

WHITE PAPER ON

CORPORATE GOVERNANCE

IN RUSSIA

White Paper on Corporate Governance in Russia

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Foreword

Good corporate governance is now widely recognised as essential for establishing an attractive investment climate characterised by competitive companies and efficient financial markets. The OECD and the World Bank Group have combined their efforts to promote policy dialogue in the area of corporate governance and have established Regional Corporate Governance Roundtables in close partnership with national policy-makers, regulators and market participants. Today, Corporate Governance Roundtables exist in Asia, Russia, Latin America, South -East Europe and Eurasia.

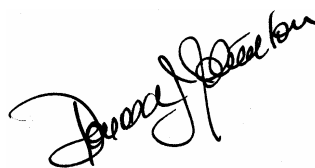
The work of the different Roundtables is adapted to the specific issues in the respective regions. But each Roundtable is using the OECD Corporate Governance Principles as a common framework for discussions and has agreed to issue a Regional Corporate Governance White Paper formulating key policy objectives and reform priorities. This White Paper prepared by the Russian Corporate Governance Roundtable is the first to be published. This, I believe, represents an important signal about Russia's commitment towards corporate governance reform, as underlined by President Putin, who in October 2001, stated that "*...Russia has a strategic goal -- to become a country that makes competitive goods and renders competitive services. All our efforts are committed to this goal. We understand that we have to solve questions pertaining to the protection of owners' rights and the improvement of corporate governance and financial transparency in business in order to be integrated into world capital markets.*"

Russia has made significant progress in corporate governance over the last few years. The legal and regulatory frameworks have been adjusted to provide for better protection against abuse, a voluntary code of corporate governance has been developed and market participants have become more alert to the importance of exercising good corporate governance. It will of course take time for the full economic benefits from this process to be realized.

It is important that Russia maintain the momentum for reforms and put in place credible enforcement mechanisms. Markets have to be reassured that corporate governance reforms are irreversibly shifting towards global standards as economic reforms start to produce results and the enterprise sector realises the value of better corporate governance. It is my sincere hope that the recommendations in this White Paper will be followed by a range of important national initiatives. These recommendations, which have been developed on a consensual basis, are a key tool for promoting, assisting and assessing progress in Russian corporate governance thereby helping to enhance confidence and international credibility in the reform process.

The organisation of the Russian Corporate Governance Roundtable and the development of this White Paper are the result of a co-operative effort. I would like to express my sincere gratitude to the World Bank Group and to all Russian institutions supporting this work, particularly the Federal Commission for the Securities Market, the Supreme Arbitrazh Court and the Ministry of Economic Development and Trade. I would also like to thank all private sector participants, labour union representatives, representatives of civil society, professional associations and other interested parties from across Russia. I also thank our partners at the Global Corporate Governance Forum and the United States Agency for International Development for their financial support to this important work.

Donald J. Johnston
Secretary General



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1. INTRODUCTION

1. Corporate governance is the system by which companies are directed and controlled. This involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. Good corporate governance should provide the proper incentives to pursue objectives that are in the interest of the company and the shareholders and should facilitate effective monitoring, thereby encouraging firms to use resources effectively.

2. During the last decade, policy makers, regulators and market participants around the world have increasingly come to emphasise the need to develop good corporate governance practices. The reason for this is an increasing amount of empirical evidence showing that good corporate governance facilitates corporate access to capital markets, improves investor's confidence and contributes to corporate competitiveness. From this perspective, considerable effort at the national and international level has been invested to promote and assist efforts to improve corporate governance.

3. The recommendations in this White Paper have been developed by the Russian Corporate Governance Roundtable, which has met regularly since June 1999. The Roundtable meetings have been organised by the Organisation for Economic Co-operation and Development (OECD) in co-operation with the World Bank Group, and have been co-hosted by the Russian Federal Commission for the Securities Markets (FCSM) and the Supreme Arbitrazh Court¹.

4. Participants to the Roundtable have been senior Russian and international policy makers, regulators and market participants. They have included representatives from the legislature, the government, the judiciary, regulatory authorities, stock exchanges, corporations, investors, stakeholder groups and individual experts. Representatives from international organisations, non-governmental groups and bilateral agencies with interest and expertise in corporate governance also participated.²

5. In developing the recommendations, the Roundtable has used the OECD Principles of Corporate Governance as a point of reference. The OECD Principles are one of the twelve core standards adopted by the International Financial Stability Forum to promote financial market stability and reduce the risk of future financial turmoil. This White Paper therefore establishes a direct link between today's Russian corporate governance agenda and internationally recognised standards.

6. Broad international participation has been strongly encouraged in order to ensure full Russian access to today's international dialogue on corporate governance and to provide Russian authorities, corporations and investors with an opportunity to discuss developments with their peers from OECD countries. The Roundtable has also taken an inclusive approach. Drafts of the recommendations have been circulated and made available for comments. The White Paper has been finalised on the basis of comments

¹ The Roundtable has also received financial support from the United States Agency for International Development and the Global Corporate Governance Forum.

² For a list of participants to the Russian Corporate Governance Roundtable, see annex A.

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and presentations during the various Roundtable meetings, as well as written comments on circulated drafts.

7. This White Paper has been developed on a consensual basis. Building on internationally recognised standards, it reflects what is commonly expected from Russian policy makers and the business community in an increasingly globalised economy. While priorities and details of legislation may differ among countries, a global consensus on the necessary framework for good corporate governance is rapidly emerging. Regional corporate governance White Papers are currently being developed by similar Roundtables in Asia, Latin America, and South-Eastern Europe.

8. The recommendations in this White Paper should be viewed as complementing other corporate governance initiatives by private and public institutions in Russia, such as the Corporate Governance Code, which has been developed by the FCSM. These recommendations are primarily concerned with corporate governance in publicly traded companies. Improving corporate governance is however a shared responsibility between the public and private sectors where individual corporations, investors and professional organisations need to play a proactive role. Experience has shown that it is ultimately a matter of self-interest for all members of the business community to assess their corporate governance regimes and implement the recommendations in this White Paper.

9. The recommendations in this White Paper should also be complemented by reforms in the area of public governance and corporate governance in the financial sector. Special attention should also be given to corporate governance issues in the on-going process of restructuring the Russian natural monopolies.

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2. KEY PRIORITIES

10. Until recently, poor corporate governance practices have been a drawback in establishing a sound investment climate in Russia. However, significant progress has been achieved during the last few years. Laws have been adopted or amended to provide for better protection against abuses. Policymakers, investors and the public at large have become alert to the issues and have pressed for change. Some of the largest corporations that have previously been the source of notorious abuses seem to be changing their behaviour for the better.

11. This progress has been fully recognised and complemented by the Roundtable. The credibility of Russian corporate governance practices and the development of equity markets will now depend on the ability to sustain momentum of these reforms, deepen their impact and render them enforceable and irreversible. As they are considered critical for Russia's ability to reap the full economic benefits of recent reforms, priority should be given to the following five areas:

A. Intensify implementation and enforcement

12. Highest priority should be given to strengthen the legal and regulatory framework to ensure effective implementation and enforcement of existing laws and regulations needed for the proper functioning of companies as well as securities markets. Effective implementation requires both sustained levels of investigation and enforcement and credible sanctions that are severe enough to deter violations. Of particular importance to enforcement are provisions relating to equitable treatment of shareholders, expropriation of corporate assets by managers or controlling shareholders and violations of disclosure requirements.

13. The legislature and the government should strengthen the judiciary's capacity to deal with commercial disputes. This requires that sufficient resources are made available to courts for hiring and training judges and other staff capable of performing their functions in a fully professional manner and with the level of integrity required for their positions. The streamlining of the rules on jurisdiction over commercial disputes will also help to develop the necessary expertise among judges that will result in a coherent predictable body of precedent.

14. Another important pillar is that the Federal Commission for the Securities Markets (FCSM) should be granted sufficient resources to pursue its core function to develop and enforce regulations. In order to make the best possible use of scarce human and financial resources, it is also recommended that the mandate of the FCSM becomes more explicitly focused on supervision of market intermediaries and monitoring of publicly held corporations.

15. Implementation and enforcement also concern investors and individual corporations. Stock exchanges, business associations, professional organisations and individual companies should develop and implement their own strategies for improved corporate governance.

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16. Russia should adopt in full and as quickly as possible International Financial Reporting Standards (IFRS) for publicly listed and non-private companies³ and be audited in compliance with International Standards of Audit.

B. Ensure clarity and coherence

17. Priority should also be given to provide clarity in defining the competency of different institutions and coherence among different legal and regulatory provisions.

18. Clear responsibility should be assigned for reporting changes in ownership and control. The regulatory authority for supervising the share registrars needs to be clarified. The status and liability of senior managers should be clarified and distinguished from that of other employees as regulated in labour law. Board members need to perceive their duties and liabilities clearly and explicitly.

C. Facilitate the development of a corporate governance culture in the private sector

19. Several Russian companies are beginning to capitalise on the benefits of good corporate governance. To assist them in this process, it is important that the legal and regulatory framework is understandable and that it does not burden the corporations with undue administrative costs. It is therefore important to develop and implement regulations to find the right balance between the costs and benefits of these provisions.

20. It is also important that the corporate sector develops, and assumes primary responsibility for, a set of corporate governance tools, such as the Code of Corporate Governance. Professional associations also need to develop their own ethical and professional standards that ensure legitimacy, improved quality of their members' services and credibility with market participants and the public at large.

D. Ensure continuing support and review of progress

21. Corporate governance reform in Russia is now at a critical stage. In order to ensure domestic and international credibility, the Roundtable should continue its work using this White Paper as the basis for promoting, assisting and assessing progress in Russian corporate governance. A core group will be formed to guide the work and provide input such as state-of-the-art expertise on specific issues as well as on related areas of corporate affairs affecting corporate governance, for example insolvency. The White Paper should also serve as a resource for Russian authorities and corporations that want to report on progress, to seek the opinion of the international business community and identify areas where technical assistance may be required.

E. Support and enhance the development of training programmes

22. An important task for governmental bodies, professional associations, and individual companies is to ensure the effective training of judges, government officials as well as managers, board members, accountants and auditors. This is of particular importance in order to raise the general awareness of good corporate governance, keep up with any changes in the laws, facilitate the transition to international financial reporting standards, and develop professional boards.

3 . Widely held non-listed companies.

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23. The Russian government, professional organisations, individual companies and the international donor community need to make available sufficient funds and resources to this effect. When building on international experiences, it is important that the training is adapted to the Russian context and reflects the needs of practitioners.

CHAPTER 1: SHAREHOLDER RIGHTS AND EQUITABLE TREATMENT OF SHAREHOLDERS

Overview of legal framework

24. Significant progress has been made in creating a modern legal framework for shareholder protection. In 1995, Russia adopted the Federal Law “On Joint-Stock Companies” (hereafter the JSC Law) that set out the principles for the protection of shareholders’ rights. This law is a significant improvement from the confusing legal framework that existed at the time of mass privatisation during the early 1990s. The duty to provide information to shareholders was considerably expanded through the Federal Law “On the Securities Market” adopted in 1996 (the Securities Law). In 1999, the Law “On the Protection of Rights and Legal Interests of Investors on the Securities Market” (the Investor Protection Law) increased the powers of the FCSM by providing a mechanism to fine companies for violation of disclosure rules. Finally, amendments to the JSC Law adopted in 2001 provide enhanced protection of shareholder rights, attempting to close various loopholes for abuse in potential major and interested party transactions. However, during the long delay between its first reading in April 1999 and its final enactment in August 2001, changes were made in some instances that weakened the provisions of the initial draft.

25. Shareholders with common shares may participate in a general meeting of shareholders and vote on all matters that fall within its competence. They have a right to information and are entitled to receive dividends, if dividends are paid, and in the event of liquidation, to a share in the company’s residual assets. The JSC Law allows preferred shares only up to 25% of the chartered capital. Preferred shares carry no ordinary voting rights but are allowed to vote on a narrow range of issues, defined in the law and company charter.

26. Shareholders with at least two percent of company voting shares have the right to introduce items to the agenda of the general meeting of shareholders and to nominate candidates to the board of directors. If the board refuses to include such items in the agenda or to include a list of candidates, the shareholder has the right to challenge this decision in court. A shareholder holding at least 10 percent of the voting shares has the right to call for an extraordinary meeting.

