p.114-133 (in Russian). From the point of view of company capital concentration, 38.3% of JSC had shareholders who owned over 25% of shares, including 31.6% JSC with one shareholder with a golden share and 6.2% JSC with two such shareholders. Only 12.8% of companies have one shareholder with a block of shares exceeding 50% and only 4.1% - one shareholder with a block of over 75% shares.

Box 4. According to the results of the 1999 poll (selection of 300 enterprises of University Higher School of Economics (GU-VShE) and the RF Ministry of the Economy), the share of the major shareholder in 1998 was 28%, three largest shareholders – 45%. The major shareholder held a golden share of 50% at 20% of companies.²² The concentration level at 53% of companies of the 2001 REB sample was characterized as “high” and “very high” (over 20%), although the average size of the maximal block of shares was 34.4% (compared to 32.5% in 1999).²³ According to BEA data, the joint stock capital concentration level has doubled since the moment of privatization: at the moment of privatization only 15% of companies had at least one shareholder with a golden share, whereas in 2000 as many as 33% of enterprises had such shareholder (shareholders). Importantly, over the reporting period the number of companies where 2-3 shareholders hold a golden share has increased four times, whereas the number of enterprises with one holder of a golden share has only doubled.²⁴

28. The latest 2002 data evidence that these tendencies continue. The results of the 2002 CEFIR/RESH survey (using the data base of the IET Market Survey Lab) show that the largest external owner controls on average 24%.²⁵ According to the survey conducted in Russia on request of the International Finance Corporation, the major shareholder in 40% of companies owns from 5% to 24.99% of shares. 19% of companies have a controlling shareholder (over 50% of shares), 23% - a blocking shareholder (25-49.99% of shares).²⁶

29. As for the latest studies, it is worth mentioning the poll of company managers conducted in 2002 by T.Dolgopyatova and B.Kuznetsov (within the frames of a more extensive study of structural changes at Russian companies, headed by Ye.G.Yasin).²⁷ The company property concentration level has not merely increased, but the gap between the average and the median has shrunk. This gap demonstrated the dispersion of stocks among small shareholders along with high capital concentration of dominant owners. The shrinking of the gap evidences the reduction of the dispersed part of joint stock capital (Table 2).

Table 2. Property Concentration Indexes

	1998 (year's end)		2001 (year's end)	
	Average	Median	Average	Median
Major shareholder's share, %	36.7/204*	30.0	42.2/224*	39.5
3 major shareholders' shares, %	48.9/163*	47/5	57.6/181*	56.0

* - number of respondents

30. Finally, according to IET data, at the beginning of 2003 one major shareholder owned an average of 29.71% of shares, and three major shareholders – 48.86% of shares.

²² Dolgopyatova T. Models and Mechanisms of corporate Control in Russian Industry (Experience of Empirical Study). – Voprosy Ekonomiki, 2001, No.5, p.46-60.

²³ Kapelyushnikov R. Ownership and Control in Russian Industry: Some Results of the Poll of Russian Enterprises. – V.: Rynok Tsennyh Bumag, 2001, No.20, p.33-38 (in Russian).

²⁴ Main Soheres and Factors of Restructuring Industrial Enterprises. M., BEA, 2001 (in Russian); Kuznetsov B., Simachev Yu/ Forming Connections between the Russian Industrial Enterprises through Participation in Joint Stock Capital and Management. Theses. RECEP seminar, July 13-14, 2001.

²⁵ Guriev S. et.al. Corporate Governance in Russian Industry, mimeo, M., CEFIR, 2003. The higher the concentration of property in the hands of the administration or a major external owner, the higher becomes the level of corporate governance. However, there is positive effect only until the concentration of property in one hands exceeds 50%. After reaching this threshold further property concentration exacerbates corporate governance. In addition, only one third of the respondents were familiar with the Corporate Behavior Code and merely 4% knew it in detail.

²⁶ Corporate Governance Practices in Russian Regions. Draft Report. IRG at IFC request, 2003.

²⁷ Dolgopyatova T., Kuznetsov B. Factors of Industrial Enterprises Adaptation. Report at the GU-VShE IV International Scientific Conference “Modernization of the Russian Economy: Social Context,” April 2-4, 2003. A total of 473 enterprises in 11 regions have been polled, although the number of responses to some individual questions is much lesser.

31. The cited empirical data require at least two important comments. Firstly, more intensive growth in the share of three major shareholders as compared to the share of one major shareholder, revealed in the course of some surveys, is quite characteristic. This difference in dynamics is connected with legal restriction on capital consolidation – 30% in corporate, and 20% in antimonopoly laws. Secondly, the actual concentration level that can hardly be detected empirically is much higher. It is well known that this is connected with the specifics of organizing the system of property in the Russian companies.

32. It is also difficult to detect alliances and agreements. The IET sample of early 2003 revealed informal strategic alliances (agreements) for 20% of companies. Another 15% of companies admitted membership in formal associations or holdings. Let's take a look at one example. According to unofficial data for 2002, Rosneft was purchasing the shares of its subsidiaries, using affiliated investment companies for this purpose. Their agreements with Rosneft contain an obligation to resell the shares purchased by them on first demand at the purchase price. The use of external companies was also motivated with the argument that Rosneft needed votes at their subsidiaries' general meetings to approve the deals with Rosneft itself, for example, for the sale of oil to the mother company without considering the minority position.

33. Cross-ownership is quite common practice, but it is also difficult to trace. The early 2003 IET sample survey registered cross- (mutual) shareholding for 32% enterprises. Cross-ownership is also typical of many Russian large groups.

34. The example of Surgutneftegaz group is characteristic. On April 2003 (according to estimate) OJSC Surgutneftegaz management controlled 67.5% of shares, most of which were on the balance of its subsidiaries: 36.7% of shares belonged to Surgutneftegaz oil company (in which OJSC Surgutneftegaz holds 99% of shares), NPF Surgutneftegaz owned 8.6% of shares. Russian law does not qualify these shares as treasury stocks, allowing for a possibility of vote. The takeover attempt expected in April 2003 led to (the management's defense reaction) an increase of the aggregate share controlled by the management (to reach some 75%), and a decision to transform Surgutneftegaz oil company from OJSC to LLC. As a result, the major OJSC Surgutneftegaz shareholder (its subsidiary Surgutneftegaz oil company) was exempt from FKCB control and released from responsibility to disclose information required of a public company.

2.3. Typical Patterns

35. Offshore companies were historically (late 1980s, with the abolishing of a monopoly on foreign trade – first half of 1990s) registered in the name of real owners, their relatives, straw parties, etc. The most common pattern was not sophisticated: Russian company – offshore holding. Nevertheless, the very fact of owning these shares (foreign companies) *constituted a violation of Russian law*.²⁸ The modern Russian legislation on affiliated persons (groups of persons) in a certain sense follows the inertia of the simplest 1990s schemes, which are actually obsolete.

36. After that the shares of many offshore companies were handed over to trusts (the simplicity of this decision was recognized rather late).²⁹ This “novelty” in creating non-transparent property structures and tax-free extraction of profit from property is connected with the gradual (for many Russian majority shareholders) acknowledgment of the aforementioned multifaceted advantages: taxes, protection against exposures, ensured inheritance, manipulation (transfer) of assets/blocks of shares for creation (reorganization) of corporate groups, etc.

37. Let us also note that the present veiled structure of property created, in part, in primary commodity sectors, results from the fundamental dilemma formed by the year 2001: “partnerships” within the frames of each major group have mainly been formed, and it was necessary to make the property and income structure more legitimate.³⁰ The creation of offshore holdings (to avoid additional taxation in Russia) was a logical step in this direction, and the

²⁸ See detailed analysis of these violations in: Apel et al., 2002.

²⁹ According to the estimates of specialists of a number of Russian companies who consulted the author, this pattern is currently typical for the overwhelming majority of large Russian enterprises (groups). The author expresses his gratitude for these consultations, keeping the names of his respondents anonymous (due to agreement).

³⁰ A more primitive pattern was used in 2000, for example: supplies of an oil producing company at a minimal price to LLC or JSC in Kalmykia, therefrom at a maximal price to an oil refinery, and then to foreign offshore companies. According to estimate, if the entire institutional structure of business organization had been legalized, the partners' incomes would have been approximately 8 times lower.

owners (“partners”) could hide behind a group of complex legal entities via holdings. All organizational structures became quasi-legitimate (i.e. formally not contradicting the law), with two exceptions: permanent violation of antimonopoly law (according to estimate, not less than 20% of all deals), and transfer pricing (including as a means of exporting capital, although there is practically no legal regulation with this respect).

38. As already mentioned above, an (offshore) trust is one of the most widely spread forms of assets protection.³¹ Whenever a trust is used by residents of the countries where it is not recognized (including Russia), the essence of the scheme looks as follows: the property to be transferred in trust is first handed over to an offshore company, after which the shares of that company are handed in trust (for details see box 5).³²

39. Consequently, the overwhelming majority of Russian citizens who hold considerable assets through offshore companies are beneficiaries of those companies, but not their formal owners (at least with respect to the controlled part of shares). When a Russian resident – natural person X – claims that N percent of Russian company Z belongs to him (including within the frames of public property structure information disclosure), it is not entirely correct, as the term “belongs” from the point of view of Russian law (when the point at issue is the stock of company Z, as well as offshore foreign companies and trusts) does not correspond to reality. As a rule, the shares of an offshore entity that owns the company shares belong to trusts, whose beneficiary is a Russian resident – natural company X.

