

SESSION VI: THE ROLE OF BOARDS OF DIRECTORS IN OVERSEEING DISCLOSURE

PRACTICES OF NON-EXECUTIVE DIRECTORS IN RUSSIAN COMPANIES

Presentation on by

Mr. Oleg Fedorov,

Member of the Management Board, National Association of Securities Market Participants (NAUFOR)
Russia

¹ Introduction

The value of transactions with the company's assets determines its profitability. Market pricing is the main feature of the market economy. The definition of the market value is introduced in the law on JSCs. (Quotation). However, there are serious problems in its determination. It is difficult to determine the market price, if there are no markets themselves. So in Russia there are no markets (exchanges) of oil, energy, gas, metals, and in the broad sense SM [Securities Market].

Article 77 of the law establishes that the market value of property and shares of a company is determined only by BOD [Board of Directors]. Criteria:

- Publications (not quotations!) on sales price
- Opinion of an independent appraiser
- Price at which a buyer is willing to pay all voting shares
- Net assets of a company.
- Publications = falsifications. In Russia 0.01% of OJSC's [Open Joint Stock Company] shares is quoted and traded in fact. Practically, appraiser's opinion works.

Conclusions

The law on JSCs allows to limit the minor Rights and the minor has the only thing to do – redemption (in 99% of the issuers.) but it completely depends on the market value. If the value is market – the right is protected, if not – the right is violated and nothing can be proved in a court!!!

The key subjects, able to influence on the corporate governance in Russia, are: corporations-issuers, the RF Government, state regulatory authorities (FCSM, MGI [State Property Ministry], MAP [Ministry for Antimonopoly Policy]), legislators (with respect to legislation), courts, Minyust [Ministry of Justice] (executive procedure), investors and professional communities, international financial organizations.

The given examples and other projects under the incidence of NAUFOR and Coordination center allow to make certain conclusions on the role of the said subjects and direction, in which it would be desirable for them to move.

RF Government.

- State authorities shall get from the Government clear instructions, actively contribute to protection of the investors rights and participate in the corporate governance reform.
- They shall become independent from the oligarchs' interests.

¹ 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. This paper is subject to further revision.

- The practice in Novgorodskaya region evidences that simple efficient and open interaction of authority with investors is highly valued by the latter and give positive effect in a medium-term perspective.
- It is necessary to recreate governmental commission on protecting investors rights with the structure similar to the commission, established by the RF Governmental decree № 730 in 1997. The commission shall include representatives of the Coordination Center on protecting investors rights and other organized investors associations.

Regulatory authorities.

- Active position of the FCSM is an exception from the rules.
- However, administrative authorities of the FCSM with respect to the issuers and its financing level are obviously insufficient.
- Granted authorities are not used to their full extent or used inefficiently. FCSM has not filed any independent claim in favor of shareholders.
- Obviously, it is necessary to increase (or, more precisely, to establish) administrative control over appraisers' activities and the process of fixing market value of joint stock companies' assets. It is necessary to increase the requirements for the appraisers and to describe in detail the procedure for fixing market value.
- There are required clear rules of determination and permanent control over structure of affiliated and interested persons from the part of FCSM and MAP.
- It is necessary that the Central Depository would transform from the paper structure into practically working body.

Legislation.

- The law in force does not ensure protection of both the minority shareholders and controlling stock owners.

There are significant shortcomings in laws on:

- determination of definition of a market value of company's assets and shares and a procedure for its fixing,
- control over structure of company's affiliated and interested persons.

Price manipulation is the main purpose or mean of many "corporate actions.

- Procedural rights of shareholders are limited in unjustified way.

The following items are described in an utterly poor way:

- executive procedures with respect to property rights to paperless securities
- and procedures for shareholders meetings,
- procedures for obtaining documents on demand from a company.
- There are no clear characteristics of bona fide purchaser of paperless securities and his rights.
- Wording of the law imposing liability on persons guilty of inflicting harm to a company or shareholders destroys almost every hope on their actual and effective implementation in a court.

Courts and Minyust.

- Shareholders' prejudice with respect to the Russian court system decreases the amount of shareholders' appeals to courts for conflicts resolution and increases the role of those methods of problem solution, adversely affect image of the market. Fruitless attempts to

appeal against the judge's decision in Mosalsk city almost in all authorities are especially demonstrative.