27. Shareholders with at least one percent of voting shares have the right to file a complaint against a member of the board of directors or management board, the CEO or an outside managing company, seeking reimbursement for damages to the company caused by their actions or failure to act. Any shareholder has the right to challenge in court a decision of the general meeting of shareholders, if the shareholder did not vote or voted against a decision, and the decision violated the shareholder’s rights and lawful interests. The amended JSC Law establishes a limitation period for challenging such general meeting decisions. The complaint must be filed within six months from the date when the shareholder learned or should have learned of the decision.

Recommendations

28. Regulation and monitoring of registrars should be strengthened and the responsibility for this regulation and monitoring clarified.

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29. Property rights protection begins with ensuring investors that their share ownership is registered in the company's books. The JSC Law only provides for registered shares in joint stock companies. While the JSC Law requires all joint stock companies to maintain a register of its shareholders, the 2001 amendments to the JSC Law make it mandatory for companies with more than 50 shareholders to transfer their registries to professional registers licensed by the FCSM. The Securities Law spells out the rules for registrars' operations and shareholders' rights to obtain proof of ownership from the registrar and requires that any transfer of securities be recorded in the company's share register. Finally, the FCSM has issued a significant number of regulations concerning registrars, without completely resolving the problem.

30. In the past, cases of manipulation and fraud in company registers were flagrant, jeopardising effective ownership transfer. These included refusal to re-register ownership rights or to transfer shares, illegally striking off shares from registers, changing share registration from common to preferred and accidental losses of records. Recently, the most frequent abuses have become less blatant and more typically concern refusal to give information to shareholders on companies or their ownership structures as well as improper handling of share transactions due to negligence. These problems are still occurring, especially in the regions.

31. The regulation and monitoring of the registrars has to be clarified and strengthened in order to ensure the highest professional standards. A clear set of regulations should include: (a) stricter licensing criteria regarding the size and the minimum number of clients of registrars, including banning a registrar from being an affiliated party of an issuer as the most critical issue remains the dependence of registrars on their main clients or shareowners (b) mandatory approval by the general meeting of shareholders of the choice of registrar and of the contractual terms between issuers and registrars. It would be useful if standard contract terms were provided, leaving only pricing and a few variables to be set by agreement. This would further improve the protection of shareholders from abusive contracts; (c) the possibility to impose significant penalties on registrars in cases of fraud or manipulation. The registrars should be held liable for violation of the rules in a credible way. This would include, regarding companies' own registrars making companies' managers personally liable. As for professional registrars, this would include the cancellation of licences; (d) in any event, the price set by registrars for disseminating information on the ownership structure should not unduly limit access by shareholders to such information.

32. The strengthening of regulation and monitoring of registrars requires a clarification of responsibilities between the FCSM and Professional Association of Registrars, Transfer-Agents and Depositories (PARTAD). The FCSM should be given the clear and official responsibility of setting regulation and monitoring compliance of registrars. However, mandatory membership of a professional organisation should be reconsidered as a regulatory option. This would allow more effective monitoring and improvement of professional standards.

33. PARTAD should, as a professional association, concentrate on providing services to its members, according to its present functions. It should focus its efforts on developing professional standards and on helping its members in applying them. In particular, it should develop its present activity of setting shared operational systems between registrars/depositories in order to improve the efficiency and reliability of the whole depository and registrar system. More generally, the association should also remain actively involved in projects to integrate the operations of depositories and registrars.

34. Notification procedures for general shareholders meetings should provide shareholders with the necessary information of the required quality on a timely basis.

35. The Russian JSC Law provides detailed rules on the procedures for calling and conducting a general meeting. In practice, a number of systematic violations have been reported which have often led to important corporate changes without the consent of shareholders. The most prevalent has been the failure

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to give shareholders adequate notice of the time and location of the general meeting and notification of the agenda. However, recent court decisions invalidated some general meeting decisions due to such violations. This is expected to discourage such abuses. More generally, the information needed for effective decision-making by shareholders has been lacking, especially regarding major transactions or changes in the capital structure to be approved or candidates to be elected to the board of directors.

36. In Russia, the mandatory 20 days notification period established by the law is in many instances insufficient to allow shareholders who vote by mail or who use nominee services to cast their votes. Companies should voluntarily extend the notification period to 45 days for the annual meeting as well as for extraordinary meetings. In the same vein, companies should hold all general meetings in central locations at a convenient date and time, in order to ensure easier access for shareholders.

37. The use of reliable corporate websites should be encouraged. The media can also play an important role in ensuring wide dissemination of the general meeting information. Companies should respect the spirit of the law and select widely distributed and easily accessible media.

38. Regarding listed companies, the FCSM should take a more proactive stand on checking systematically the procedures for general meeting notification as well as the publication of general meeting results.

39. To increase shareholder participation in general meetings, companies should improve the procedures for proxy voting and, when possible, make use of new information and communication technology for absentee voting.

40. The right to participate in a general meeting may be exercised by a shareholder both personally and through a representative. There have been numerous cases in Russia where procedural requirements for voting during the general meetings have not been observed and shareholders have been prevented from voting on various grounds. While absentee voting is possible, casting votes in absentia remains difficult in practice. Proxy voting is also quite rudimentary. For example, the Law provides that a proxy must contain the representative's passport data. In practice, interpreting "passport data" arbitrarily and the requirement of cumbersome certification procedures has prevented some "unwelcome" shareholders from participating in meetings.

41. Companies should use all reliable means for sending absentee ballots, including use of electronic telecommunications if such is available. Special attention should be given to security issues, especially regarding receipt by shareholders and return of the ballot to the company. If necessary, the appropriate security requirements for using electronic communications and information technology should be defined by regulation.

42. Rules and procedures should be devised to facilitate and encourage proxy voting as well as to reduce abuse. The provision of formal instructions by shareholders on the use of proxies should be facilitated. Large companies should also hire outside professionals to collect proxies and organise proxy procedures in a predictable manner. Moreover, shareholder protection groups should be allowed to assist minority shareholders in consolidating their votes at general shareholder meetings, including by way of proxy.

43. To address these procedural difficulties in securing votes, the FCSM and shareholder protection groups should work together to develop a set of rules and practices that include sufficient checks against and remedies for possible abuse in the proxy process. These rules should also assign clearly the responsibilities for reaching beneficial owners in the dissemination of information and facilitating their participation in the corporate decision making process (i.e. general meetings).

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44. In particular, in case of American Depository Receipts (ADR) and Global Depository Receipts (GDR) issues, voting rights should be used in the best interest of holders instead of being automatically transferred to management. The FCSM should check that adequate measures to deal with notification and participation in general meetings have been taken into consideration by depositories. This could include, for example, contracting with a company in the relevant country to distribute information and collect proxies or ballots.

45. Companies should pay the dividends agreed upon at the general meeting within a reasonable time frame.

46. Until recently, Russian companies have seldom paid dividends to their shareholders and when they did, the delay between the general meeting decision and the actual payment was often unacceptable. The annual general meetings should clearly set deadlines for dividend payments. These deadlines should be as short as possible. Payment should be made at the same time to all shareholders. The 2001 amendments to the JSC Law largely addressed these concerns, and there is now a two-month cut-off date for companies who fail to establish a deadline during the general meeting.

47. The law should make clear that it is the responsibility of significant shareholders, domestic as well as foreign, to report changes in ownership to the company, the stock exchange and the public at large. The legal framework needs to have a single and coherent approach and enable the identification of beneficial owners.

48. It is essential that the ownership and control structure of an enterprise remains fully transparent to all shareholders under all circumstances. This is critical for outside shareholders to properly assess how control is exercised and evaluate their own position and interest in providing equity finance. Moreover, disclosure of ownership and control structures is key in order to effectively address abusive related party transactions, insider dealing and conflicts of interest, which are the most widespread and pernicious shareholder abuses. These abuses quite frequently involve the use of offshore corporate vehicles or holding structures controlled by management or controlling shareholders.

49. In order to be effective, legal requirements for ownership disclosure should explicitly address the case of parties acting in concert and being *de facto* or *de jure* controlled by other interested parties. Sanctions for non-disclosure should also cover these cases. In other words, the veil of corporations set up to hide abusive practices should be pierced wherever necessary to identify beneficial owners.

50. Requirements for disclosing ownership are scattered among different laws and regulatory acts in Russia. Moreover, these requirements are sometimes contradictory, or at least not fully consistent. Some consider the percentage of authorised capital, while others look at the percentage of votes. Some legal acts also consider indirect control, through nominee accounts. Finally, under current rules, there is no obligation to disclose even formal shareholders' agreements.

51. Legal and regulatory changes may thus be required in order to achieve consistency between different legal acts, by removing contradictions and harmonising requirements. The legal and regulatory framework should also clearly state the procedures and division of responsibilities between the different parties involved (the shareholders, the issuers, the registrars, the trustees, the FCSM).

52. With respect to open joint-stock companies, it should be clearly stipulated in the law and FCSM regulations that it is the significant shareholders themselves that have an obligation to inform the issuing company, the stock market and the public of their ownership, whenever this is required by the law. This includes the responsibility for timely disclosure of any significant change in stock ownership. Time limits for such information should also be explicitly provided in the law/regulation.

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53. This responsibility to disclose one's ownership also holds for significant ownership through nominee accounts. Financial institutions entrusted with these nominee accounts as well as registrars have to comply with the existing reporting requirements vis-à-vis issuing companies.

54. The FCSM should have sufficient means and legal authority to enforce the disclosure requirements regarding ownership and control structures (please refer to paragraph 197 in Chapter 5). It should actively check that listed companies provide accurate and timely information on their ownership and control structure.

55. Where necessary and feasible, the FCSM should also conduct its own information inquiries into indirect shareholding positions, as this would significantly improve the ability to identify abuse early on. It could, for example, intensify contacts and enter into agreements with other regulatory agencies and bodies (e.g. company registrars) that may facilitate obtaining and sharing information regarding beneficial owners.

56. The law should also provide adequate and credible criminal and administrative sanctions for failure to disclose significant changes in ownership. These sanctions should be sufficiently high and encompass shareholders, issuers, as well as registrars.

57. In order for companies to fulfil the legal reporting requirements concerning their ownership structure, they should work closely with their registrars to monitor changes in ownership.

58. The company should devote resources and set up mechanisms allowing them to effectively collect information on their ownership structure. Companies should, for example, make it clear in their contracts with the registrars that the latter should keep companies informed on a regular basis of the ownership structure, as well as significant changes in the ownership structures when these occur. The board of directors, assisted by the audit committee, should ensure that their registrars provide such information.

59. Companies should disclose this information appropriately, to the public in their financial statements, to individual shareholders on request and to the FCSM by informing them directly. In addition to meeting Russian disclosure requirements, companies should also make available in Russia information that they have already revealed in the context of foreign listings.

60. The responsibility and liability of managers and board members for disclosing their personal interests in any corporate transaction should be clarified.

61. Many investors in Russia remain frustrated in their efforts to confront abusive interested party transactions. This has been one of the most pervasive shareholder rights abuses, including in companies with significant state ownership. Lack of a clear definition of an interested party, lack of credible sanctions for failure to disclose interested party transactions and lack of access by injured parties to information about company transactions have all contributed significantly to this problem. . The Amended JSC Law now provides a more clear and broad definition of interested parties. Moreover, it also specifies the decision making process for approving interested party transactions. However, the law still does not contain credible sanctions that may be applied against the individuals who engage in self-dealing and/or fail to follow required procedures in this area.

62. The monitoring of compliance with mandatory approval procedures should be undertaken carefully also when the State or regional authorities may be considered as the "interested party" under the 2001 amendments to the JSC Law (art 81). Indeed, these amendments enlarge the definition of an interested party by including the State authorities "which have the right to issue mandatory instructions to the company". Even though the interpretation of this amendment remains problematic, it may become a

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useful tool to prevent transactions by state-controlled entities that serve state interests at the expense of other shareholders.

63. However, such provisions to avoid abusive interested party transactions will only be effectively complied with if there is disclosure of material interests. Currently, disclosure obligations for material interests exist only as regards specific transactions, namely major transactions. The law requires interested parties to a specific major transaction to advise the company of their interests but does not specify how. Consequently, reporting depends almost entirely on the good faith of the interested parties.

64. Abusive self-dealing should be prohibited⁴. In order to prevent such abuses, managers and directors should be held clearly responsible for the full disclosure of personal interests in any transaction, whatever its size. They should disclose these interests to the board of directors. Moreover, prior approval by the board of directors should be required. In order for the board of directors to be provided with enough time to judge the fairness of the transaction, notification should be made on a timely basis. To strengthen oversight, the board of directors may establish an audit committee consisting of board members that should check that the adequate decision making procedures are followed once such interests have been disclosed. In addition, the company should have internal policies to sanction cases where the manager or director fails to make the required disclosure. Court sanctions should also be available.