Box 5. Let’s take a look at the most typical scheme (more complex schemes are connected with “optimizing taxes” and are not considered herein).

The beneficiary-to-be hires a specialized trust or law company to prepare a trust deed and (as a rule) act as trustee in the future. The specialized company sets up a trust. The trust deed is concluded between several lawyers registered in a special (corporate and trust) register within the given jurisdiction. The trust deed (to which the future beneficiary may not be a party) stipulates that the trust beneficiary is, firstly, the principal one – Russian resident – natural person X, secondly, other natural persons, including family members, etc., thirdly, other funds and entities (down to level N). The trust deed stipulates only special rules (terms and conditions) of functioning of a concrete trust: the number of beneficiaries, sequence and proportions of transfer of benefits, etc.

Assuming Russian company Z has several shareholders – Cyprus offshore companies A, B, C, etc. Each of the latter owns, for instance, 9, 5, 7, etc. percent of shares of company Z. Companies A, B, and C are owned 100 percent by a trust (trusts) registered in the Cayman Islands. Consequently, corporate directors of companies A, B, and C are accountable to the trustee.

The Russian company Z paid dividends to its shareholders – Cyprus offshore companies A, B, C, etc., which, in turn, pay dividends to their owner – the trust. This money (let’s say, \$100 million, or part of it if offshore companies A, B and C use the proceeds for other purposes on formal instruction of the trust and actual order of the beneficiary) is transferred to the trust bank account. The beneficiary requests a certain sum (for example, \$10 million) for his personal needs, which money is transferred to the personal account of the principal beneficiary and officially declared with the tax authorities. The remaining \$90 million formally do not constitute his personal income and are not taxable by law, but can be spent, for example, by offshore companies A, B, C on instruction from the trustee (specialized trust) at the request (in a discrete trust) of the beneficiary to purchase the stock of another Russian company Y, in which the beneficiary is interested. Offshore company A or some other companies: C, D, E (offshore subsidiaries or directly belonging to the trust, but not connected with each other, if there is a need to complicate the property structure) would be registered in the register of shareholders of the newly acquired Russian company. Presently there is a possibility in Russia today to directly control a trust, regardless of the tax aspects of the problem, i.e. appointing oneself a trust agent, disregarding the tax aspects in other jurisdictions.

³¹ An offshore limited liability partnership is another instrument of assets protection. Its use is connected with the impossibility of filing a claim to the property of a limited partner, invested in a partnership, by the limited partner’s creditors.

³² There are also more primitive patterns: for example, the best assets of the Russian company X are directly sold at a nominal (minimal) price to a certain offshore trust in jurisdiction Y. The director of the Russian company becomes a beneficiary of the trust, while the profits from the trust activity are transferred to a foreign bank. At the same time, the company director is formally neither the owner, nor founder, nor shareholder.

40. Other frequently used methods of concealing information on the actual owners of shares include the transfer of stocks into the ownership of an offshore company whose owners are unknown (often used directly during the purchase of shares to avoid the antimonopoly law), the transfer of shares in trust in keeping with Russian law, transfer of shares into foundations set up in offshore zones, cross-ownership of shares, shareholding via ADR-GDR, holdings, etc. As a matter of fact, the above patterns are often combined, involving several trust managers and several offshore companies. Bearer shares were also used quite extensively, until fully banned by the government in 2002.

41. In MAP estimates, if companies formerly preferred to conceal themselves behind offshore companies, they now often reveal themselves in major transactions. In other words, since the beginning of the 2000s there has been *a certain tendency on the part of the owners towards legalization of assets, but the motives are not always obvious* (most frequently it is connected with preparing the business for sale).³³ Nevertheless, antimonopoly law (the threshold of the size of transactions requiring MAP permission) remains an obstacle for disclosing such information.

42. Individual examples already exist. For example, besides the banks pressure, the preparation of ADR of the third level for listing may be an incentive towards such information disclosure. YUKOS is the most famous and, possibly, the only example thereof (with the exception of the initially private Wimm-Bill-Dann).

43. It is seen from Table 1 (SCRIN-Emitent data) that the 2002 OJSC YUKOS register contained only nominee shareholders OJSC Trustee and Investment Bank (controlled by Menatep Group Ltd.) – 59.21%; JSC Brunswick UBS Warburg Nominees – 13.52%, LLC Deutsche Bank – 12.99%. Nevertheless, practically full data on the structure of property (control) as of June 10 2002 were disclosed on the Group Menatep LTD. Site (see Box 6).

Box 6. The Gibraltar Group Menatep Ltd. is the owner of 100% of shares of Yukos Universal Ltd.(Man Island), which owns 3.54% of shares of YUKOS oil company. Hulley Enterprise Ltd. (the subsidiary of Yukos Universal Ltd., Cyprus) owns 57.47% of YUKOS oil company shares. The co-owners of Group Menatep Ltd. are six natural persons (four hold 7% each, one 8%, and one 9.65%), the trust foundation Special Trust Arrangement (50%, the only beneficiary is YUKOS head M.Khodorkovsky), and several minority shareholders (4.5% in aggregate). Apparently, with such structure the decisive influence belongs to M.Khodorkovsky (59.65% participation, including the trust), but the idea of a trust consists in the fact that formal decisions are taken by the Group Menatep Ltd. director and trustees, rather than the beneficiary. It is stipulated that if M.Khodorkovsky is deprived of his ability to act as a beneficiary (in the event of abduction, imprisonment, forced voting against his will, etc.), the voting right shall be transferred to a Group Menatep Ltd. co-owner appointed in advance.

44. Certain data on the property structure were disclosed by LUKOIL, AFK Sistema, and a number of other major companies. For instance, it was known about the owner of AFK Sistema, that has stakes in approximately 200 companies and is estimated at some \$2-2.8 billion, only that 97.22% of all shares belong to a certain OJSC Sistema-Invest. As a result of additional emission of AFK shares, OJSC shareholders have exchanged their shares for AFK shares, becoming direct owners. According to an FKCB report (summer 2002), 75.965% of shares belong to chairman of AFK board of directors V.Yevtushenkov, and 4.861%, 4.861%, and 3.403%, respectively, belong to other natural persons. 2.16% belongs to a certain Rayson International Corp. The destiny of the block of shares of the Moscow government, whose existence was admitted by the city mayor in 1999, remains non-transparent.

45. Of course, such motive as the issuance of ADR is insufficient for complete (ultimate) transparency of beneficial ownership. Apparently, there is some “time” factor connected with the completion of the groups’ reorganization (following privatization and the subsequent takeovers), creating fully legal (protected) schemes of asset ownership and legal optimizing of taxation of the gained benefits. In other words, *a certain period of time should elapse after which the risk of losing the acquired (often in violation of civil and criminal law) assets becomes minimal*.³⁴ The impossibility for a time being *to reveal the sources of the acquired property, including the facts of evading taxes, is also of principal importance*. The length of this period mainly depends on the skills of the real – beneficial – owners and their consultants. The overwhelming majority of Russian groups and companies are still not ready for it. The secretiveness of the real owners is, therefore caused by objective reasons and, as practice shows, even the strictest

³³ Materials of the ID Commersant conference: Successful Restructuring of Enterprises. Problems and Practical Solutions, 2001.

³⁴ Using a vulgar expression, this idea could be formulated in the following way: so far there is too much illegally gained property that is still to be laundered.

laws on disclosure of the relevant information will be observed without adequate reciprocal conditions in the companies themselves.

46. In this connection, it is necessary to take into account one more important consideration. Regardless of the launching of any costly and complex program of raising transparency, any reasonable owner is capable of putting the transparency process under control: everything that is not intended to become transparent would neatly pass unnoticed by the stakeholders (small shareholders, the state, valuers, auditors, rating agencies, investment companies, analysts). On the contrary, everything bright and positive may not only become transparent, but also serve the purposes of latent business advertising. Nevertheless, there is also another aspect to the problem: if the company has embarked upon the road of transparency, it would be quite difficult for it to conceal most events, and any clandestine actions would become an element of an affair or criminal collusion and could lead to criminal persecution.³⁵ This factor is rather important, although so far unacknowledged by many companies as an obstacle on the way towards transparency of their business.

3. PARTICULARS OF BENEFICIAL OWNERSHIP IN RUSSIA: LEGAL REGULATION

3.1. Notion of Beneficiary and Beneficial Owner in RF Law

47. In keeping with RF civil law, a *beneficiary*, or *beneficial owner*, is present in some legal relations, which means a person to whom certain funds, incomes or property rights are due, specifically:

- a person in whose interests a trustee exercises property trust management is called a beneficiary (Art.1012 of the RF Civil Code);
- a person in whose favor an insurance contract has been concluded (under Art.929, 930, 931);
- rent recipient (Chapter 33 of the RF Civil Code);
- the notion of beneficiary is also used in legal relations connected with setting a bank guarantee (Art.368 of the RF Civil Code);
- a person in whose favor a letter of credit has been issued (Unified Rules and Traditions for Documentary Letters of Credit);
- in accordance with Art.79 (5) of the Federal Law “On Inconsistency (Bankruptcy),” “during enforcement of a debtor’s liabilities using a bank guarantee in accordance with the debt cancellation schedule, a provisional manager or administrative manager who has signed the agreement in the interests of creditors whose demands are subject to satisfaction in accordance with the approved debt cancellation schedule, shall be recognized as the beneficiary.”

48. Therefore, Russian law defines a beneficiary as a person to whom certain funds, incomes, fulfillment of obligations, etc., are due. The legal definition of a beneficial owner is absent from the Russian legislation.