- Independence, safety and financing of NO and control over judges' decisions by way of disciplinary liability!
- It is necessary for the judges to understand the importance of thorough issuers' observance of the procedures established by the law.
- Terms of cases' consideration do not obviously correspond with the necessary ones. Even positive court decision, which is received too late, as a rule, becomes useless for shareholders.
- Regular cooperation of the judges with the regulatory authorities, professional investors communities is necessary for increasing professionalism of the judges and clearer idea of the customs of trade. Such contacts with the RF Higher Arbitration Court and the RF Supreme Court will help to provide more efficiently relevant interpretations on law implementation practice.
- It is desirable to establish specialized court structures on securities and corporate issues. Greater professionalism, independence and efficiency of the courts may substantially increase the investors confidence in the market.
- It is necessary to organize one more joint plenum sooner.
- According to YUKOS' practice it is necessary to achieve such interpretation of legislation, so that the shareholders may achieve abolishment of a meeting's decision, if at the moment of its holding there has been arrested a blocking stock (stock missing for blocking) and after such meeting grounds for its arrest have not been confirmed by a court decision in force.

Issuers.

- Literally they play the key role in the process of establishment of corporate and management culture in the country.
- Managers and owners of the companies obviously surpass minority shareholders in abilities for achieving set aims (any), have more financial resources and opportunities to lobby their interests.
- In Russia there is a tendency towards the issuers' stratification into those, who in a pointed manner ignore shareholders rights, and those, who declare a qualitative turn with "the face to the investors". Such processes have to be only welcomed and assisted. However, there has passed not enough time to examine sincerity of such declarations.
- Events of deliberate disregard of shareholders rights adjoin together with lack of knowledge of legal procedures or misunderstanding of importance of observance of the corporate governance principles for a company's future.
- Issuers violating shareholders rights have to be subject to administrative or court prosecution.
- Companies willing to become real market ones have to open as much as possible information on their activities, conduct all transactions at market prices, engage minority (portfolio) shareholders in control and management bodies, close "gaps" of legislation on protecting shareholders rights and interests with foundation documents.

Professional communities.

- NAUFOR has occupied the most active position on issues of protection of investors rights on the basis of the developed Program for protecting shareholders rights among the existing SRO [self-regulated organizations].
- On the initiative of NAUFOR there has been established the Coordination Center for protecting investors rights (Chairman D.V. Vasilyev).

- NAUFOR and Coordination Center have been actively assisting shareholders, reflecting their position, coordinating their activities, applying to state authorities for cooperation, bringing court actions in the interests of shareholders.
- Three cases at participation or patronage of NAUFOR have been passed to the RF Higher Arbitration Court in the supervision procedure.
- Unfortunately, we have not managed to involve exchanges into that process, since they consider protection of issuers interests as priority.
- Since the beginning of the year the further implementation of the Program for protecting shareholders rights passes on to the Coordination Center in the priority order. It will try to change attitude of all said subjects and to achieve establishment of favorable conditions for activities of any investors – foreign and national.

Investors.

- They have started to realize the importance of corporate governance quality as the criterion for selection of investment objects.
- Legislation gives them an opportunity to influence on company's corporate policy. However, practically everywhere it can be observed that portfolio investors in pure form are not able to protect their assets in a qualitative way and even to efficiently track status and plans of companies, in which they are shareholders.
- Practice certifies that portfolio investors should have and preserve blocking stock in company and learn to use it materially and to consolidate votes. Certain investors do not wish in principle to be occupied with this; other investors, as a rule, have weak regular and informational ensuring of these activities.
- It seems that the way out can be in strengthening of this direction of investors activities and in establishment of specialized associations for protection of shareholders interests.
- It is necessary for portfolio investors to use all their rights to join revision commission and board of directors of company.
- They have to unite their resources and to grant wide powers to representatives (nominal holders) with respect to forming of agenda and actions of meeting, realization of shareholders rights to perform redemption of company's shares or to obtain obligatory information.
- Unfortunately, methods of real protection of shareholders rights are extremely limited today. For the time being, the most fruitful are scandals in mass media and collective protests of investors.

International financial organizations.

Can help to form civilized corporate structure in Russia:

- if in order to grant loans of IBRD, EBRD, IMF and others start to stipulate that there should be relevant changes in legislation, perfection of court and law enforcement systems, effectiveness of work of regulatory bodies,
- if they are able to direct part of funds to establishment and support of information disclosure systems on market participants and to support of activities of investors associations, making protection of shareholders rights and perfection of corporate governance culture their aim,
- if they are able to develop and implement programs for teaching principles and mechanisms of corporate governance of representatives of state authorities, court-executive system, legislators and issuers.