65. The limitations contained in the Labour Code on the overall amount of liability that may be imposed upon an employee are not appropriate in cases where management cause damages to the company through transactions in which they have an interest. In order to strengthen the incentives to comply with rules concerning such transactions, Russian legislation could provide for a broad-based criminal liability of directors for abuse of corporate funds, as this is the case in some OECD countries. The elements of such criminal conduct would need to be clearly defined in the Russian environment.

66. Courts should be able to preventively stop interested party transactions as an interim measure when there are sufficient indications of illicit self-dealing. In addition, one way of making it easier for shareholders and companies to seek legal redress could be a default determination of damages that can be easily applied in cases involving interested party transactions. Another avenue to consider could be to shift the burden of proof to the alleged interested party under certain circumstances, such as when the contracting partner in the transaction is a corporate entity whose beneficial ownership cannot be traced to an individual or publicly held corporation in a reputable market.

67. Compliance with approval procedures regarding major transactions needs to be improved.

68. Major transactions have been especially problematic in Russia. In the past, the provisions regarding major transactions were vague and sanctions for violations of approval procedures not always respected. The 2001 amendments to the JSC Law have clarified and completed the definition of major transactions⁵, as well as procedures for their approval.

69. Effective compliance with these new obligations is crucial. In many cases, this will require a vote at an extraordinary meeting of shareholders, as it is not always possible to wait until the scheduled AGM. Consequently, particular attention should be given to the respect of notification procedures for such

4 . It is also of the utmost importance that financial institutions such as banks, investment funds and custodian institutions adopt specific safeguards against self-dealing.

5. A major transaction is defined in the Amended JSC law as a transaction (including loan, credit, pledge or mortgage) or a series of interrelated transactions involving the purchase, alienation or the possibility of alienation by a company, directly or indirectly, of property the value of which constitutes 25 % or more of the balance-sheet value of the company's assets determined on the basis of the company's latest accounting reports.

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meetings and to the quality and timeliness of the information given to the shareholders prior to these meetings.

70. Shareholders should have access to an expedient remedy in case the required procedures for approving major transactions have not been respected. Courts should be able to rapidly issue a temporary order that suspends the execution of these transactions until the case concerning the breach of procedures can be considered. Failure to follow required procedures should be grounds for the transaction itself to be held void. If necessary, the JSC Law or the relevant portions of the Civil Code should be amended to clarify this and to define a reasonable limitations period.

71. Major transactions and changes in capital structures should be performed at a fair price that ensures equitable treatment of all shareholders.

72. All shareholders should be treated equitably in the course of major transactions and changes in capital structure. Until the adoption of the amendments to the JSC Law in 2001, the provisions of the JSC Law on new share issues were sufficiently vague to allow a systematic share dilution and the disregard of pre-emption rights. The JSC Law now makes pre-emptive rights compulsory during major changes in capital structures. Procedures for mandatory buy-backs were also adopted in cases of reorganisation, major transactions and amendments to the charter limiting the rights of shareholders.

73. In practice, companies have often been able to sell their stock to insiders for only a fraction of its true value, while major transactions have been done at the expense of minority shareholders by way of unfair prices. The JSC Law currently provides two ways to evaluate a company's share price: market capitalisation for traded companies and an independent appraisal for illiquid ones. But appraisals up to now have failed to establish confidence amongst investors, as in most cases the prices were significantly miscalculated. The independence of the appraiser is often questioned.

74. The recourse to independent appraisers should be encouraged. Specific procedures should be designed to enable their effective independence and improve the quality of their services. Indeed, an independent appraising mechanism is a critical tool to ensure that all shareholders are treated equitably during major transactions and changes in capital structures. Moreover, the availability of a fair appraisal mechanism is becoming even more crucial given the current wave of major reorganisations.

75. The liability of the appraiser for a manifest miscalculation of a fair value should be established and effectively enforced. The board of directors should also be held liable for relying on an expert where such reliance is not in reasonable or good faith, or for relying on an unqualified or non-independent appraiser.

76. The role of shareholder associations in developing better corporate governance should be fully recognised.

77. Shareholder participation is on the rise, especially as institutional investors are concerned. In this respect, the creation of investor protection associations in 1999 has been an important development. This signals the will of equity market players in Russia to put the corporate governance issue at the centre of reform efforts.

78. These associations should be full members in the process of improving corporate governance culture. Their role may also be expanded to improve enforcement through collective action procedures. They could provide other services to minority shareholders, allowing them to unite their voices.

79. Stock options and other stock-based compensation plans should be prepared with great care, be fully transparent and approved by shareholders.

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80. A small number of large listed companies have started to award stock options to senior management. These schemes can be a useful instrument to align the interests of managers and shareholders, to improve managers' incentives and thereby corporate performance. However, a legal framework for this new concept and practice needs to be developed in Russia. To begin with, the accounting treatment of such plans should be very transparent. Their effect on the capital structure, including possible dilution of existing shareholders, also needs to be transparent to shareholders.

81. It is important that shareholders are given the right to initially scrutinise and approve such plans and whenever there are any material amendments. In addition, disclosure regarding the implementation of the existing plans should be made systematically at the annual meeting of shareholders. Finally, there should be clear limits as to the amount of stock that can be issued in relation to the option plan as a percentage of total outstanding equity.

82. In general, widespread use of stock option plans is usually dependent on the existence of an efficient capital market as well as a fair and transparent price evaluation process. The lack of these conditions renders the implementation of stock option plans extremely sensitive to market manipulation by insiders. Combined with a history of share dilution, this suggests that the introduction of stock option plans in Russia should be pursued with great caution.

CHAPTER 2: THE ROLE OF STAKEHOLDERS IN CORPORATE GOVERNANCE

Overview

83. The competitiveness and ultimate success of the corporation is the result of teamwork that embodies contribution from a range of different resource providers including investors, employees, creditors and suppliers. Corporations should recognise that the contributions of all stakeholders constitute a valuable resource for building competitive and profitable companies. It is therefore in the long-term interest of the corporations to foster wealth-creating co-operation among stakeholders. The governance framework should reflect and recognise that the interests of the corporation are served by acknowledging the interests of stakeholders and their contributions. In Russia, many of these stakeholders are also owners. The recommendations in this chapter, however, concern their role as stakeholders and not their role as shareholders.

84. The debate in Russia on the role of stakeholders in corporate governance has been developed in a very different context from the one prevailing in OECD economies. This is not surprising given the Russian heritage. A major concern of transition regarding the development of the business sector was to move away from the model of the enterprise as a social unit towards an enterprise that is a profit-making entity based on clear property rights and capable of attracting capital.

85. In Russia, employees⁶ mainly derive their stakeholder rights from labour and trade union legislation. Under this legislation, in addition to rights granted to them such as minimum wage and social protection, employees have a right to participate in the governance of a company through representation in work collectives, trade unions and other professional bodies. Employees have a right to be informed by companies and to conduct negotiations through employee representatives in cases of increase of charter capital, reorganisation, liquidation and other key decisions that might have an impact on work conditions. Trade unions can also initiate such consultations. However, consultation and other labour rights contained in labour laws are not always observed in practice.

86. During the normal course of business, it is rare that creditors are represented on the board of directors, and when this occurs it is either because of special personal relations with directors, or because the creditor is also a shareholder in the company. On the other hand, according to the Civil Code and bankruptcy legislation, creditors have significant control over a company that defaults on its debt. Under such circumstances, creditors may request early fulfilment of the debtor's obligations or initiate bankruptcy procedures, receive information on decisions taken by management, and participate in the management of the debtor.

87. Outside of these legal obligations, only a small number of companies are starting to take voluntary measures to acknowledge good stakeholder relations as a valuable resource for building competitive and profitable enterprises in the long-term. Companies will need to actively address key stakeholder concerns, such as environmental policies and labour relations, as they begin to realise the long-term value of corporate reputation and to focus their efforts on consistent corporate performance. Such

⁶ The references to employees in this chapter address non-executive employees and not top management.

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issues are of particular importance to investors, including international investors, and will affect companies' ability to attract needed capital through equity markets.

Recommendations

88. The board of directors should ensure that adequate mechanisms are in place to provide familiarity and compliance with legislation related to the rights of stakeholders.

89. While Russian law does not assign clear responsibility for ensuring compliance with applicable laws, the governance structure of all companies should reflect their commitment to respect the legal rights of stakeholders. In practice, the board of directors should ensure that mechanisms are in place so that the corporation and its officers understand and observe the legal rights of stakeholders. An effective way for the board of directors to address these issues in a systematic manner is to annually prepare and issue a report on stakeholder relations.

90. Employees should be granted the right to obtain effective legal redress.

91. While labour legislation provides the possibility for employees to seek redress for violation of their rights, in practice there are no mechanisms in place to enforce it. It has been proven difficult for employees to use the legal system to enforce their contractual rights.

92. The protection of employees' rights should be strengthened, including an allowance for an effective legal redress mechanism. However, it is important in this regard that the legal standards and obligations for managers are addressed separately from those of non-executive employees.

93. Companies should consult and communicate with employees and other stakeholders.

94. Some Russian companies allow trade unions or other representatives of employees, creditors and also other stakeholders such as regional authorities to participate in the board of directors. However, this practice is not widespread. The participation of stakeholders in the governance of a company is therefore focused on consultation.

95. Employees have the legal right to be informed on, and be consulted by the board of directors on labour-related issues. Not only is such consultation required by law, it also provides the board of directors with a potentially useful source of information regarding labour relations and other company matters. Companies should strive to establish a consultation process on these issues.

96. Companies should consider establishing mechanisms for consultation with other stakeholders, such as regional authorities, environmental bodies, social protection and social service agencies and others, when this can be helpful in allowing them to prepare for critical corporate decisions or can help the enterprise to remain in compliance with rules. Further, a dialogue with key stakeholders enhances a company's reputation among consumers and the general public. It could also help limit the company's liabilities for matters such as employee severance pay and possible environmental problems.

97. Companies should follow agreed international instruments on corporate social responsibility such as International Labour Organisation (ILO) Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy as well as the OECD Guidelines for Multinational Enterprises.

98. Russian companies need to be responsive to the concerns and interests of local communities in which they operate. In many countries, there is an increased trend to address the corporate responsibility

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issue either by developing corporate internal codes or by following internationally agreed instruments, which set out voluntary standards of behaviour in areas such as social and environmental policy.

99. Corporate governance abuses by regional and local authorities should be prevented.

100. In many cases, local communities are legitimate stakeholders and corporations should take their interests into consideration through consultations. In Russia, this is especially the case in the widespread presence of large “company towns” or regions, which depend on one big employer. But there have been many cases where regional and local authorities have abused their relationship with corporations.

101. Some regional and local bodies have shielded insiders from take-over attempts, obstructed the enforcement of property rights, and perpetuated the system of using enterprises as a source of private benefits for managers and local officials. Regional or local bodies may also attempt to prefer local/regional competitors or owners to “outsiders”, or to control the commercial activities of enterprises in other ways (for example, by prohibiting sales of certain goods outside the locality or region).

102. This behaviour is often illegal, but the available remedies are not always effective. In some cases, the boundaries of proper regional/local authority may not yet be completely clear after the restructuring of these bodies over the past decade. Where this is the case, steps should be taken to clarify the role of the authorities through legislative or other means.

103. Abuses of the bankruptcy process should be effectively addressed.

104. Judicial practice has revealed numerous cases where bankruptcy procedures have been abused as a means to acquire assets or entire companies. They are also used to eliminate competitors, to strip assets or to exclude certain shareholders. These abuses have been facilitated by the bankruptcy administrators’ poor supervision. These problems have undermined the credibility of the bankruptcy law.

105. It is important that the Russian government and legislators take the necessary steps to improve the legal and institutional framework for bankruptcy and prevent abuse of the process.

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CHAPTER 3: DISCLOSURE AND TRANSPARENCY

Overview of disclosure rules and practices

106. A strong disclosure regime is critical to a market-based system of monitoring companies and is central to shareholders' ability to exercise their judgement and hence making use of their property rights. Shareholders and potential investors require access to timely, reliable and comparable information in sufficient detail for them to make informed decisions. There is currently a good legal and regulatory basis in Russia for obtaining basic information about a publicly listed company. The Russian JSC Law contains a list of documents that a joint-stock company is required to make available. The Securities Law and numerous regulations by the Ministry of Finance and the FCSM require additional disclosure. However, the application and enforcement of these laws and regulations is weak.