³⁵ Moshkovich B. Illusive Transparency or Manageable Cost of Business? – V.: Company Management, 2002, No.12, p.69-72 (in Russian).

3.2. Legal Regulation of Stockholders Information Disclosure in Russia

(A) Information disclosure by nominee stockholders on beneficial owners whose shares are in nominee ownership

49. Although Russian law does not have a definition of beneficial owner applicable to the stock market, Russian law makes a distinction between the notions of *nominee shareholder and owner of securities*. In accordance with Art.8 of the Federal Law “On the Stock Market,” a nominee shareholder is a person registered with the register keeping system, including depositors of a depository, who is not the owner of the relevant stocks.

50. In accordance with Art.8 of the Federal Law “On the Stock Market,” in order to discharge the ownership rights fixed by securities, the register keeper is entitled to demand from the nominee stockholder a list of owners, whose stocks he nominally holds. At the same time, the nominee stockholder is responsible for refusal to present the aforementioned lists to the register keeper to his clients, the register keeper and issuing entity under Russian Federation law. If the nominee shareholder fails to present the aforementioned list to the registrar within the established time, the registrar shall notify the Federal Commission thereof in writing within ten days after the expiration of the said time.³⁶

51. In this case, it is necessary to pay attention to technical inconsistency of the norms of the said FKCB Resolution with provisions of Art.8 of the Federal Law “On the Stock Market.” The Law stipulates that right to demand information disclosure on stockholders belongs to the company register keeper, whereas in accordance with the Resolution, such right belongs only to the registrar. According to the Federal Law “On the Stock Market,” in a company with less than 50 shareholders the company itself may act as the joint stock company register keeper. Proceeding from the above, the relevant clause of FKCB Resolution No.27 of 2 October 1997 should be streamlined with Art.8 of the Federal Law “On the Stock Market.”

52. It is also necessary to pay attention to another problem connected with information disclosure on ultimate company shareholders by nominee shareholders. Often they simply don't have this information, as a nominee shareholder may also have information of another company, which is not an ultimate shareholder, rather than the real owner. For example, stocks could be transferred to a trust or a foundation created in an offshore zone. At the same time, in accordance with Russian law, neither the nominee shareholder nor the joint stock company nor the registrar has a right to demand information on the beneficial owner of stocks transferred in trust.

53. There is one more thing worth mentioning. Although the shareholders' register may contain information on nominee shareholders, the list of persons entitled to participate in a general shareholders' meeting must reflect information on the owners of stocks (Art.51 of the Federal Law “On the Stock Market”). At the same time, as already mentioned above, nominee shareholders must present to the register keeper information on persons in whose interests they own the stocks. Consequently, companies dispose of information, if not on beneficial owners of their shares, on offshore companies and trusts holding relevant shares.

(B) Information disclosure by beneficial owners on their ownership of underwritten stocks

54. In accordance with Art.30 of the Federal Law “On the Stock Market,” the owner must disclose information on his ownership of underwritten stocks issued by some issuing entity (with the exception of non-convertible debenture) in the following cases:

- coming into possession of 20 percent or more of any type of underwritten stocks of an issuing entity;
- increasing the share of any type of underwritten stocks of an issuing entity in possession to a level multiple by each 5 percent exceeding 20 percent of this type of stocks;
- lowering the share of any type of underwritten stocks of an issuing entity in possession to a level multiple by each 5 percent exceeding 20 percent of this type of stocks.

³⁶ FKCB Resolution No.27 of 2 October 1997 “On Approval of the Provision on Keeping Register of Owners of Registered Stocks.”

55. The owner discloses the relevant information by notifying the federal executive authority regulating the stock market or its authorized body.

56. It is necessary to mention that Russian law has no provisions on *administrative responsibility* of stockholders for non-presentation of information or presentation of false information on their ownership. For instance, the RF Code of Administrative Offense envisages responsibility for violating legislative requirements of information disclosure on the stock market only with respect to the issuing entities, professional participants of the stock market, and persons rendering services in the sphere of public presentation of the disclosed information.

57. At the same time, according to the Federal Law “On the Stock Market,” the damage inflicted as a result of violation of the RF law on securities is subject to reimbursement in the manner stipulated by RF civil law. Nevertheless, the law does not envisage the order of imposing civil responsibility on owners of stocks for violation of the law on the order of disclosing information on their ownership, or a list of entities granted the right to file relevant claims against the owners of stocks to collect compensation for damage sustained as a result of violation of information disclosure on stock ownership. The absence of relevant provisions in the Federal Law “On the Stock Market” entails a risk of abuse in the sphere of imposing civil responsibility for violations of information disclosure procedures and hampers the development of the stock market in general.

58. It is also worth mentioning that the Federal Law “On the Stock Market” envisages the obligation of affiliated persons to disclose information on legal entities in which they independently or jointly with their affiliated person (persons) own 20 or more percent of voting shares. At the same time, in keeping with the Law, affiliated persons must notify the company in writing on the company shares in their possession not later than ten days after the acquisition of the said shares. If non-presentation or untimely presentation of the said information to the company at the fault of the affiliated person results in damage to the company property, the affiliated person shall be liable to the company in the amount of the inflicted damage.

59. Nevertheless, if non-presentation or untimely presentation of information on stock ownership by the affiliated person has resulted in damage to the company property, it would be rather difficult to prove the guilt of the affiliated person, as well as the cause-and-effect relation between the guilt of the affiliated party and the damage inflicted on the company. In addition, in most cases the company officials would hardly wish to conflict with a shareholder who owns 20% or more voting stocks of this issuing entity, allowing to shield affiliated persons from responsibility to the joint stock company and third parties.³⁷

60. It is expedient to seek the solution to the problem in establishing administrative responsibility of affiliated persons for correctness, completeness, and timeliness of presenting information to the stock issuing entity, as the RF Code of Administrative Offense does not envisage administrative responsibility of affiliated persons for committing the aforementioned offense. In our opinion, it is also necessary to legislatively fix the possibility of imposing property liability on affiliated persons by third parties, specifically, counteragents in related transactions and shareholders, for violation of the law on joint stock companies by affiliated persons.

61. It is also necessary to note that while formerly there was a problem of absence of legislative requirements of information disclosure on affiliated persons on Internet web-sites, in accordance with the recently adopted FKCB Resolution “On Disclosure of Information on Affiliated Persons of Open Joint Stock Companies,”³⁸ joint stock companies, whose underwritten securities are admitted for listing by at least one organizer of trade on the stock market holding an FKCB license, must disclose information on affiliated persons, including by means of placement of a list of affiliated persons of the joint stock company, indicating all changes to that list, on a web-site. However, there is a risk of violation of this requirement of the Resolution, as Russia has not adopted a single law obliging joint stock companies to open their Internet sites.

³⁷ Abramov A.Ye. Information on Owners of Securities: Confidentiality and Transparency. – NAUFOR Herald, 2001, No.3 (47).

³⁸ Approved by FKCB Resolution No.03-19/ps. of 1 April 2003.

(C) Information disclosure by the issuing entity on beneficial owners of its stocks

62. Specialists in corporate governance and the stock market have more than once tries to draw attention to *the lack of a single approach* to disclosure of information on stockholders. In some cases the point at issue is information disclosure on the share in the charter capital, in others – the share of voting stocks or the share of any type of underwritten stocks of an issuing entity.

63. In compliance with Art.22 of the Federal Law “On the Stock Market,” the stock offering statement and quarterly reports shall disclose:

- information on the issuing entity’s shareholders who own not less than 5 percent of its charter capital or not less than 5 percent of its equities, including the size of the share of the issuing entity’s shareholder in its charter capital, as well as the share of equities in his possession;
- information on changes in the composition and size of participation of the issuing entity’s shareholders who own not less than 5 percent of its charter capital or not less than 5 percent of its equities over the five last fiscal years or for each completed fiscal year, if the issuing entity has been exercising its activity for less than five years.

64. During the issuance of additional stocks, convertible stocks, and bonds, additional requirements are placed on the issuing entities with respect to disclosure of information on the owners of their stocks. In accordance with the Standards of Issuance of Bonds and Their Prospectuses,³⁹ as well as the Standards of Issuance of Stocks and Convertible Debentures,⁴⁰ the issuing entity shall disclose “information on shareholders – owners or two and more percent of the company voting shares.”

65. In compliance with Art.30 of the Federal Law “On the Stock Market,” the issuing entity is to disclose information, in the form of report on material fact, on appearance in the issuing entity’s register of a person owning 25% of its underwritten stocks of any type.⁴¹ Other requirements are set by the Statute of the order of information disclosure on material facts (events and actions) relating to financial and economic activity of the underwritten stocks issuing entity⁴²: issuing entities placing their shares by open subscription and issuing entities the state registration of whose stock issues constitutes the competence of the Federal Commission, must report the purchase by any person of a share in their charter capitals exceeding 5%, as well as the changes in such share (share of stocks) in the amount multiple by 5%. Other issuing entities must report the purchase by any person of a share in their charter capitals exceeding 20% and (or) 20% of their stocks, as well as any changes in such share (share of stocks) in the amount multiple by 5%. The contradiction of these norms consists in the fact that the Federal Law “On the Stock Market” contains a closed list of material facts which must be disclosed by the issuing entity.⁴³

66. Another problem in this case is the lack of a unified approach to setting the information disclosure threshold. While in accordance with the above Provision issuing entities must disclose information *on the share in the charter capital*, the Law requires disclosure of information on persons holding over 25% of *underwritten stocks of any individual type*. Moreover, the above norm of Art.30 of the Federal Law “On the Stock Market” according to which the issuing entity must disclose information on appearance in its register of a person owning over 25% of its

³⁹ Approved by FKCB Resolution No.27 of 19 October 2001.

⁴⁰ Approved by FKCB Resolution No.16/ps. of 30 April 2002.

⁴¹ In reality, companies disclose in their reports on material facts information on nominee shareholders. For example, the report on materials facts of 10.02.2003 concerning the change in the distribution of OJSC LUKOIL shares informed of a change in the share of the nominee shareholder of LLC Specialized Depository Company Garant (according to www.skrin.ru data).

⁴² Approved by FKCB Resolution No.32 of 12 August 1998.

⁴³ It should be noted that the inconsistency of provisions of the Federal Law “On the Stock Market” and the Statute of the order of information disclosure on material facts (events and actions) relating to financial and economic activity of the underwritten stocks issuing entity have been eliminated in the Draft FKCB Resolution “On Approval of the Statute of the order of information disclosure by underwritten stocks issuing entities (approved by the Russian FKCB Expert Council on 11.06.2003, placed on the web-site: www.lin.ru) , in accordance with which it is required to disclose data on appearance in the register of the issuing entity of a person who owns over 25 percent of any type of its underwritten stocks, which fully agrees with the Law “On the Stock Market.”

underwritten stock of any individual type disagrees with other provisions of the law relating to information disclosure, as well as the norms of Emission Standards, requiring disclosure of information on *owners of the company shares*, rather than any type of underwritten stocks.

67. It is also worth mentioning that the purpose of information disclosure about owners of over 25% of nonconvertible debentures is unclear, as, firstly, the owning of nonconvertible debentures does not enable their holders to influence the company performance or participate in its management. Moreover, the issuing entity does not always dispose of information on the owners of its bonds. In fact, information about them can be obtained only during the placement of those securities, payment of warranted dividends and (or) their cancellation. However, the issuing entity only possesses information on nominee holders of nonconvertible debentures or holders registered in the register or depositary.

68. Moreover, the aforementioned provision of the Law requires information disclosure on *appearance in the issuing entity's register* of a person owning over 25% of its underwritten stocks of any type, and no exception is made for persons holding over 25% of bonds. As a rule, the register of bond owners is not kept. According to the existing practice, bonds are issued on the market in a documentary form, and there is a rule for their obligatory centralized storage, therefore bondholders are registered in a depositary, which, however, is not a register.

69. Consequently, the provision of Art.30 of the Federal Law "On the Stock Market" fixing the issuing entity's obligation to disclose information on the appearance in the register of a person holding over 25% of any underwritten stocks of the issuing entity, including nonconvertible debentures, is redundant and in many respects unworkable, besides being incorrectly formulated. Proceeding from the above, it is necessary to *change the working of the aforementioned provision* of Art.30 of the Federal Law "On the Stock Market."

70. As already stated above, in accordance with the aforementioned FKCB Resolution, issuing entities must disclose information on the purchase by some person of 5 and more percent of their shares, and on the changes in such share (share of stocks) in the amount multiple by 5% in the form of report on material facts.

71. Nevertheless, although the Law stipulated the issuing entity's obligation to disclose information on the above facts, no corresponding obligation of shareholders to present to the company information on the purchase of the aforementioned amount of the issuing entity's shares has been introduced. As already stated herein, in compliance with the Federal Law "On the Stock Market," only the holders of over 20% of the company stocks must disclose information. Therefore, the issuing entity may simply be unaware of the fact of purchase of its stocks (this particularly concerns issuing entities with a high percent of traded stocks), as it is impossible to trace the aforementioned facts. Moreover, as already noted, responsibility for non-presentation or inadequate presentation of information in the given cases rests with the company itself.

72. So, a solution to this problem could involve fixing a legislative requirement that persons coming into possession of 5 and more percent of an issuing entity's shares shall inform the company thereof. It is also necessary to establish the responsibility of the said persons for non-presentation or inadequate presentation of the said information to the company. Another way out of this situation could be the imposition of the company obligation to disclose these facts on a quarterly basis.⁴⁴

73. In order to improve the enforcement system of these norms, it is necessary to introduce a common approach to legislative norms requiring information disclosure on stockholders. With this end in view, it is necessary first of all to *decide which information is needed for regulating authorities, shareholders and investments and for what purpose*: information on holders of voting shares, and shares, or other underwritten securities.

⁴⁴ The outlined problem will be overcome by adoption of the Draft FKCB Resolution «On Approval of the Provision of the Order of Information Disclosure by Entities Issuing Underwritten Stocks» (approved by the Russian FKCB Expert Council on 11.06.2003, placed on the web-site: www.lin.ru).

(D) Responsibility

74. The problem of enforcement is connected above all with the lack of the very notion of beneficial owner in Russian law (see details below).

75. We are unaware of any facts of imposition of responsibility for inadequate information disclosure on the company shareholders, although the law allows it. For example, Art.15.19 of the RF Code of Administrative Offense envisages the issuing entity's responsibility for violating the information disclosure procedure on the stock market. Apparently, fines can be imposed for the said offense also for nonobservance of legal requirements of information disclosure on the company shareholders.

76. Therefore, the way out of the existing situation consists in more acting enforcement of legal norms envisaging responsibility for inadequate information disclosure.

77. It is also necessary to mention the problem of imposing criminal and administrative responsibility for violating legal requirements on information disclosure on the company shareholders.

78. As already mentioned, Art.15.19 of the RF Code of Administrative Offense envisages bringing to responsibility issuing entities, professional participants in the stock market, or persons rendering services of publishing the disclosed information, for violating the information disclosure procedure on the stock market, the disclosure of which is mandated by the legislation. At the same time, the Code does not contain an exhaustive list of violations punishable under this article with administrative responsibility. Therefore, *the violation of any requirement of the law on the information disclosure procedure should be regarded as administrative offense entailing administrative responsibility.*

79. The RF Criminal Code (Art.185.1) envisages criminal responsibility for habitual evasion from granting information to an investor or controlling authority as prescribed by the Russian law on securities. Evasion from granting information containing data on the issuing entity may also mean evasion from disclosing information on the real shareholders of the issuing entity. Nevertheless, in order to bring to criminal responsibility under these charges, *it is also necessary to prove that the said actions have inflicted major damage on citizens, organizations, or the state.*

80. It should be noted that the said provisions of the Criminal Code and the RF Code of Administrative Offense in their present wording enable to impose criminal or administrative responsibility for any violation of legal requirements of information disclosure. However, while bringing to criminal responsibility for the said offense is rather difficult (as it would take proving the fact of major damage as well as causal effect between the deed and the inflicted damage), it is possible to impose administrative responsibility for violating legal requirements of information disclosure for any offense, including the violation of legislative requirement of disclosing information on stock owners.

81. Enforcement stretches beyond the frames of this paper as an independent and ample problem, although the significance of this sphere cannot be overestimated.

82. The problem of relevancy of concrete legal decisions is acquiring particular importance in the Russian practice. While in no way attempting to make lopsided evaluations, let us give only one example involving OJSC Taganrog cauldron making plant Krasny Kotelschik, where the corporate conflict is connected, to all appearances, with the attempt at a hostile takeover with the use of administrative methods, typical in Russia in early 2000s. According to the Determination of the Rostov Regional Arbitration Court of 15 May 2003, all nominees shareholders were to present to officers of the court confidential information on owners of OJSC Krasny Kotelschik, including those who are not mentioned in the statements of claim. In the opinion of OJSC Board, stakeholders have thus obtained formerly inaccessible information on owners.⁴⁵

⁴⁵ There are attempts to turn the Arbitration Court into a mechanism of takeovers, Letted to Chairman of the Supreme Arbitration Court of the RF V.F.Yakovlev from Chairman of the Board of OJSC Krasny Kotelschik. *Commerzant*, 2003, May 30.

83. At the same time, it is important that the court has an opportunity to make its own assessments of affiliation and its consequences during the consideration of a particular corporate dispute. However, the courts use formal data on affiliated persons, the requirements to which are set by antimonopoly and corporate law. For the same reasons the notion of beneficial owner is not subject to consideration by the Russian courts at all.

3.3. Beneficial Owner in the System of Trusts

84. In general terms, a trust is an obligation of one person (beneficial owner) to use the property transferred to him by a trust founder in the interests of certain persons – beneficiaries.⁴⁶ The particularity of a trust is the fact that a beneficial owner holds the title to the property and he has all proprietary rights: the right of ownership, use, and management, whereas the right to profit from the property in trust belongs to the beneficial owner.

85. The system of regulating trust relations initially fixed in the Russian legal system was based on the institution of trust – beneficial ownership in the Anglo-American tradition (i.e. *real right*, RF Presidential Decree “On Beneficial Ownership (Trust)” No.2296 of 24 December 1993).⁴⁷ This system was abolished under the formal pretext that the founder’s property was poorly protected and there were wide opportunities for managerial abuse (although the new system of beneficial management was not any better in this respect).