107. Since 1999, the Investor Protection Law has provided the FCSM with the authority to fine joint stock companies and their managers for violating information disclosure rules. The FCSM is required to publicly report every penalty it imposes. Important corporate events, such as major transactions, changes in the executive and supervisory structure and board of directors' decisions, must be announced in the FCSM newsletter, which is regularly published. Moreover, the Law explicitly makes it a broker's duty to provide current and prospective shareholders with a complete set of documents that would shed light on the structure, activities and policies of the company.

108. Stock exchanges in Russia have taken some steps to introduce tougher disclosure requirements. However, additional action needs to be taken to improve enforcement. The exchanges need to respond to compliance failures with sanctions and if necessary de-list a company that fails to comply with information disclosure rules.

109. A common and consistent financial language is a paramount requirement for a fully functioning market economy. International accounting and auditing standards⁷ are the most logical tool in the global market for full and fair financial disclosure. The introduction and implementation of IFRS in Russia has been a challenge. Historically, Russian Accounting Standards (RAS)-based financial statements have served as a statistics gathering function and are unsuited for decision-making in a market economy. In addition, they provide limited information to both management and investors. In contrast, international standards will provide the relevant and reliable information that is required in a market economy.

110. A new law on audit has been adopted in 2001. This law seems to incorporate most of the standards included in the IFAC international standards of audit. It also clearly distinguishes the audit process from a tax compliant audit that was previously the main focus of auditors.

⁷ International Financial Reporting Standards (IFRS) are increasingly becoming the benchmarks for accounting and have been endorsed by the International Organisation of Securities Commissions (IOSCO) and the Bank for International Settlements. IFRS and International Standards of Audit (ISA) were also identified as the key standards to follow by the Task Force on the Implementation of Standards of the Financial Stability Forum (FSF). The world's largest accounting firms and the International Federation of Accountants (IFAC), which represents the accounting and audit profession on the international level, support the use of IFRS and ISA. The FSF also identified the IOSCO objectives and principles of securities regulation as a key standard to follow and the IOSCO International Disclosure Standards for Cross-Border Offerings and Initial Listings by Foreign Issuers provide specific guidance on the content of non-financial disclosure.

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111. A handful of Russian companies have attempted to provide effective disclosure; however a large number still fall significantly short of international practice. Full and fair disclosure requires the provision of accurate material information, i.e. information whose omission or misstatement could influence the economic decisions made by the users of the information. Applying the concept of materiality as required under IFRS helps companies and auditors to decide what information is truly relevant to investors and other stakeholders. In Russia, this concept has not been well understood and insufficient or opaque disclosure of material information remains one of the main deterrents to investment.

Recommendations

112. Russia should adopt in full and as quickly as possible International Financial Reporting Standards (IFRS) for publicly listed and non-private companies⁸.

113. The quality of information is only as good as the standards under which it is compiled and disclosed. The 1998 Russian Accounting Reform Programme envisaged an evolving Russian Accounting Standards (RAS) system, which would gradually move closer to IFRS, as recommended by the International Accounting Standards Board (IASB). However, progress has been slow and reforms still fall short of full compliance. This is partly due to the significant difficulties inherent in a complete shift to IFRS. Issues of changing taxation provisions and separating tax from financial reporting accounting, inflation accounting, asset valuation and fair market valuation where markets are thin or absent, valuation of non-cash transactions and the way to handle discounting of debts for the likelihood of financial recovery, have posed serious problems.

114. The Ministry of Finance adopted a new 10-year plan for the transition to IFRS. It includes four stages. During stage one (2001-2003) Russia would develop tax reconciliation procedures for RAS and IFRS reporting. At stage two (2003-2005) a legal and market environment would be established to support the transition to IFRS at the corporate level. At the same time, the Finance Ministry would revise RAS to bring them closer to IFRS. At stage three (to commence in 2006), IFRS would become statutory for public companies. The plan divides companies into four groups by ownership, size and listing. Listed public companies are subject to the strictest requirements. They are encouraged to abandon RAS for IFRS starting from 2003.

115. The adoption of IFRS would be especially important regarding consolidation. Indeed, consolidation of financial statements is critical for understanding a company's business and its value to its shareholders. However, in practice, Russian companies often use different consolidation methods that do not follow the IFRS standards and do not meet investor expectations. Some large companies do not prepare consolidated financial statements at all. Subsidiaries of enterprises that report under IFRS should be required to apply IFRS in place of RAS.

116. As noted above in the shareholder chapter, the disclosure of company control structures is particularly pertinent for Russian companies. Furthermore, the following issues need to be specifically addressed in financial reporting : (1) Consolidation; (2) Non-cash payments and barter transactions that should be recorded and disclosed in the financial statements and the accompanying required notes; (3) More detailed segment information; (4) Undisclosed liabilities including notes on contingent liabilities or company guarantees; (5) Information on accounts receivable and payables including the age of the amounts and probability to collect; (6) Asset impairment write-downs; (7) Depreciation rules that are still focused on tax accounting; (8) Accounting policies, details on changes in equity, number of shares issued, extraordinary events; (9) Related party transactions and (10) Transfer pricing policies.

8. Widely held non-listed companies.

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117. Companies should expand disclosure to include non-financial disclosure of all information material to investment and voting decisions.

118. Disclosing more information than is required by the law will enhance the corporate governance image of businesses in Russia. It is important to realise that this information is not only useful to investors but is also important for the effective management of the company and will enhance company value. The initiative by a few companies to include this information in annual reports or by introducing corporate governance codes should be further expanded. These companies should further develop and discuss publicly their individual corporate governance norms.

119. While information that constitutes commercial secret should be protected, this is frequently used as a justification by management to withhold important information that in other jurisdictions is routinely reported. The issuer should be required to justify confidential treatment of otherwise required information before a third party such as the regulator, by establishing both the need for confidentiality and ensuring that the omitted information is not material.⁹

120. As voluntary best practice, the following specific information should be disclosed in addition to the basic financial information: (1) Company objectives, generally and for the upcoming period; (2) Information on board members and key executives, including remuneration; (3) Future trends and material foreseeable risk factors; (4) Governance and stakeholder policies.

121. Management and the board of directors need to be fully aware of their responsibility for all financial and non-financial disclosures.

122. In most Russian companies, management and the board of directors do not fully understand their responsibility for the preparation of financial statements, even if the law establishes this responsibility. If the board of directors and management do not take responsibility for and are not properly trained in financial disclosure, the auditor will face a more difficult and sometimes impossible task in preparing financial statements. The board of directors and management must be actively engaged in the process of preparing financial statements and other disclosures. The board's audit committee should be the ultimate driver providing the necessary checks and balances in the process of preparing disclosures.

123. In listed companies, the management and the revision commission should be required by law to provide a signed representation letter to the shareholders each year along with the annual financial statements. The representation letter should state that the financial statements represent fairly the financial information of the company and that to the best of their knowledge the company has fully complied with all rules and regulations. In this respect, a false statement should be treated as a false disclosure and be sanctioned as such by the FCSM.

124. Professional audit associations need to raise professional standards and monitor the quality of their members' performance.

125. Credible audited financial statements are a fundamental pre-requisite for Russian enterprises to obtain debt and equity financing in a significant volume and at an acceptable price. The independent external auditor is a critical link in establishing the proper checks and balances required for bringing global investor confidence into the economy. In Russia, an independent external audit does not always provide assurances to investors. Many independent audit reports are issued fraudulently by so-called "black auditor firms" who know the financial statements are materially misstated and are intended to deceive tax authorities and minority shareholders.

⁹ See, for example, the European Union practice regarding omission of information, described in Part II, Section XIV of the IOSCO Non-Financial Disclosure Requirements for Cross Border Offerings and Initial Listings By Foreign Issuers.

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126. Effective compliance with professional standards is critically needed. The adoption of the Federal Law “On Auditing” in 2001 is a positive step in this direction, as it provides two levels of quality control, at the federal level by the government regulator and at the level of professional associations.

127. Special emphasis should be put on professional standards regarding the independence of auditors. In practice, management often exerts pressure on shareholders to approve auditors that have been selected on non-objective criteria and often have conflicting interests. This is the case, for example, when auditors enter into other fee-generating relationships with the company that may taint independence. Consequently, some auditors tend to overly favour management’s view of the company they are supposed to audit independently.

128. Further consideration should be given to the elements of the audit report to be disclosed to shareholders. At a minimum, material breaches of the law with an impact on financial reporting should be disclosed. A civil law remedy for fraudulent work by auditors could be introduced in these cases so those auditors can be held financially liable to the victims of negligence.

129. The licensing authority for auditors should be able to impose credible sanctions when there is audit failure. It should also closely monitor the work of professional associations. However, reinforcing self-regulation is also critical to improve the quality of audits and ensure the independence of the audit profession. Professional associations of accountants and auditors have the task of improving the qualifications and ethics of their members to meet international standards. These associations should be responsible for improving professional standards and imposing sanctions on members who neglect to adequately fulfil their responsibilities. The numerous professional associations within Russia need to be consolidated to a manageable number of credible associations that will fulfil this oversight role. In order to strengthen the role of these professional bodies, mandatory membership of auditors of public companies in the relevant association of their choice should be considered.

130. The FCSM and stock exchanges should require publicly listed companies to disclose any changes of auditors as well as the level of fees paid to auditors for non-auditor services.

131. According to the JSC Law, the general meeting of shareholders approves the nomination of the external auditor and the board of directors determines the amount of fees to be paid. A company is required to bring in an auditor who has no property interests tying him to the company or its shareholders. This external auditor conducts an annual audit and provides confirmation of the annual financial statement.

132. To protect the independence of auditors, it is important that management is deterred from changing auditors merely because they disagree with the auditor’s findings or opinion. Full disclosure of suggested changes and a discussion in the general meeting of the need to change auditors would enhance the effectiveness of audits in the long run.

133. Full transparency is also necessary regarding any fee-generating relationships other than the audit itself, which the auditors have with the company.

134. The government should have the ability to impose broader sanctions on compliance violations by the auditor.

135. Disclosure is not enough to improve the credibility of audits. The 2001 Audit Law includes some sanctions for compliance violations by auditors, including withdrawal of license and fines, and a reference to establishment of criminal liability for a deliberately false auditor’s report. The specified fines apply to conduct of audit by an unlicensed firm or individual, and to the avoidance of a required audit by a company. But the fines are not high enough to serve as a substantial deterrent to a large firm. Moreover, there are no sanctions on other kinds of violations. These sanctions would be especially relevant, for

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example, to prevent the preparation of an audit by parties with certain relationships to the audited entity. Victims (such as shareholders and certain creditors) of negligent, reckless or fraudulent audit work should have effective means of redress against the auditors.

136. To improve the fairness of disclosure, the FCSM and stock exchanges should prohibit asymmetrical disclosure to certain privileged parties and trading on material, non-public information.

137. Fair disclosure means that access to relevant information is available to all shareholders at the same time. The ultimate objective of fair disclosure is to create a “level playing field” for all market participants. At present, some Russian companies allow major shareholders to have privileged access to information. This undermines market integrity by exacerbating information asymmetries and opportunities for trading on insider information, which should be forbidden. This issue is receiving increasing attention in some OECD countries and is even more dangerous in Russia than elsewhere, considering the lack of legislation prohibiting trading on insider information

138. Due to the importance of fairness, the timing of disclosure is as important as the content of the disclosure. Information that is not delivered on a timely basis has reduced value. Delayed disclosure may be equivalent to hiding or misrepresenting information. According to Russian rules, financial statements and other information disclosure should be provided to shareholders on a timely basis. However, in practice there is an excessive time lag between the date of the material event and release of information to the public by the company.

139. Publicly listed companies should disclose routine company information, such as quarterly reports, on a periodic basis without time delays. Price-sensitive information should be provided immediately; this includes changes in key management, major transactions, losses of major customers, significant change in the company’s economic environment, major litigation, inside trading of shares, default on debt, and insolvency filing. This information is often not provided immediately by Russian companies. Monitoring of this timely disclosure should be the responsibility of the FCSM.

140. Companies and the FCSM need to improve information dissemination procedures by making information available to investors and the public through various channels, such as press releases, filings with the authorities, and posting information on their website.