86. Since mid 1990’s the prevailing approach was based on the Roman-German legal tradition (*personal right*, RF Civil Code, the Law “On the Stock Market,” etc.) – trust management. The procedures and conditions of trust management of property in the RF are established by Art.209 (4) and Chapter 53 of the RF Civil Code. The transfer of property in trust *does not entail the transfer of title* to it to the trust manager. FKCB Resolution No.37 of 17 October 1997 “On Approval of the Statute of Trust Management of Securities and Funds Invested in Securities” contains a list of objects in trust management. The order of trust management of credit organizations and banks is regulated by the Law “On Banks and Banking” and the Instruction “On the Order of Exercising Trust Management Transactions and Accounting for Such Transactions by Credit Organizations in the Russian Federation.”⁴⁸ Trust management of stock is indicated in the RF Law “On the Stock Market” as one of the forms of professional activity.

87. The absence of the notion of “trust – beneficial ownership” in Russian law is crucial for purposes of identifying beneficial owners. This entails *overt legal collisions with other jurisdictions during the attempts at joint (international) control and monitoring*.

88. Apparently, the opposition of beneficial ownership (trust) and beneficial management in Russia is somewhat artificial. In the opinion of A.Genkin, the nature of trust management is closest to personal right including some elements of real right (most lawyers regard a deed of trust as a basic indication of trust). The natural way of development of the legal concept of trust in Russia (and consequently, effective protection of rights of all parties to trust relations) should consist in the adoption of a concept of split property right and analysis of mutual standing of the principal and the trustee *in terms of each particular trust deed* and situation described by a concrete legal act. This requires, in part, the borrowing of some elements of the Anglo-American legal tradition.⁴⁹

3.4. Legal Collision of Different Jurisdictions

89. The dualism “trust – beneficial management” is the best illustration of a legal collision resulting from any attempts of a Russian agency to obtain information on beneficial owners. The enforcement problem is connected above all with the lack of the very notion of beneficial owner in Russian law.

⁴⁶ See, in particular: Genkin A.S. *Effective Trust. Experience of Western Europe and Russian Practice*. M., ALPINA, 1999 (in Russian); Lupoi M. *Trusts: a comparative study*. Cambridge University Press, 2000; Gnedovets D., Grishankov D., Kirichenko N. *Operation Trust*. – V: *Expert*, 1996, No.11, p.30-35 (in Russian); Benevolenskaya Z.E. *Property Trust Management in Business*. St.Petersburg, Legal Center, 2002 (in Russian).

⁴⁷ First mention of trust appeared in regulatory acts on privatization: para 6 of the Presidential Decree of 1 July 1992 “On Organizational Measures for Transforming Public Enterprises, Voluntary Associations of Public Enterprises into Joint Stock Companies,” the “Provisional Statute of Holding Companies Created during the Transformation of Public Enterprises into Joint Stock Companies” (approved by RF Presidential Decree No.1392 of 16 November 1992 “On Industrial Policy Measures during the Privatization of Public Enterprises”).

⁴⁸ Approved by Order No.02-287 of the Bank of Russia of 02.07.97.

⁴⁹ Drobyshev P. *Legal Regulation of Trust Management*. – V: *The Stock Market*, 1997, No.22 (in Russian).

90. Let's look at one example. Apparently, the Russian prosecutor's office should operate within the Russian legal environment. Therefore, investigating a case of financial embezzlement involving a certain Cyprus company A, it is easy to request information on company A shareholders (who, obviously, are mere intermediates not directly linked with the real beneficial owners). A more "advanced" option would be to request information on shareholders represented by the nominee shareholders. However, due to the absence of the notion of "beneficial owner" in Russian law, it is impossible to request information on Company A beneficial owners from Cyprus. There is a possibility to appeal to Cyprus law, which has the notion of beneficial owner, but that would result in a legal collision with the Russian law that does not have such notion.

91. Let's assume that the Russian prosecutor's office (or another public authority) has nevertheless managed to obtain such data. Obviously, they cannot be of much use from the point of view of Russian law: if I fail to disclose information on the shares of company A in my possession I would violate the Russian law; but if I am a beneficiary, rather than the owner of company A, from the point of view of Russian law, *I am nobody, and I have not broken any laws, since I don't own the company*. Russian law does not prohibit being a beneficial owner of a company that has billions of dollars worth of assets, but does impose restrictions on the purchase of shares to the sum exceeding 75,000 dollars.

92. Certain steps have been taken lately to increase information transparency of offshore entities in order to prevent unlawful activities directed at legalizing illicit profits. On 21 March 2002 the Russian FKCB and the Central Bank of Cyprus have signed a Memorandum of understanding. This document sets the main principles of cooperation and information exchange between these authoritative bodies to exercise supervision and control of the stock market. There are plans to sign similar memoranda with the Czech Securities Commission.

93. However, the parties' ideas about the possibilities of such cooperation turned out to be quite contradictive. It concerns, above all, the granting of information on Russian beneficial owners by the Central Bank of Cyprus. According to a statement by FKCB Chairman (later refuted), such information *is granted* to the Commission within the frames of the agreements reached.⁵⁰ Nevertheless, according to Art.11 of Cyprus International Trusts Law 1992 (No.69(I) of 1992)⁵¹, a beneficial owner or another person, including government officials and officers of the Central Bank of Cyprus, shall not disclose information or documents revealing the names of a trust founder and beneficiaries to an unauthorized person other than by a court decision. Even these "non-transparent" data on prospects for information disclosure on beneficial owners, according to estimate, have already caused a decline in the foreign companies' interest towards this jurisdiction.⁵²

94. It is also quite obvious that the tightening of currency legislation and financial (tax) control over Russian companies' relationships with offshore companies abroad, as well as the toughening of international policy, would only lead to the emergence of more sophisticated patterns. Declining the use of traditional offshore companies, Russian companies would more actively resort to the services of the European entities that do not have an offshore status (companies in Hungary, Iceland, holdings in Denmark, Finland, and Spain, in addition to traditional holdings in Luxembourg, the Netherlands, etc.). Legal entities and private persons carrying out financial transactions and interested in full confidentiality of beneficial (real) owners, would invigorate their activities in the Pacific and Caribbean regions (Belize, St. Vincent, Dominica, Panama, and the Seychelles).

⁵⁰ Statement by FKCB Chairman I.Kostikov at the conference «International Tax Planning for Banks, Insurance and Financial Companies in RF» (Geneva, 15 March 2003).

⁵¹ http://www.centralbank.gov.cy/media/pdf/ITLWE_ITCSLAW.pdf

⁵² «If information on the true owners of Cyprus companies is handed over to Russian officials, it would be bad for everyone. The implications would include mass-scale criminal proceedings on charges of concealing profits, evading taxes, violating the law on the purchase of foreign companies' shares" (Golikova L. Russia Billions Are Left without Cyprus. – Comersant, 2003, 27 May, p.20). "Many people are willing to pay taxes, but are not ready to say out loud who the true – beneficial – owner of the company is. Disclosure of this information could trigger the liquidation of all offshore companies without exception... The Russian authorities are interested in finding out the origins of the primary funds that ended up... in an offshore company. To be more specific, information whether this Cyprus company and the Russian seller of stock or issuing entity whose shares are purchased in Russia are affiliated. The CB of Cyprus may well demand information on the origins of these funds presented by the company in the form of reference. According to the law, this document must be signed by the beneficial owner rather than a trust manager. This paper would arouse keen interest of the Russian officials... However, there is an antidote for any poison. Patters of information concealment still exist. (Kislitsina M. Russians Own up to 40% of Cyprus Companies. – Op.cit.). It is also apparent that many transactions of offshore companies can be contested by MAP.

3.5. Antimonopoly Regulation and Beneficial Ownership Information Disclosure

95. The problem of information disclosure on beneficial owners is very important within the context of antimonopoly regulation and control of economic concentration.⁵³

96. According to Art.18 of the Federal Law “On Competition and Restriction of Monopolistic Activity on Product Markets,” the acquiring by a person (group of persons) of voting stocks (shares) in the charter capital of an economic entity, with the said person (group of persons) gaining the right to dispose of more than 20 percent of the said stocks (shares) shall be done with preliminary consent of the antimonopoly body on the basis of an application from a legal or natural person. Preliminary consent to carry out the said transactions is required if the total asset value stated in the latest balance sheet of the aforementioned persons exceeds 200 000 minimal salaries or if one of them is an economic entity listed in the Register of economic entities that have over 35 percent of a certain product market, or if the purchaser is a group of persons controlling the activity of the said economic entity. The antimonopoly body dismisses the application, among other things, if granting the application can lead to restriction of competition on the product market, including as a result of emergence or strengthening of an economic entity’s (entities’) dominant position. In some cases the law also envisages the possibility of purchasing shares in the charter capital of economic entities by notice.

97. All major mergers and acquisitions in Russia, just like in the US, for example, are formally subject to antimonopoly control on the earliest stages. In reality, however, MAP RF is contacted *post factum*, after the necessary block of shares has already been purchased by a certain number of formally independent companies, and the control gained by the group needs to be legalized (for various reasons, including the group’s reorganization).

98. Quite often it is precisely the desire to evade the aforementioned requirements of the law that is the prime reason of concealing information on the true purchasers and owners of blocks of economic entities’ shares. Frequently major Russian companies have special departments and units (often branched out into independent companies, formally not connected with the principal company), whose objective is to develop schemes for concealing information on the actual buyers of stocks of some or other company. As a matter of fact, in order to implement these schemes several different legal entities are usually set up, which makes it practically impossible to identify the real beneficiary. In addition, to evade the requirements of the law one transacted is being “broken” into several, or the shares are purchased by several offshore companies established in zones where confidentiality regimes exist with respect to beneficial ownership information.

99. A typical example of MAP opportunities in this sphere is the purchase of gas distribution networks, presumably, by Mezhhregiongaz company in 1999-2000. However, MAP has no evidence that the shares were purchased exactly by this company, as the acquisitions were carried out by companies set up by Mezhhregiongaz, where the founder’s stake is formally small.