141. The channels through which information is disclosed is critical to ensuring that users have timely, cost-effective and equitable access. It is the primary responsibility of the company to disseminate this information. However, regulating agencies and professional associations can provide mechanisms to facilitate the effective dissemination of this information.

142. The FCSM has started using new technologies to enhance the fairness and efficiency of the disclosure process, including the submission and access of financial and non-financial information by electronic means. Along this line, the charters of publicly traded companies are in the process of being made available on the FCSM server. The development by the National Association of Professional Participants of the Securities Market (NAUFOR) of an information disclosure tool, “SKRIN Issuer”, is another example of the potential effectiveness of electronic methods for disclosure. This instrument is used on-line and allows for information on 5,000 issuers to be disclosed at the same time to all interested parties.

143. In order to adopt a pro-active disclosure policy, large publicly listed companies should establish or significantly strengthen their Investor Relations Departments, as this is a major tool in building long-term relationships between investors and the company. One of their main first tasks would be to improve

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the information value of the companies' websites, including primarily general meeting notices, agendas, as well as information on main corporate events. These Investor Relations Departments should also be in charge of handling shareholders requests, queries and complaints. Companies should also make extensive use of mass media in disseminating information.

144. Major training and education programmes should be developed for companies, accountants and auditors, universities and the government.

145. The lack of experience by most companies, accountants and staff members of government bodies dealing with financial reporting is a major cause for concern. The proper application of standards requires improving the quality of the accounting profession. This will only come with sufficient training and expertise in companies, accounting firms and the government. Professional associations are expected to play a key role in developing and introducing these training programmes.

146. To facilitate the transition to IFRS and familiarisation by the business community, it will be important that practical guidelines on the implementation of internationally accepted standards be provided as quickly as possible to companies, the accounting/audit profession, and government. It should be also recognised that it is important to educate the next generations and thus design proper curricula for universities.

CHAPTER 4: THE RESPONSIBILITIES OF THE BOARD

Overview of legal framework

147. The structure, composition and functioning of the board are regulated in the Russian JSC Law and in the Civil Code. While certain provisions are mandatory, others are dispositive and allow some characteristics of the board to be defined in the charters of the individual corporations. The law stipulates that all companies with 50 or more voting shareholders are required to have a board of directors. All companies must have at least a single-person executive body (manager or general manager). On a voluntary basis, joint stock companies may further establish a management board. Russian law also mandates a revision commission that is independent of the board of directors and reports directly to the annual general meeting of shareholders (hereafter “annual meeting”) on the completeness and accuracy of the company’s accounts. The discussion and recommendations in this chapter concern the board of directors.

148. The JSC Law requires that the annual meeting elect the board of directors until the next annual meeting. There are no limitations on successive re-elections. Shareholders owning at least two percent of the shares can nominate candidates to the board of directors. A cumulative voting procedure is mandatory in companies with more than 1,000 common stock shareholders and is optional for other companies. The general meeting may vote to remove a board member before the expiration of the term. When the general meeting intends to remove a board member who has been elected by cumulative voting, a decision on early termination must apply to the entire board of directors.

149. The law requires that the board of directors of open joint stock companies with more than 1,000 voting shareholders have at least seven board members. The board of directors of companies with more than 10,000 voting shareholders should have at least nine members. The law restricts the participation of senior managers in the board of directors in two ways. Firstly, the chief executive officer is not allowed to serve as the chairman of the board of directors. Secondly, members of the management board can occupy no more than twenty-five percent of the seats on the board of directors. However, the law does not exclude participation of other managers and employees in the board of directors.

150. According to Russian law, the competence of the board of directors includes both procedural and strategic functions. In terms of procedural issues, the board of directors is for example required to convene and propose the agenda for the annual meeting and approve the company registrar. The board of director’s strategic responsibilities include the duty to determine the company’s principal areas of activity, propose dividends, approve major transactions, execute repurchases of corporate securities and determine the value of securities issues. The board of directors also gives preliminary approval of the annual report before it is submitted to the annual meeting.

Recommendations

151. Company law should clearly stipulate that it is the board of directors' duty, and the duty of each board member, to act in the best interests of the company and to treat all shareholders in a fair and equitable manner.

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152. Russian law does not include any provisions on the equitable treatment of shareholders by the board of directors. In practice, there is a widespread misunderstanding that board members are expected to owe their allegiance to the group that nominated them. As a consequence, board members often make decisions in affiliation with the interests of controlling shareholders, at the expense of other shareholders.

153. Directors appointed by controlling shareholders should have a duty to represent the shareholders collectively and not just the interests of the group that nominated them or otherwise influenced their election. In case a director has a clear conflict of interest in a transaction, the director should be excluded from deliberations and voting.

154. Special concerns are raised in large companies with significant state ownership, in which board members nominated by the state may prefer the broader state interest – including political concerns – over the interests of the company and its shareholders. Direct conflicts of interest may arise where the state nominates as board members officials whose other responsibilities include regulation or oversight of the company or management of a related sphere of the economy, and for this reason such officials should not be nominated as board members.

155. Board members should be provided with practical guidance on the meaning of the legal requirement to act “reasonably and in good faith”, in order to assist in determining what can be considered as “sound business judgement”.

156. The law requires board members in Russia to act in the best interests of the company and exercise their rights and duties towards the company “reasonably and in good faith”. Failure to meet this obligation renders the board members, individually or collectively, liable for “losses incurred due to actions or inaction for which they are at fault”. Individual board members, who voted against the decisions that caused losses, or did not participate in the decision, cannot be held responsible. The law allows a company or shareholders holding at least one percent of common shares to submit a claim for damages to the company in court against the involved individual.

157. In practice, however, board members and others are left with little guidance as to the meaning of the duty to act “reasonably and in good faith”. This lack of clarity does not only give an opportunity for misuse of board members’ authority, but it is also a problem for board members seeking practical guidance on appropriate conduct and for shareholders that wish to seek redress.

158. While any short definition of “reasonably and in good faith” is difficult to establish, useful guidance can be provided through the progressive building of cases and interpretations. It is therefore recommended that the business community, together with concerned regulatory bodies, judicial authorities, and the legal profession, engage in systematic work to produce a practical guide on the requirements for fulfilling the basic board of directors’ duties. Such a guide could include examples of proper conduct and references to authentic cases. One useful function of the Institute of Directors could be to provide training and orientation on the basis of such a guide. When developed over time, such guidelines could also provide the courts with a non-binding interpretation and practical implications of the duty to act “reasonably and in good faith” which should reflect what is considered to be sound business judgement.

159. Listing requirements should require companies to have a sufficient number of independent board members and apply a broader definition of independence than the current legal definition.

160. Russian law provides a rather narrow definition of an independent board member by defining it as somebody who, for the past year, has not been a company manager or a related party to the company. Family ties with someone who, for the previous year, has been a company manager or a related party to the company also disqualifies anyone as an independent director. Importantly, the legal concept and

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application of board independence is primarily aimed at regulating board member's participation in decisions that involve related party transactions, while there is a much wider range of significant issues that require an independent judgement by board members.

161. The use of independent directors generally improves the dynamics of the board of directors' work and its ability to make informed decisions in the best interest of all shareholders and the company. In particular, independent board members are expected to enhance the monitoring function of the board. This is especially important in an environment like Russia where the relationships between managers, controlling shareholders and board members are often very close and respective responsibilities sometimes confused. In Russia board members are still largely selected by controlling shareholders and therefore likely to be under their influence, even if they qualify as independent directors.

162. For this reason, stock exchanges should require that listed companies have a sufficient number of independent directors. Independence should imply an ability to exercise judgement independently, particularly from managers and major shareholders. An independent board member should not be employed by the company nor closely related to the company, its management or major shareholders through significant economic, family or other ties.

163. For the purpose of identifying, nominating and electing independent board members the existing cumulative voting provision in Russia should be respected, as it provides minority shareholders with incentives to nominate such candidates.

164. Companies should clearly recognise that in addition to strategic guidance, a key function of the board of directors is the duty to monitor management.

165. It is widespread practice in Russian companies to leave the board of directors to perform primarily procedural tasks. This attitude does not take advantage of the board members' individual skills and experiences that could improve the quality of corporate decision making. Moreover, it undermines the board's authority in an environment where managers have been repeatedly accused of abuse and expropriation of corporate assets.

166. In order for the board to fulfil its duty, it should be clearly recognised that its key functions are to monitor and evaluate senior management, as well as to provide strategic guidance. Other key board functions include management of conflicting interests, ensuring the integrity of the corporate accounting and financial reporting system and overseeing the process of corporate disclosure and communication.

167. In order to improve the dynamics of the board and its collective competence, the board should also regularly address director training and board performance evaluation.

168. Companies should strengthen the functioning of the board of directors through the use of specialised committees, in particular to improve oversight of the audit, nomination and remuneration functions.

169. While the law does not contain any provisions pertaining to the delegation of particular powers of the board of directors to committees, it does imply that the board can constitute and empower committees to perform important elements of its mandate.

170. An increased use of committees with specific functions could significantly enhance the board of directors' efficiency by allowing a dedicated number of board members to focus on specific aspects, particularly in areas where there are potential conflicts of interest. Such committees typically include the audit, remuneration and nomination committees. These committees should consist of a majority of independent board members as defined in paragraph 162.

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171. When introducing audit committees, companies should consider the existence of the revision commission, which is the statutory body responsible for internal financial control. International experience has shown that even in countries where the company law mandates the existence of an equivalent of the Russian revision commission, it may still be very useful to establish a special board of directors' committee charged with reviewing and reporting on the internal control and audit function. Such an audit committee does not relieve the board from its accountability regarding financial statements, but enhances the board's capacity to perform its tasks. The audit committee should consist exclusively of independent board members and be directly accountable to the full board. By evaluating the extent and effectiveness of the internal and external audit process, the audit committee plays a complementary role to the already existing revision commission.

172. In order to ensure a transparent and fair nomination of board members, it may also be useful to create a nomination committee that assists in identifying candidates and ensure a transparent nomination process. This process should, among other things, ensure that shareholders are provided with maximum information on all candidates sufficiently in advance of the general meeting.

173. Board members should be pro-active in seeking relevant, accurate and timely information; they should be provided with adequate resources to inform themselves on significant issues.

174. Access to relevant and timely information is key to the board of directors' ability to carry out its mandate in a professional manner. In practice, the extent and quality of briefing materials presented to the board of directors in Russia is very deficient. It is completely inexistent, not thoroughly prepared, or submitted on the evening prior to the day of a board meeting. Independent board members are sometimes barred from basic information that they require to fully exercising their duties. In some cases, charters restrict a board member's access to corporate information for fear of abusive use to the benefit of competitors.

175. To clarify management's responsibility, the company by-laws should specify that the provision of such information to the board of directors is the obligation of management. When appropriate, board members should also have access to individual managers to request additional information.

176. To be effective, the board of directors must take an active role in ensuring that it has access to the information it requires. The board's information needs vary depending on its agenda and corporate strategy. Financial information is obviously critical. But the board of directors also needs access to relevant, accurate and timely information about corporate performance and potential risks. Information about related party transactions and potential conflicts of interests involving controlling shareholders and senior managers is also critical.

177. The board of directors should be provided with the financial means to pursue its work independently from management, commensurate with its responsibilities to the company and its accountability to shareholders. This includes first, receiving sufficient compensation and second, adequate operational resources to carry out its functions. In particular, the board and its committees require sufficient funds dedicated to seeking independent expertise when needed.

178. Companies, professional associations and international partners should support and cooperate in the development of training programmes for board members.

179. The effectiveness of the board of directors depends critically on the quality of the individual board members. They should be well-qualified professionals that can exercise independent judgement with maximum integrity. Despite substantial progress during the last decade, there is still a relative shortage of individuals with suitable business experience.

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180. Sustained efforts to train board members should therefore be a priority. Companies and professional associations need to dedicate sufficient resources to allow for the training of board members. Companies should be especially encouraged to provide induction training for new non-executive board members. The recent establishment of professional associations of board members in Russia provides an opportunity to train a core group of qualified professionals. In relation to these training programmes, professional associations may also create a database of suitable domestic and foreign candidates to board of directors. These associations should also facilitate the development of formal and informal networks where companies, individual board members and training providers can exchange experiences and information.

CHAPTER 5: IMPLEMENTATION AND ENFORCEMENT

Overview

181. Most Russian laws and regulations in the area of corporate governance have been substantially improved during the last few years. The Russian Civil Code, JSC Law, Securities Law, and Investor Protection Law offer a fairly comprehensive framework of procedural and structural provisions. They also include provisions for legal redress and specify the mandate of supervisory agencies and self-regulatory bodies. However, sanctions for some significant violations of the law remain too low.

182. A severe shortcoming is the relatively weak implementation and enforcement of existing rules and laws. This is a well-known problem that has troubled foreign and domestic investors alike, and greatly contributed to the generally unfavourable view of legal protection in the Russian stock market. A related problem is the remaining inconsistencies between different laws and regulations, which sometimes creates confusion on matters of authority and legal interpretation.

183. Understandably, the judiciary has had great difficulty in dealing with the very rapid growth of commercial litigation that has occurred since the start of transition; a problem which has been aggravated by a vast amount of changes in legislation. Difficulties in keeping up with changes, insufficient training, lack of experience, few precedents and a general shortage of resources have thus plagued the system, leading to sometimes questionable judgements.

184. Considering the gap between the letter of the law and actual practice, priority should be given to improving implementation and enforcement of existing rules and regulations. This requires a significant empowerment of the judicial system. It also calls for capacity building, an emphasis on rigorous enforcement by the FCSM, a better focus of professional organisations and the expeditious introduction of voluntary best practices at the corporate level.

Recommendations

185. The capacity of the judicial system must be strengthened to effectively deal with commercial disputes.

186. A solid and predictable judiciary is a key prerequisite for a credible corporate governance system and a well functioning business sector. It is therefore of utmost importance that the Russian judiciary is immediately granted sufficient resources. More specifically, the compensation of judges and other court personnel should be increased to ensure the recruitment and retaining of educated and experienced professionals that can perform their duties with the absolute integrity required for their positions.

187. Priority should be given to improving training in commercial law, especially with respect to company law, securities law and bankruptcy law. It is also crucial to provide judges with training in basic business concepts, since the lack of exposure to regular business practices sometimes result in an extremely literal application of the law. As part of this training, it is important to provide judges with background on the basic business and economic concepts that underlie such legislation, since the lack of

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such background sometimes results in an extremely literal application of legislative language that may be unreasonable in the context of normal business practices.

188. It may also be useful to examine ways of encouraging greater specialisation in commercial law among judges and setting clear rules on competence. The judicial process should be streamlined by giving to the Arbitrazh Courts the full jurisdiction for adjudication of commercial cases, as they have developed considerably more expertise than the courts of general jurisdiction. The establishment of a specialised section of the Arbitrazh Courts dealing with corporate and securities cases would go a step further.

189. Sufficient resources should be deployed to the investigation of instances of suspected serious frauds committed by top management of public companies. Prosecution should be brought on an impartial basis.

190. Finally, written court opinions in the corporate law area should be widely published, circulated and made available as public record to facilitate interpretation of the law by judges. The use of electronic means and mass media can significantly enhance local judges' access to information and improve the accountability of the legal system. International assistance could be provided to put in place such an information sharing and dissemination system.

191. Private dispute settlement mechanisms should be improved and include the use of professional independent arbitration.

192. Corporations and investors in many countries have experienced that alternative dispute resolution procedures, such as administrative hearings or independent arbitration procedures can be cost-effective and fair methods for dispute settlement.

193. The use of private arbitration mechanisms, at least as an alternative to court litigation, will effectively reduce the workload of the judicial system and serve the business community by speeding up the resolution of commercial disputes. Such mechanisms might be of particular use for settling minority shareholder disputes. As a first step in this process, the Russian stock exchanges may consider providing a voluntary standard private arbitration mechanism to settle disputes between shareholders and listed companies.

194. However, private arbitration is not a substitute for strong judicial institutions. Arbitrators can encounter the same problems as the judicial system in identifying and interpreting the law. They are often dependent on an active and consistent judiciary that, through its rulings, contributes to the interpretation of the law. Most importantly, the execution of arbitration decisions depends on the effectiveness of the judicial system.

195. The Federal Commission for the Securities Market should be provided with the necessary resources to fulfil its mandate, including the supervision of self-regulatory organisations.

196. The Federal Commission for the Securities Market holds a broad range of functions, as the regulator of the Russian securities markets. This includes licensing, regulating and monitoring issuers of corporate securities, stock exchanges, brokers/dealers, registrars, depositories and self-regulatory organisations. The FCSM's work is conducted in its Moscow headquarters and its 15 regional offices.

197. Effective enforcement by the FCSM requires sufficient human and budgetary resources. It must be able to recruit and retain staff that meets the highest professional standards and who pursues their duties with absolute integrity. This calls for budgetary stability that allows adequate resources to secure competitive salaries, state of the art equipment and appropriate facilities. Since its creation in 1992, the FCSM has been understaffed and under-funded while its already long list of responsibilities has been

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expanded. For example, the FCSM has reabsorbed some duties that were previously assigned to professional associations without receiving additional resources to efficiently discharge the responsibilities performed by these professional associations.

198. It is important that the FCSM operates in accordance with best practices, especially regarding transparency and accountability, as defined in the IOSCO Objectives and Principles of Securities Regulation.

199. Regular staff training should also be emphasised, including exchange of expertise with similar authorities abroad. For this purpose the FCSM may seek support from multilateral and bilateral technical assistance agencies.

200. The first priority of the FCSM should be to ensure integrity and fairness in the securities market through the enforcement of existing rules and the development of specific regulations to this effect.

201. The FCSM plays an important role in formulating policy in co-operation with the government and in identifying best practice in co-operation with corporations. However, the highest priority of the FCSM should be the maintenance of a fair securities market through the enforcement of relevant rules. In this respect, available sanctions for violation of securities market regulations should be increased to a level that makes enforcement credible.

202. In prioritising its work, the FCSM should primarily focus on listed companies. Its requirements towards non-listed open JSC with a relatively limited number of shareholders should be significantly simplified, in particular with respect to reporting requirements. The FCSM should not regulate closed JSC.

203. The existing professional associations of broker-dealers, registrars and depositories must intensify their focus on developing solid professional standards.

204. Professional associations should focus on providing services to their members. This includes reputation building, training, and dissemination of professional information and serving as a representative body for their members. They should also be active in the increasingly important work of developing rules of conduct and business standards for their members. Regulators should facilitate the development and enforcement of these standards.

205. Mandatory membership in professional organisations should be reconsidered as a regulatory option. The future role and status of self-regulatory bodies should be further developed and the proper avenues for this are presently under consideration.

206. In order to facilitate implementation, enforcement and compliance, the government and the legislature should rapidly identify and remove remaining inconsistencies and contradictions in rules and laws affecting corporate governance and fill in existing gaps in legislation.

207. While corporate governance related regulations and laws have greatly improved, there are still some areas where there are significant inconsistencies. Provisions of the Civil Code and of the JSC Law contradict some provisions of the Labour Code. One prominent example is the liability of corporate officers or senior management for damages caused to the corporation or to shareholders by inappropriate actions. This makes the JSC Law provision on the liability of corporate officers difficult, if not impossible, to enforce. Another example concerns the requirements for disclosing ownership where stipulated requirements are sometimes contradictory or at least not fully consistent.

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208. Another typical problem arises when one piece of legislation refers to a rule supposedly established in another law, while no such provisions exist. For example, there are many instances in which laws state that violations of particular provisions will entail “the liability established by law”, presumably indicating an expectation that civil, criminal or administrative sanctions will be included in the corresponding code, but in fact no such liability is established.

209. Provisions regulating take-overs procedures should also be provided in the law, as this is especially important for the protection of minority shareholders rights. This is even more crucial given the ongoing reorganisation of natural monopolies and large companies in the energy sector.

210. The Corporate Governance Code is conceived and should be used as an important voluntary instrument for improving corporate governance behaviour.

211. The development of a Corporate Governance Code is an important complement to the White Paper and ongoing legislative, regulatory and private sector efforts to raise corporate governance standards in Russia.

212. The Corporate Governance Code should remain strictly voluntary. Investors and corporations will need a certain period of familiarisation with the various provisions of the Code and their practical implications.

213. The Roundtable should continue its work and establish a core group of Russian and international experts to review and support progress in the area of corporate governance and other corporate sector issues.

214. Corporate governance is a key ingredient of the investment climate. In an increasingly global marketplace it is important to keep both domestic and foreign investors assured that corporate governance reforms are progressing in a rapid and irreversible manner. It is also important to explain to a wide audience, specific aspects of Russian corporate governance and pursue a dialogue that results in defining practical ways to improve implementation. Overall, maintaining an international context for discussion of corporate governance progress would only enhance the credibility of reforms.

215. For this purpose, the Roundtable should continue its work using the White Paper as the basis for promoting, assisting and assessing progress in Russian corporate governance. The Roundtable will form a core group that will provide expertise on specific corporate governance issues as well as on related areas of corporate affairs, for example insolvency.

216. The work will have an inclusive and practical approach building on the present Roundtable network. It should be a resource for policy makers, regulators, corporations, investors and others with an interest to reap the full benefits of recent improvements in legislation. The Roundtable will further develop new scope for co-ordination of efforts with the Russian authorities and the private sector.

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United States	Mr. E. Michael Hunter President Dart Management Inc. Summit

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INTERNATIONAL ORGANIZATIONS

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ANNEX C: RELEVANT ORGANISATIONS AND CORPORATE GOVERNANCE INITIATIVES IN RUSSIA (1999-2001)¹⁰

Organisation, address	Corporate Governance Activity Description	Contact point, Details
State Authorities		
<p>1. Ministry of Economic Development and Trade of Russia</p> <p>Department on Business Regulation and Corporate Governance Development</p> <p>Address: 1/3, 1st Tverskaya-Yamskaya str. 125818 Moscow Russia</p>	<p>One of the main functions of the Department on Business Regulation and Corporate Governance Development is formulation and implementation of state policy in the area of corporate governance. This includes:</p> <ul style="list-style-type: none"> - Legal regulation; - Research on international experience on reforms of corporate legislation; - Development of measures on improving financial transparency of enterprises and disclosure of non-financial information; - Improvement of legal and organisational mechanisms for internal and external audit, formation of an independent audit institution. - Analysis of bankruptcy practice and etc. 	<p>Mr. Tseren Tserenov Chief of the Department on Entrepreneurship Regulation and Corporate Governance Development Tel./Fax: 7 (095) 209 87 59 251 60 47</p> <p>e-mail: tserenov@economy.gov.ru</p> <p>Internet site: www.economy.gov.ru</p>
<p>2. State Duma of the Federal Assembly of Russia</p> <p>Working Group on Improving</p>	<p>The Working Group on Improving Corporate Governance was established in April 2001. It includes representatives of FCSM, the Ministry of Antimonopoly Policy, the Ministry of Economic Development and Trade, the Ministry of Property Relations, NAUFOR, Association for the Protection of Investors' Rights, Institute of Corporate Law and Management, Institute of Stock Market and Management, investment companies ("Brunswick Warburg", "Hermitage Capital Management"), major companies (Gazprom, YUKOS), and international organisations – OECD, IFC, World Bank.</p>	<p>Mr. Anatoly Aksakov, Deputy Chairman Committee for the Economy Policy and Entrepreneurship</p> <p>Tel.: 7 (095) 292 79 72/48 14 Fax: 7 (095) 292 52 50</p>

¹⁰ This information was provided by the institutions themselves. The Report "The Corporate Governance Initiative of the World Economic Forum Russia Meeting 2001" by "Troyka-Dialog" Investment Bank was also extensively used. The descriptions provided in this table do not necessarily reflect the views of the OECD.

This list is not exhaustive, there are several other institutions involved in improving corporate governance.