100. The biggest deal in the aluminum sector in 2000 (consolidation of 70% of assets within the frameworks of Russky Aluminy) definitely went beyond the frames of a routine MAP decision. Russky Aluminy LLC was registered in spring 2000 in Omsk, but blocks of shares of aluminum and alumina companies remained in the hands of offshore companies. Hence, there was no subject for MAP consideration, as the activity involved nothing more than a “redistribution of capitals within joint stock companies... Some offshore companies were selling their interests to other offshore companies.”⁵⁴ The MAP official point of view, however, was that a structure like Russky Aluminy has a right to exist due to its predominant export orientation, while the existence of three holdings in the sector (besides Russky Aluminy, there is SUAL and North-West, at that time not yet acquisitioned by SUAL) ensures a sufficient level of domestic competition. Later, however, real assets were transferred to Russky Aluminy.

⁵³ See detailed analysis of problems relating to economic concentration in: Radygin A., Entov R., Shmelyova N. Problems of Mergers and Takeovers in the Corporate Sector. M., IET, 2002. See also: Aistova M.D. Restructuring of Enterprises: Problems of Management. M., Alpina, 2002; Varlamova A.N. Legal Regulation of Competition in Russia. M., YurInfoR, 2002; Khabarova I.A. Corporate Governance: Problems of Integration. M., ALPINA, 2000.

⁵⁴ The presented viewpoints belong to Minister for Antimonopoly Policy I.Yuzhanov, Deputy Ministers for Antimonopoly Policy A.Tsyganov and A.Golomolzin, related in their interview with Commersant in 2000.

101. In 2000, MAP RF was granted the right to request data on sources and volumes of assets debited to companies' accounts. According to Art.18 of the Federal Law "On Competition and Restriction of Monopolistic Activity on Product Markets," the federal antimonopoly body shall dismiss the application (for a transaction) if granting the application may result in restriction of competition on the product market, among other things, as a result of emergence or strengthening of an economic entity's (entities') dominant position, or if the antimonopoly body discovers during the consideration of documents that the information important for decision-making contained in them is unreliable, or *the participants in the transaction have failed to timely present information on the sources, terms of obtaining, and size of cash assets and other property required for carrying out the transaction, demanded by the antimonopoly body*. This changes the nature of antimonopoly investigation, enabling to consider the application for virtually an indefinite period of time, seeking to reveal the actual connection between formally independent transactions. MAP is formally entitled to repeatedly request these data until the ultimate beneficiary in the transaction is finally revealed.

102. According to estimates of MAP RF itself, control is often onerous today both for the market actors and for MAP. On average, MAP RF okays approximately 94% of all transactions, imposes certain conditions for 5% of the deals, and dismisses 1%. Without going into the entire spectrum of possible improvements, let us only outline those directly related to the problem of beneficial ownership:

- adoption of amendments to the law on competition, simplifying the procedure of antimonopoly control (raising the quantitative threshold of transactions which require permission of the antimonopoly body, simplifying the system of considering applications for mergers and takeovers);
- development of more detailed criteria of establishing control over the activity of an economic entity in antimonopoly law (the definition based on over 50% of voting shares, the composition of the board of directors, the executive body, or another collegial body of an economic entity offers excessively simplified interpretation of corporate interaction);
- harmonization of antimonopoly law and corporate practice;
- detailed definition of the criteria of "acquiring by a person (group of persons) of rights enabling it to determine the terms and conditions of an economic entity's entrepreneurial activity" (Art.18 (1));
- adoption of the Law "On Affiliated Persons."

3.6. Law against Legalization (Laundering) Illicit Profits and Information Disclosure on Beneficial Owners

103. Certain measures are being taken lately in the world in general and in Russia, in particular, to oppose the laundering of illicit profits. One of the areas of activities aimed against illicit profit laundering is the adoption of measures aimed at identification of beneficiaries in money transactions.

104. In accordance with Art. 7 of the Federal Law "On Resistance to Legalizing (Laundering) Illicitly Gained Profits and Financing Terrorism,"⁵⁵ organizations carrying out transactions with money or other property, specifically, credit organizations and professional participants of the stock market, shall, among other things, documentarily register and submit to an authorized body not later than the workday following the day of the transaction, inter alia, data needed for identifying the recipient in the transaction involving money or other property, and his representative.

105. In particular, in order to identify and scrutinize a client which is a legal entity, a credit organization obtains the information on *founders, owners of property of the legal entity, persons empowered to issue obligatory instructions to the economic entity or in some other way influence its decisions, including information on the principal company or the main participating company, holding company, or financial-industrial group* (if the client

⁵⁵ Federal Law No.115-FZ of 7 August 2001.

participates in it). It is also necessary to obtain data on the person opening the account for the legal entity (making a deposit in favor of the legal entity) if the account is not opened (the deposit is made) by the legal entity itself.⁵⁶

106. The subordinate legal framework of the Law “On Opposing Legalization (Laundering) of Illicit Profits” is being gradually developed, but according to estimate, so far it has not made a serious impact on the use of offshore companies.⁵⁷

107. In keeping with FKCB Instruction “On Methodological Recommendations for the Implementation by Professional Stock Market Participants of Requirements of Federal Law No.115-FZ of 07.08.2001 “On Opposition to Legalization (Laundering) of Illicit Profits,”⁵⁸ organizations – professional participants in the stock market should develop programs of exercising internal control, including *client identification and examining programs*.

108. Although the adoption of the aforementioned rules for identifying beneficiaries and bank clients which are legal entities and the presentation of the relevant data to bodies engaged in fighting legalization (laundering) of illicit profits aroused stormy discussions about their conformity to deposit protection measures, these requirements of the Russian legislation fully agree with the globally adopted measures of fighting the legalization (laundering) of illicit profits. For instance, in accordance with the International Convention for the Suppression of the Financing of Terrorism,⁵⁹ the convention member states cooperate in preventing criminal legalization of illicit profits, in part, by amending domestic legislation, including the adoption of *rules prohibiting the opening of accounts whose owners or beneficiaries are no identified*, and measures to ensure verification of the persons of the real participants in these transactions.

109. It should also be noted that in keeping with the Wolfsberg principles,⁶⁰ banks must identify beneficiaries on every account. If a client is a trust manager, it is necessary to ascertain the trust structure to an extent enabling to identify the origin of the funds, persons controlling fund movement, and identify persons or institutions authorized to dismiss trust managers. Nevertheless, the application of the said Principles is voluntary for the banks. Only twelve international banks have signed them by now.⁶¹

110. The amendments to the RF Law “On Banks and Banking” under consideration in 2003 are targeted at restricting the share of offshore companies in the charter capital of banks to 10%. Earlier these restrictions were to be imposed for banks participating in the deposit insurance system. At present the plans are being discussed with respect to all banks, with restrictions to be imposed not only on nominee owners, but also on companies that control them. In this way it is planned to extend control so as to reach the ultimate owners. At the same time, a number of representatives of the banking community have voiced a logical objection that such restrictions should initially be imposed on Russia’s major corporations generating most of GDP. Another obvious effect would be simple extension of the control chain in banks unwilling to reveal the ultimate owners.

111. In conclusion, we would like to draw your attention to the fact that the opposition to legalization of illicit profits is presently hampered by the absence in Russian law of a legal definition of beneficial owner accepted in international practice, as well as requirements for identification of beneficial owners.

⁵⁶ These requirements are set by CB Letter No. 137-T of 28 November 2001 “On Recommendations for Development by Credit Organizations of Internal Control Rules for Purposes of Opposing Legalization (Laundering) of Illicit Profits and Suppressing the Financing of Terrorism.”

⁵⁷ Tax Consulting U.K. estimates.

⁵⁸ FKCB Instruction No.613/r of 3 June 2002.

⁵⁹ The Convention was adopted on 110 January 2000 and ratified by Russian Federation Federal Law No.88-FZ of 10 July 2002.

⁶⁰ The Global Anti-Money-Laundering Guidelines for Private Banking (the Wolfsberg Principles) were signed on October 30, 2000.

⁶¹ CBR Letter No.24-T of 15 February 2001 “On the Wolfsberg Principles.”

CONCLUSIONS AND RECOMMENDATIONS

112. The principal incentives for information disclosure on beneficial (real) owners, as demonstrated above, consist in objective prerequisites existing at the levels of companies themselves. Nevertheless, the formation of a civilized corporate governance system in Russia is impossible without setting requirements of information disclosure on beneficial shareholders. The solution of this problem is also directly connected with the tasks of effective prevention of corporate tax, antimonopoly, and other offenses, as well as the efficiency of struggle against legalization (laundering) of illicit profits.

113. The White Paper⁶² prepared on results of the Round Table on corporate governance in Russia maps out the necessity of some amendments: to explicitly define the responsibility for notifying about the changes in the structure of company property and control; to apply a single and unambiguous approach to disclosure by shareholders of information on the changes in their property to the company, the stock exchange and the public, and to provide opportunities for identifying beneficial owners; to envisage sanctions for nondisclosure of information both for cases of coordinated actions of the parties, and cases involving parties *de facto* and *de jure* controlled by other stakeholders, etc.

114. At the same time, the situation with beneficial ownership information disclosure is quite complicated at present. It should be well understood that *effective solution is only possible on the basis of a set of measures*.