<p>Corporate Governance</p> <p>Address: 1, Okhotny riad, 103265, Moscow, Russia</p>	<p>The main functions include:</p> <ul style="list-style-type: none"> - Analysing corporate governance practices in Russian joint stock companies in order to identify key directions for its improvement; - Organising interaction with the state executive and management authorities, social organisations of entrepreneurs, scientific institutes as well as stock market participants within the framework of working out the concept of improvement of the corporate governance legislation; - Drafting specific recommendations on corporate governance improvement, in particular, amendments to the legal acts regulating the securities market, activities of joint stock companies, mechanisms of determining market prices on shares and property of enterprises, information disclosure and other corporate governance aspects; - Organisation of public discussion of documents prepared by the work group. 	<p>e-mail: aksakov@duma.gov</p> <p>Internet site: www.duma.ru</p>
<p>3. The Federal Commission on Securities Market (FCSM)</p> <p>Address: Floor 13, 9, Leninsky prospekt, 117939, Moscow, Russia</p>	<p>The Federal Commission on Securities Market was established in November 1994. It is the federal executive organisation responsible for implementing government policy on the securities market, regulating activities of professional securities market participants, and protecting the rights of investors and shareholders.</p> <p>The FCSM has put forward the Program focused on improving corporate governance practice. Implementing this Program, the Federal Commission has focused its activities on the following main fronts:</p> <ol style="list-style-type: none"> 1. Forming the legal framework for good corporate governance, including: <ul style="list-style-type: none"> - Drafting the Russian Corporate Governance Code; - Law-making. 2. Public awareness and information campaign. 3. Professional training on corporate governance, including: <ul style="list-style-type: none"> - Development and introduction of professional and qualification standards for corporate directors and regulators; - Corporate governance enforcement support; 4. Establishment of institutional infrastructure for good corporate governance. <p>FCSM set up the Co-ordination Council for Corporate Governance in 2000. The Council embraces representatives of the groups whose interests are linked to corporate governance practices, such as law-makers, ministries, self-regulatory organisations, private companies and banks, international organisations etc.</p>	<p>Mr. Igor Kostikov, Chairman Mr. Alexei Sharonov, Member of the Commission Tel. 7 (095) 935 87 90/93 Fax 7 (095) 959 93 08 e-mail: sec@fcsm.ru</p> <p>Ms. Marina Merzlikina, Corporate Governance Program Coordinator Tel. 7 (095) 797 95 65 Fax 7 (095) 797 95 66</p> <p>e-mail: mmerzlikina@ccmd.ru</p> <p>Internet site: www.fedcom.ru</p>
<p>4. The Supreme Arbitrazh Court of the Russian Federation</p> <p>Address: 12, Maly Kharitonyevsky per. 101000 Moscow Russia</p>	<p>The Supreme Arbitrazh Court of the Russian Federation is the supreme judicial body competent to settle economic disputes and other cases examined by arbitration courts, to exercise judicial supervision over their activity and to provide explanations of court proceedings. The most important task of the Supreme Arbitrazh Court is to ensure the uniform understanding and implementation of legislation in the sphere of economic relations by all arbitration courts. The fulfilment of this task is exercised by means of studying the judicial practice and preparing explanations and interpretation of the legal acts.</p>	<p>Mr. Veniamin Yakovlev, Chairman Tel. 7 (095) 208 11 19 Fax 7 (095) 208 44 00 Internet site: www.arbitr.ru</p>

Self-regulatory and non-profit organisations		
<p>5. Investor Protection Association (IPA)</p> <p>Address: 6, Building 1, Brigadirsky pereulok, Moscow, 107005, Russia</p>	<p>The IPA is a non-commercial organisation, established in April 2000 on the basis of the Co-ordination Centre for protection of investors' rights. Its purpose is to unite investors' efforts aimed at protection of their rights and improvement of the corporate governance in Russia. The Association members include domestic and international investors with sizeable investments and considerable work experience on the Russian market.</p> <p>The Association offers its members assistance in the following areas:</p> <ul style="list-style-type: none"> - Expert Advice on corporate governance; - Representation of investors' interests in legal cases and conflict situations; - Representation of collective position in government bodies; - Promotion of collective position in public opinion - Networking opportunities & Communication support. 	<p>Mr. Alexander Ikonnikov, Executive Director Tel./Fax 7 (095) 787 24 42</p> <p>Internet site: www.corp-gov.ru</p>
<p>6. Russian Institute of Directors (RID)</p> <p>Address: 7, Kitaygorodsky proyezd, building 2, Moscow 103074, Russia</p>	<p>The <u>mission</u> of the Russian Institute of Directors is to promote better competitiveness of Russian companies by improving their corporate governance system through high professional standards and ethical norms in the work of Board members and through an association of professional governors who share development values of socially responsible business in Russia.</p> <p>Main activities:</p> <ul style="list-style-type: none"> - Developing high qualification and professional standards for corporate directors and putting them in place through education, certification and on-going professional development; - Developing and putting in place ethical norms of corporate directors' professional work (Code of Professional Ethics); - Consolidation of the professional community of Russian corporate directors, representation of its interests in government authorities and with the public, promotion of its co-operation with other professional communities in Russia and abroad and with major corporate relations groups (associations of shareholders, collective institutions, etc); - - Running programs (research, information, consultation and publishing) targeted at assisting the professional community of corporate directors, increasing its efficiency and at shaping a sound Russian corporate governance model. 	<p>Mr. Igor Belikov, General Director Tel/Fax: 7 (095) 220 45 45; 220 45 40; 220 45 35 E-mail: info@rid.ru www.rid.ru</p>
<p>7. Professional Association of Registers, Transfer-Agents and Depositors (PARTAD)</p> <p>Address: 11, Desiatiletiya Oktiabria Street, 119048 Moscow Russia</p>	<p>PARTAD is a non-commercial organisation, established in 1994. The purposes of the Association include:</p> <ul style="list-style-type: none"> - to assist the creation and development of the infrastructure of the securities market in the Russian Federation; - to protect and provide for the exercise of the securities owner rights through the development and control over the compliance by the Association members with the standards and professional practices; - to provide informational, methodological and consulting support of the Association members when engaged in professional activities; - to represent the professional interests of the Association members in state and other institutions and organizations, to assist state bodies to develop and make decisions concerning the rights and interests of the Association and its members; - to develop the methodological bases of stock market functioning; - to study and disseminate Russian and international expertise in the field of securities ownership 	<p>Mr. Petr Lanskov Member of the Board Tel: 7 (095) 245 6729/6429/ 6419 Fax: 7 (095) 795 25 69 e-mail: lanskov@infi.ru</p> <p>Internet site: www.partad.ru</p>

	<p>registration.</p> <ul style="list-style-type: none"> - to protect interests of the Association members; - to improve standards of professional activity, including professional ethics standards on the securities market. <p>PARTAD actively participated in developing amendments to the Russian Companies Law and the Russian Law on the Securities Market. It also organises conferences, training courses, seminars for managers, shareholders and investors.</p>	
<p>8. National Association of Professional Participants of Securities Market (NAUFOR)</p> <p>Address: 6, Brigadirsky Pereulok, building 1 Moscow, 107005 Russia</p>	<p>NAUFOR was founded in 1995. It has played a significant role in promoting awareness of problems in the area of corporate governance in Russia.</p> <p>In 1998, NAUFOR launched the Investors Protection Program in Russia. The aims of the Program included:</p> <ul style="list-style-type: none"> - Increasing investment attractiveness of the Russian securities market for foreign and domestic investors; - Preventing violations of investors' rights and restoration of investors' rights; - Promoting openness of the Russian securities market; - Improving legislation on investors' rights protection etc. <p>NAUFOR has been maintaining the on-line information resource, "Skrin", which is monitoring 1,825 Russian companies. "Skrin" posts information on quarterly accounts, details about executive and non-executive directors, related parties, dividend history and ownership structure, auditors and registrars.</p>	<p>Mr. Ivan Lazarko, Chairman, NAUFOR Board</p> <p>Tel. 7 (095) 787 77 75 Fax 7 (095) 787 24 85</p> <p>Internet site: www.naufor.ru www.skrin.ru</p>
<p>9. "Russian Trade System" Stock Exchange (RTS)</p> <p>Chayanova 15, bld. 5 Moscow 125267 Russia</p>	<p>The RTS Stock Exchange is one of the largest and most actively operated electronic trading floors in Russia. Established in January 1997 by dealer-broker companies, its mission is to consolidate regional securities markets into an organised securities industry and regulate OTC trading in Russia, the RTS, however traces its origins back to the Russian Trading System – the first electronic trading floor in Russia, introduced to the market in mid-1995.</p> <p>In 1999, the RTS extended its existing OTC status to include a trading floor, the second largest after MICEX, with close to \$ 25 mln in daily turnover. The RTS offers close to 420 companies, including 24 listed under tiers one and two and are subject to stringent disclosure scrutiny by the exchange. The RTS listing rules require that to be listed under Tier 1, a company must file audited annual financial statements, prepared in compliance with GAAP or IAS, with the exchange.</p> <p>The RTS hosts the on-line forum to discuss and promote the FCSM draft corporate governance code. The RTS information division maintains an on-line corporate news resource.</p>	<p>Mr. Ivan Tyryshkin, President Tel.: (7095) 705 9031 Fax: (7095) 733 9515 Internet site: www.rts.ru</p>
<p>10. Moscow Interbank Currency Exchange (MICEX)</p> <p>Address: 13, B. Kislovskiy</p>	<p>MICEX was established in 1992. Since then MICEX became the Russia's largest exchange in terms of volumes. In 2001, MICEX declared that its broad goal was to tailor "best standards" of good corporate governance into its listing requirements and to build systems to monitor how listed companies abide by good corporate governance principles in the long term.</p> <p>Currently companies which have obtained a listing with MICEX are subject to stringent disclosure scrutiny by the exchange.</p> <p>MICEX regards information transparency as an important principle of exchange trading. Participants of trades and investors can follow the course of trading sessions through the Internet and leading Russian and foreign</p>	<p>Mr. Alexander Zakharov, Chief Executive Officer</p> <p>Tel. 7 (095) 234 4811 Fax 7 (095) 705 9622</p>

per., Moscow 103009, Russia	news agencies.	
11. The Institute of Professional Auditors (IPAR) Address: 14/1, Nametkina ul., 117420 Moscow Russia	IPAR is the first self-regulatory auditing association in Russia. The main objectives of the Institute activities: assistance in professional activities carried out by the Institute members, representation of their rights and protection of legitimate interests, providing of all-round assistance, self-regulation and internal control. Therefore, IPAR worked on the Program of Dissemination and Implementation of International Accounting Standards in Russia – the base of corporate governance. One of the most important projects of IPAR is the implementation of audit Quality Control system in Russia with support of the Eurasia Foundation. The Institute also takes part in the Parliamentary hearings on corporate governance. IPAR participated in the roundtable meeting on corporate governance of the Industrialists & Entrepreneurs Union of Russia and many other corporate governance events. It has 10 branches in Russian regions.	Mr. Daria Dolotenkova Chairman of the Board Tel: 7 (095) 332 04 92 Fax: 7 (095) 332 04 92 e-mail: ipar@sops.ru Internet site: www.e-ipar.ru
12. The Russian Managers Association (ARM) Address: Office 303, Chaika-Plaza- 2, 28/1, Sredny Tishinsky per., Moscow, 123557 Russia	The ARM is a non-profit public organisation whose mission is to provide a consolidated platform for representing the professional interest of the Russian executive manager community. The major goals of the ARM include: <ul style="list-style-type: none"> - Developing thorough and impartial understanding of the key issues and trends of high importance for the Russian business activity; - Accumulating and promoting international best practices in business management including developing information and analytical resources, establishing an efficient environment for business communication; - Promoting international contacts and communications between the Russian and international business communities. <p>The ARM conducted the study of the role of independent directors in Russia in co-operation with IPA. The survey provided two significant findings: a comprehensive list of independent directors in Russian corporations and a picture of how major Russian corporations understand the role of boards and independent directors. Now the ARM is conducting the survey of the readiness of Russian companies to implement the new Russian Corporate Governance Code.</p>	Mr. Dmitry Zelenin, President Mr. Sergei Litovchenko, Executive Director Tel.: 7 (095) 777 0370 Fax: 7 (095) 206 1129 e-mail: info@amr.ru internet site: www.amr.ru (Russian) www.rmas.org (English)
13. Russian Union of Industrials and Entrepreneurs (RSPP) Address: 10/4, Staraya Ploschad, Moscow 103070 Russia	The RSPP was launched in 1991 as a lobbying organisation for national industrial majors. The RSPP is the largest business association in Russia. The union is increasingly involving itself in dialog between regulators and the regulated and has grown to become an active and influential constituent of economic, social and political life. In 2001 the RSPP launched its own Corporate Governance Development Workgroup and established the Corporate Governance Department.	Mr. Arkady Volsky, President Tel.: 7 (095) 748 4228 Fax: 7 (095) 206 1129 Internet site: www.rsppr.ru