115. (1) *Fixing the notion of “beneficial owner” in Russian law* should be considered as the maximum objective. According to some estimates, the introduction of the notion of beneficial owner to the RF Civil Code would be similar to adoption of modern international standards in this sphere, and this is the only possible way of exercising effective control of real owners and overcoming legal collision of jurisdictions.

116. (2) The lack of the notion “trust – beneficial ownership” in Russian law is crucial for purposes of identifying beneficial owners. This leads to *overt legal collisions with other jurisdictions when attempts are made by supervisory and law-enforcement bodies to exercise joint (international) control and monitoring*.

117. A natural way of development of the legal concept of trust in Russia (and, accordingly, effective protection of property rights of all participants in trust relations) should consist in the adoption of a concept of “split” property rights and analysis of mutual standing of the principal and trustee *with respect to each concrete trust deed* and to the situation described by a concrete legal act. This requires, in part, the adoption of certain elements of the Anglo-American legal tradition.

118. (3) The biggest role in considering the problem of beneficial ownership as regards Russia is *de facto* identification of majority (controlling) company owners – beneficiaries. Of prime importance in this context is the overall policy of the state aiming at stimulating transparency of property and control. Political, tax, and legislative guarantees issues by the state against property redistribution if the companies adopt transparent property structures (crucial for Russia) are fundamentally important.

119. At the same time, the tightening of legislation from the point of view of openness of the property structure (including ultimate beneficiaries) should contribute, in part, to revealing concrete goals and states of the parties in the transactions. The development of corporate law and the law on the stock market specifically in the area of identifying the owners of stock should become a priority focus:

- provisions of FKCB Resolution No.27 of 2 October 1997 should be streamlined with Art. 8 of the Federal Law “On the Stock Market” (the Law stipulates that the right to demand information disclosure on stock holders belongs to the keeper of the company register, whereas in accordance with the Resolution, this right is granted only to the registrar);

⁶² White Paper on Corporate Governance in Russia. OECD, 2002.

- The nominee holder and the registrar shall be granted the right to request information on the ultimate – beneficial owner of shares under specific circumstances explicitly described by the law, in keeping with international practice. In the event of non-presentation of such information, the nominee holder and the registrar must refuse from rendering relevant services;
- it is necessary to legislatively fix the transparency of the chain of nominee holders;
- a detailed legal definition is needed to describe the range of responsibilities of register keepers, officials and employees, and the introduction of provisions to the RF Criminal Code concerning the responsibility of register keepers and their employees for misdemeanor (swindling, manipulations, non-presentation of information, participation in insider deals);
- it is necessary to look into the possibility of introducing a legal requirement of beneficial ownership information disclosure by *shareholders – offshore companies* (although this measure cannot become effective without the introduction of the relevant norms – on lowering the threshold of confidentiality and data disclosure on the ultimate beneficial owners – on the international level);
- The RF Code of Administrative Offense should be augmented with *provisions on administrative responsibility of owners* of stock for non-presentation of information or presentation of unreliable information on their ownership (in addition to the existing responsibility of the issuing entity, the professional stock market participant and persons rendering services of publication of the disclosed information);
- the Law “On the Stock Market” (or another act) should establish *the order of imposing civil responsibility on owners of stocks* for violating the law on the order of information disclosure on their ownership, and contain the list of entities empowered to sue stockholders for the violation of stockholding information disclosures procedures (the Federal Law “On the Stock Market” stipulates that the damage inflicted as a result of violation of the RF law on stocks shall be subject to compensation in the order established by RF civil law);
- The RF Law “On Joint Stock Companies” envisages the responsibility of affiliated persons to disclose information on legal entities in which they independently or jointly with their affiliated person (persons) own 20 or more percent of voting shares. It is necessary to introduce *administrative responsibility of affiliated persons* for the correctness, completeness, and timeliness of presenting information to a stock issuing entity (the RF Code of Administrative Offense does not envisage such responsibility);
- it is expedient to legislatively fix *the possibility of imposing civil liability on affiliated persons by third parties*, in particular, counterparts in related transactions and shareholders, for the violation of the law on joint stock companies by affiliated persons;
- the Law “On Joint Stock Companies” should contain a provision obliging open joint stock companies that meet certain criteria *to open their own web-sites* (simultaneously creating a legal framework for requirements of FKCB Resolution No. 03-19/ps of 1 April 2003 “On Disclosure of Information on Affiliated Persons of Open Joint Stock Companies”);
- it is necessary to ensure *a single approach to legislative provisions* requiring information disclosure on the owners of stocks (change in ownership), specifically: (a) to establish obligatory notification of the issuing entity about its ownership for “direct” and “indirect” (via affiliated persons and other instruments) shareholders and augment the existing laws with the necessary definitions; (b) to specify which information is needed for regulatory authorities, shareholders and investors, and for what purposes: information on holders of voting shares, any shares, or other underwritten securities; (c) to coordinate the requirements of Art.22, 23, and 30 of the Law “On the Stock Market” (part of which are unfeasible in practice), the Statute of the order of information disclosure on material facts... (approved by FKCB Resolution No.32 of 12 August 1998), the Standards of Issuance of Bonds... (approved by FKCB

Resolution No.27 of 19 October 2001), the Standards of Issuance of Stocks and Convertible Debentures (approved by FKCB Resolution No.16/ps of 30 April 2001); the Law “On Competition and Restriction of Monopolistic Activity” (“indirect management of votes”);

- it is also necessary to work out a single approach to “large blocks of shares,” envisaging two levels of monitoring: first – the share in the charter capital, total votes, indirect ownership via affiliated persons, second – definition of the share in the charter capital (total votes), which is the real threshold of influence in a company;⁶³
- a legislative provision is needed on compulsory disclosure of information on indirect influence: *agreements between shareholders* of the company and its affiliated persons on coordinated influence, *trust management* of the company shares, *shares transferred to enforce obligations* with the transfer of voting rights, etc. (as a material fact);
- although the law envisages the issuing entity’s duty to disclose information on material facts, it is also necessary to introduce *corresponding responsibility of shareholders* to publish information on the purchase of the aforementioned quantity of the issuing entity’s shares (otherwise in any circumstances the responsibility for non-presentation or inadequate presentation of the said information to the public (as an alternative, it is possible to introduce public duty to disclose material facts exclusively on a quarterly basis);
- to specify the notion “data on the issuing entity” in the RF Criminal Code (Art.185.1) envisaging criminal responsibility for persistent non-presentation or inadequate presentation of information on securities specified by Russian Federation law to the investor or controlling authority, bearing in mind fixed evasion of presenting information on an issuing entity’s shares;
- increasing the responsibility of officials of open joint stock companies, the collegial body and the managing company for non-presentation or distortion of information on the company shareholders;
- adopting a legal provision allowing the recognition as null and void a transaction with the participation of a company whose real owner cannot be identified;
- lowering legal requirements to private joint stock companies not targeted at drawing investment on the stock market (JSC and LLC);
- it is necessary to adopt and enforce the requirement of the International Organization of Securities Commissions (IOSCO) on disclosure of non-financial information for trans-border listing and placement (the issuing entity must justify the confidentiality of information demanded from it by a third party, specifically, a regulatory body). In other words, protection of commercial secret is necessary, but it should not be used as a pretext for justifying the concealment of substantial information, which is traditionally disclosed in other countries;
- introduction to the RF Criminal Code provisions envisaging criminal responsibility for preventing public control (given that the criteria of such prevention are explicitly defined).

120. (4) The problem of beneficial ownership information disclosure cannot be adequately tackled without a broad spectrum of amendments to *corporate law in general* (besides information disclosure proper):

- regulation of a monitoring insider deals on the stock market (adoption of a special law);

⁶³ In the opinion of T.Medvedeva and A.Timofeyeva, it is expedient to establish a single 10% vote influence threshold. If there are privileged and other types of shares (with differing nominal values, privileged multi-vote shares, etc.) the share in the charter capital does not provide real information on the owners, therefore the actual number of votes turns out to be more important (speech at the OECD –World Bank Round Table on corporate governance in Russia in 16 November 2000).

- detailed elaboration of legal requirements to major transactions and related transactions;
- regulation of takeovers (the market of corporate control, detailed elaboration of provisions of Art. 80 of the Law “On Joint Stock Companies” or adoption of a separate law);
- adoption of a special law on reorganization of commercial organizations;
- protection of honest buyers (shareholders) against the consequences of applying voidable transactions with stocks;
- introduction of full economic responsibility of founders hiding behind nominees (similar to Art. 46 of the German law on joint stock companies);
- introducing requirements to cross-ownership of stocks;
- transparent regulation (control) of the activity of the actual controlling owners (and their managers) that can damage other groups of shareholders (dividends, transfer pricing, understating export prices, withdrawing assets, taxes, capital export, etc.);
- specifying the notion of “official” of a commercial organization (joint stock companies) in Russian law (both in the FKCB Provision on material events and in the Law “On Joint Stock Companies”), specifically, to compile an exhaustive list of persons responsible for violating corporate law;
- setting transparent requirements to the transfer of shares and blocks of shares owned by civil servants, in trust management for the period of their civil service;
- further tax encouragement of dividend payments (as a minimal legal norm on 5-7 years invariability of the low/zero tax rate for natural persons’ tax received in the form of dividends or, more importantly, profit tax exemption in the part of paid dividends from shareholding other companies’ stocks for legal persons.

121. Apparently, practically each of the problems listed above requires individual description, therefore is not specially dwelled upon herein.

122. (5) Antimonopoly law should be an important aspect of regulation in this sphere (at least as far as regulation of economic concentration is concerned);

- liberalization of legislative thresholds requiring consent of government authorities (MAP);
- it is necessary to include in the rules of control of economic concentration the possibility to take into account third parties’ opinions on the nature of the transaction;
- revision of the excessively simplified criterion of over 50% (voting shares, composition of the board of directors, the executive body, another collegial body of an economic entity) as the necessary condition of establishing control;
- coordinating antimonopoly law with corporate practice (specifically, streamlining the 20% shares thresholds in antimonopoly law and the 25% threshold needed for blocking influence);
- explicit definition in the legislation of the notion
- explicit definition of the criteria of “acquiring by a person (group of persons) of rights enabling it to determine the terms and conditions of an economic entity’s entrepreneurial activity” that can presently have a broad interpretation;

- looking into the possibility of introducing the notion of “group” (of legal entities, related companies, commercial organizations, etc.)⁶⁴ to Russian law, introducing adequate amendments to the Law “On Joint Stock Companies” (together with provisions of the RF Civil Code) that in its present form restricts such possibility (specifically, blocking the efforts aimed at bringing the controlling company to account for actions imposed on it by its affiliated company, and losses thus inflicted on the latter’s minority shareholders). It is expedient in this connection to study approaches to problems of corporate control and responsibility that exist in the German law on corporate groups and the French trade law;
- adopting a detailed Law “On Affiliated Persons” that does not restrict the subject to the goals of antimonopoly regulation (property structure transparency and detecting related transactions are no less important).

123. (6) Bank regulation is effective for purposes of monitoring beneficial ownership. Moreover, the introduction of the notion of “beneficial owner” can be introduced particularly quickly (for the legal system as a whole) precisely in this sphere. It is necessary, in particular:

- to toughen “anti-offshore” policy and effective monitoring with respect to “suspicious” financial transactions and new (outside the Bank of Russia “black list”) offshore jurisdictions;
- introducing detailed and exhaustive indications of a “beneficial owner” (specifically, within the frames of enforcement of rules prohibiting the opening of account whose owners or beneficiaries are not identified, and measures to ensure the identification of personalities of the real participants in such transactions⁶⁵);
- working out stimuli for adoption by Russia’s major banks of the Wolfsberg Principles (the Global Anti-Money-Laundering Guidelines for Private Banking signed on October 30, 2000);
- an attempt to interpret the notion of “real owner” with respect to banks and restrict the share of offshore companies in the charter capital of Russian banks to 10% (amendments to the RF Law “On Banks and Banking”).

124. (7) An effective reform of the accounting system could render an indirect positive influence on adequate solution of the problem. Transition to IAS would open up an opportunity to control consolidated accounts on the level of subsidiaries (over 50%) and associated companies (over 20%). Nevertheless, specific issues of identification of the ultimate beneficiaries of Russian companies cannot be tackled within the frames of transition to international standards alone (for example, the problem of consolidation of foreign trusts in IAS, the distinction of the role of dividends in the net profit according to IAS/GAAP and the Russian standards of accounting, etc.).

125. Apart from the general tasks of transition to IAS, it is necessary to envisage concrete measures of responsibility for presenting data within the existing accounting standards (PBU). For example, presenting PBU-based data on affiliated persons is obligatory for Russian enterprises, but practically no responsibility is envisaged for non-presentation.⁶⁶

126. (8) The solution of the said problem is impossible without international cooperation in information disclosure. It is necessary to step up relevant activity of FKCB and MAP (bilateral agreements, initiatives for the adoption of standards and regulations developed by international organizations, etc.). It is expedient to apply joint effort of all stakeholders (FKCB, MAP, MERT, MNS, Bank of Russia, law-enforcement bodies, etc.) to develop and adopt an integral concept of Russia’s international cooperation in beneficial ownership information disclosure.

⁶⁴ In the modern Western law such entities have different names: related companies, system of companies, organization of organizations, partnership of partnerships, secondary group partnership, holdings, financial-industrial groups, groups of companies, or companies.

⁶⁵ In keeping with the International Convention for the Suppression of the Financing of Terrorism (adopted on 10 January 2000 and ratified by Russian Federal Law No.88-FZ of 10 July 2002).

⁶⁶ Statute of accounting “Information on Affiliated Persons.” PBU 11/2000, approved by Order of the RF Finance Ministry No. 5n of 13 January 2000.

127. Apparently, the efficiency of this type of international cooperation is directly linked with globally adopted measures (OECD, EC, FATF, etc.) to amend the legislation of the relevant offshore zones.

128. At the same time, effective decisions are needed to work out approaches to offshore companies within the frames of Russian law. So far, broad opportunities still exist for carrying out transactions with stocks through offshore companies, and, in fact, so do the grounds for concealing the true owners (which is practically the same thing, concealment of the controlling block of shares or controlling influence via a system of affiliated persons). This concerns both the concealment of illegal transactions and carrying out absolutely legitimate transactions by most investors (therefore, there cannot be a single approach).

129. It is necessary to adopt a special law to regulate offshore business:

- develop a system of legal acts enabling the tax authorities to prevent the channeling of profit to offshore entities;
- liquidate internal offshore zones and introduce discriminate measures with respect to companies registered in external offshore zones (specifically, restrict the share of offshore companies in the charter capitals of Russian public companies, etc.);
- employing positive foreign “anti-offshore” practice (mandatory investigations of resident’s transactions with offshore companies, restrictions on setting up base firms in offshore zones, additional tax on all deductions made to offshore companies, the practice of examining trust agreements and taxation of the beneficiary even if no income has been paid to the latter, etc.);
- increasing the information level of public supervisory, tax, and law-enforcement bodies.

130. (9) Although Russian corporate law – despite the existence of a number of serious flaws – can be evaluated as quite well developed, legal innovation alone is far from enough to raise the level of corporate governance. *Inner corporate* initiatives and *corporate culture* play a substantial role in this respect. Achievements in corporate culture and culture of contracts in general are products of durable historical development, while concrete initiatives on the level of companies need objective conditions to be formed.

131. The recommendations of the Corporate Behavior Code are, undoubtedly, important within the context of the long process of development of corporate culture. Any attempts to use forced methods to ensure that all companies observe all standards of the Code are unproductive, but it is expedient to introduce a whole set of recommendations of the Code into corporate law. Specifically, in the sphere of information disclosure on the structure of property and control, it is information on indirect ownership, special agreements on formation of a block of shareholders, on “related” and other transactions affecting the interests of shareholders, and some others.

132. (10) Which system of obtaining beneficial ownership and control information can be selected, taking into account Russia’s specifics? OECD recommendations⁶⁷ suggest three options:

	System of obtaining preliminary information by the authorities	System of obtaining information through mediators (“corporate service providers”)⁶⁸	System of obtaining information with the use of the investigative system
1.	If this system is employed, the requirements for comprehensive disclosure of	If this system is employed, “corporate service providers” carry out the responsibilities of	If this system is employed, the authorities place full responsibilities

⁶⁷ Options for Obtaining Beneficial Ownership and Control Information. Paris, OECD, September 2002.

⁶⁸ In this case, mediators or corporate service providers mean: agents rendering services in establishing the company, trust companies, registered agents, lawyers, notaries, trust owners, companies rendering nominee shareholding services, directors and officers.

	beneficial ownership and control information are applied as early as the stage of establishing the company. This information shall be renewed in the event of any changes.	obtaining, verification, and accumulation of beneficial ownership and control information with respect to companies established with their participation, whose cases they handled, or companies that used their fiduciary services. The aforementioned mediators were to ensure access to this information for the authorities for purposes of conducting investigations of illegal actions and carrying out regulatory/controlling functions.	for obtaining information with the system of enforcement, subpoenas and other methods of interaction with companies for the purpose of identifying beneficial owners if there are suspicions of illegal actions.
2.	<p>The system of preliminary information disclosure is most appropriate</p> <p><i>in countries:</i></p> <p>1) with a poor investigative system;</p> <p>2) where a high percent of the company capital is owned by nonresidents (this particularly concerns companies owned by natural persons and holding companies);</p> <p>3) with a high proportion of holding companies and assets managing companies;</p> <p>4) where anonymity mechanisms can be applied.</p>	<p>The system of obtaining information through mediators is most appropriate</p> <p><i>in countries:</i></p> <p>1) with adequate mechanisms for monitoring the fulfillment of mediators' duties of obtaining beneficial ownership and control information;</p> <p>2) with a sufficient quantity of "service suppliers" that have the necessary experience and resources for collecting and accumulating beneficial ownership and control information.</p>	<p>The system of obtaining information with the use of the investigative system is most appropriate</p> <p><i>in countries:</i></p> <p>1) where the authorities have a strong enforcement system and possibilities for obtaining beneficial ownership and control information;</p> <p>2) with a reliable enforcement system;</p> <p>3) with an effective and rational legal system;</p> <p>4) where beneficial ownership and control information can be obtained within the borders of the same country.</p>

133. Following the aforementioned criteria, the choice for Russia is so far quite limited: the dominant mechanism in the mid-term should be the beneficial ownership and control information disclosure system envisaging the introduction of legal entities' responsibility to disclose information to government agencies at the state of establishment and registration, as well as the duty to regularly update this information in the event of any changes. The responsibility of beneficial ownership and control information disclosure to government agencies may be imposed both on a legal entity and on the ultimate beneficiary or organization rendering corporate services in establishment and organization of the company's management. At the same time it is apparent that effective employment of this system requires much to be done both in the sphere of corporate law and in many related spheres, including enforcement.