<p>14. Moscow Chamber of Commerce and Industry (MCCI)</p> <p>Address: 22, Akademik Pilugin St, Moscow, Russia</p>	<p>The MCCI was established in 1994 by major enterprises, organisations and private firms in Moscow and Moscow region. The mission of the Chamber is to support local firms and enterprises and promoting trade, as well is to establish relationships with foreign companies. The department of foreign economic activities is designed to promote Russian companies abroad and assist foreign businesses in Russia.</p>	<p>Mr. Anatoly Gavrilenko, Chairman of the Stock Market, Derivatives and Electronic Commerce Department</p> <p>Tel./Fax: 7 (095) 132 72 33</p> <p>Internet site: www.mtpp.org</p>
<p>15. National Association of Independent Directors (NAID)</p> <p>Address: 20/12, Podsosensky per, Moscow, 103062 Russia</p>	<p>NAID is a non-commercial professional organisation that was established by the Investor Protection Association (IPA) and Ernst&Young CIS within the framework of the Independent Director Program.</p> <p>The mission of this organisation is to assist Russian companies to increase their efficiency through introduction of best independent director' practices. Accomplishment of this mission is to be done through meeting the following key objectives: formation of the professional independent directors community and improvement of their qualification level; explanation of the role and significance of independent directors among company managers, state authorities and the general public; facilitation of efficient interaction between independent directors and companies.</p> <p>The organisation is created and will develop based on the principle of self-regulation, with the objective to introduce high ethical norms and professional standards of the independent directors activities. Members of the organisation will include independent directors with managerial experience and experience in Boards of Directors of joint stock companies.</p>	<p>Mr. Alexander Filatov, Head of the Independent Director Program</p> <p>Ms. Olga Tarilova, Consultant</p> <p>Tel.: 7 (095) 938 66 51 Fax: 7 (095) 938 66 75 e-mail: info@corp-gov.ru</p>
<p>16. Institute for Stock Market and Management (ISMM)</p> <p>Address: 7, Kitaigorodsky proyezd, building 2, Moscow 103074 Russia</p>	<p>The ISMM was established in 1997 with the following principal aims and tasks:</p> <ul style="list-style-type: none"> - Assistance to the state federal authorities, authorities of the Russian Federation entities, local self-government bodies, public organizations, mass media and individuals in the dissemination of knowledge in the area of development of the market economy, stock market, securities and management; - Assistance in attracting the funds of Russian organizations and residents, as well as foreign loans, donations and technical assistance for the development of the securities market, formation of new methods and principles of economic process management; - Assistance in training high-skilled specialists in the sphere of the stock market and management, and development of the legislative base regulating the activities of the agents and securities market institutions. <p>The Institute organises corporate governance seminars and workshops in corporate governance. It carries out the survey on the role of independent directors in Russia (joint project with the Russian Managers Association). The ISMM channels public discussion of the Russian Code on Corporate Governance. It is an initiator of establishment of the Russian Institute of Directors (RID).</p>	<p>Mr. Igor Belikov, General Director</p> <p>Tel.: 7 (095) 220 45 45 Fax: 7 (095) 220 45 40</p> <p>Internet site: www.ismm.ru</p>

<p>17. Yekaterinburg Centre for Collective Investments</p> <p>Address: 15, Tramvainy Pereulok, 620041 Yekaterinburg</p>	<p>The Yekaterinburg Centre for Collective Investments (Russian acronym YeTSKI) was set up in 1997 as a non-profit institution within the framework of an investor protection program being carried out by the Federal Securities Commission. The Centre was established for the purpose of improvement of investment climate and stock market development in the Urals.</p> <p>The main tasks of the Centre:</p> <ul style="list-style-type: none"> - Improving trust in the stock market and knowledge among various population groups about the possibilities offered by the stock market; - Helping all stock market players and corporate agents to see the need to build an efficient system of corporate governance. - The Centre works along the following basic lines: - Providing free consultative services to the public about shareholder rights, including issues relating to the functioning of the securities market. - Providing consultative services to issuers regarding information disclosure, interaction with the regulators, organization and conduct of shareholder meetings, establishment of an efficient corporate governance system. - Collection and analysis of information about major events taking place in the regional securities market, creation and maintenance of data bases about issuers and investment institutions that are regularly updated and analysed by experts. - Organization of seminars and conferences about various aspects of stock market functioning, corporate governance and shareholder rights. - Interaction with regional mass media. Dissemination of information, training and analysis materials for publication among the mass media, and providing consultative services and expert opinions. <p>Since 1999 the Centre has been carrying out a regional project named Corporate Governance. As part of the project the Yekaterinburg Centre joined forces with the CIPE, USA, to hold a Corporate Governance Conference in Yekaterinburg in February of 2000. The Centre has developed a corporate governance training course and is implementing an educational program in collaboration of a local universities, the Urals branch of NAUFOR and the Urals division of the Federal Securities Commission.</p>	<p>Executive director of the Yekaterinburg Centre for Collective Investments Ms. Galina Dronova Phone/fax 7(3432) 65 62 77 E-mail: upc@etel.ru</p>
Universities		
<p>18. State University – Higher School of Economics (HSE)</p> <p>Address: 20, Miasntiskaya Str., Moscow 101987 Russia</p>	<p>HSE has been involved in a number of World Bank and TACIS projects, governments programs, such as Executive Training for Enterprises (“Yeltsin Initiative”) and procurement training.</p> <p>HSE offers training on corporate governance for business students, academics, instructors, top managers and directors. This program is sponsored by the Canadian International Development Agency (CIDA) and supported by the Schulich School of Business at York University. The overall objective of the training program is to build the capacity of Russian higher-education institutions to conduct corporate governance training for future business leaders and corporate directors and to encourage the emergence of an influential core cadre of champions of corporate governance in the public and private spheres. Therefore the program seeks to promote sound corporate governance practices in Russia.</p>	<p>Dr. Andrei Kouznetsov, Co-ordinator of the Russia-Canada Corporate Governance Program Tel.: 7 (095) 921-3375 Fax :7 (095) 928-4536 Internet site: www.hse.ru</p>
<p>19. Schulich School of Business,</p>	<p>The Russia-Canada Corporate Governance Program, sponsored by the Canadian International Development Agency, aims to build the capacity of higher-education institutions to conduct corporate governance training for directors, regulators, and future business leaders in Russia. Schulich School of Business is responsible for the</p>	<p>Dr. Alina Pekarsky, P.Eng. Project Director Russia-Canada Corporate Governance Program</p>

<p>York University</p> <p>The Russia-Canada Corporate Governance Program</p> <p>Address: 4700 Keele Street Toronto, Ontario Canada M4S 1C4</p>	<p>program management. Its partner in Russia is the State University - Higher School of Economics in Moscow (HSE). The Program includes: Training Instructors at the summer course held yearly in Toronto; Seminars for corporate directors, held in Canada or Russia; Institutional capacity building through the establishment of a Corporate Governance Centre in Moscow at the HSE and support of program participants' work on advancement of corporate governance practices in different regions of Russia.</p>	<p>E-mail: apekarsky.schulich.yorku.ca Tel: (416) 736-2100 ext. 33787; (416) 736-5091 Fax: (416) 736-5319 Web site: www.schulich.yorku.ca; www.rcg.schulich.yorku.ca</p>
Private Institutions		
<p>20. Institute of Corporate Law and Corporate Governance (ICLG)</p> <p>Address: 5, Building 2, Zvonarsky Pereulok, Moscow, 103031, Russia</p>	<p>The mission of the ICLG is to establish private initiatives and practices that will strengthen corporate governance and protect investor rights. The main objectives and activities of the Institute are:</p> <ul style="list-style-type: none"> - Develop a rating system for corporate governance practices of Russian enterprises. - Monitor corporate actions in Russia and create a research database. - Analyse and monitor court decisions. - Bring law suits on behalf of or in conjunction with investors to influence the creation of precedents and practices. - Propose institutional and legislative reforms that will speed the establishment of better corporate governance practices. - Provide consultancy services for Russian and foreign investors, enterprises and professional participants in the securities market regarding all aspects of corporate governance. 	<p>Mr. Dmitry Vasiliev, Executive Director:</p> <p>Tel.: 7 (095) 258 35 69 Fax: 7 (095) 258 35 68</p> <p>www.iclg.ru</p>
<p>21. Investment Bank Troika & Dialog</p> <p>Address: 4, Romanov Pereulok, Moscow, 103009, Russia</p>	<p>Investment Bank "Troika-Dialog" was founded in 1991. It is an active participant in domestic and international corporate governance initiatives. Troika was among the founding members of the Investor Protection Association and of the World Economic Forum on Corporate Governance. Troika has worked with regulators and international specialists to raise the standards of business practice in Russia.</p> <p>Troika carries out extensive corporate research. It has developed and maintains a methodology of investment risk assessment, with a special focus on corporate governance related risks. Since 1998, Troika has been issuing the weekly "Corporate Governance Actions" publication that is available on its internet site.</p>	<p>Mr. Bernard Sucher, Managing Director</p> <p>Ms. Elena Krasnitskaya, Corporate Governance Expert</p> <p>Tel: (7 095) 258 05 11 Fax (7 095) 258 05 82 e-mail: elena_krasnitskaya@troika.ru Internet site: www.troika.ru</p>
<p>22. Standard & Poor's Corporate Governance Services</p> <p>Address: 11, Gogolevsky boulevard, 121019, Moscow, Russia</p>	<p>Standard & Poor's offers products and services that contribute to transparent, efficient markets and that give the financial community a set of benchmarks they need to make informed financial decisions. Standard & Poor's Corporate Governance Services offers a methodology that analyses the interactions between a company's management, board of directors, shareholders and other financial stakeholders.</p> <p>Standard & Poor's Corporate Governance Services has developed the following ratings:</p> <ul style="list-style-type: none"> - A <u>Corporate Governance Score</u> that allows a company to further differentiate itself in an increasingly competitive market. - <u>Corporate Governance Evaluation</u> that assists companies to identify strengths and weaknesses in their 	<p>Ms. Julia Kochetygova, Director Corporate Governance Services (Moscow) Tel. (7 095) 745 2903 Fax (7 095) 745 29 05 e-mail: julia_kochetygova@standardandpoors.com Internet site: www.standardandpoors.com</p>

	corporate governance processes. It also helps them to benchmark their existing standards with codes and guidelines of corporate governance practices.	
	International Organisations	
<p>23. World Bank Group – International Bank for Reconstruction and Development</p> <p>1818 H Street NW Washington, DC 20433, USA</p>	<p>(I) The Financial Sector Assessment Program (FSAP), a joint World Bank and IMF effort introduced in May 1999, aims to increase the effectiveness of efforts to promote the soundness of financial systems in member countries. Detailed assessments of observance of relevant financial sector standards and codes, which give rise to Reports on Observance of Standards and Codes (ROSCs) as a by-product, are a key component of the FSAP. The ROSCs summarize the extent to which countries observe certain internationally recognized standards. These include corporate governance; accounting; auditing; insolvency and creditor rights; data dissemination, monetary and financial policy transparency; fiscal transparency; banking supervision; securities; insurance; and payments systems. Reports summarizing countries' observance of these standards are prepared and published on a voluntary basis.</p> <p>(II) The Capital Market Development Project (CMDP) is a \$55 million technical assistance loan to the Russian Federation, approved in 1996. The project is designed to strengthen the institutional capacity of the Russian Securities Commission to supervise and regulate the securities market and ensure sound corporate governance.</p>	<p>Olivier Frémond Program Coordinator Private Sector Advisory Corporate Governance (PSACG) Tel.: (202) 473 2714 Fax: (202) 522 2029 Email: ofremond@worldbank.org</p> <p>Ms. Sylvie K. Bossoutrot, Operations Officer Tel: 1 202 473 8569 Fax: 1 202 522 3687 Email: sbossoutrot@worldbank.org Internet site: www.worldbank.org</p>
<p>24. Global Corporate Governance Forum</p> <p>Address: C/O The World Bank Group 1818 H Street NW Washington D.C. 20433</p>	<p>The Global Corporate Governance Forum is co-founded by the World Bank and the OECD and serves as a donor body with donors from both OECD and non-OECD countries. This is a new international initiative which brings together the leading bodies engaged with governance reform worldwide: multilateral banks active in developing countries and transition economies, international organisations, country groupings, engaged with governance reform, alongside professional standards setting bodies, and the private sector. The Forum has been established to provide assistance to developing transition economies on corporate governance. It has three functions: to broaden the dialogue on corporate governance; to exchange experience and good practices; to coordinate activities and identify and fill gaps in provision of technical assistance.</p>	<p>Ms. Anne Simpson Manager Tel: 1 202 473 6857 Fax 1 202 522 2029 Email: cgsecretariat@worldbank.org Internet site: www.gcgf.org</p>
<p>25. International Financial Corporation</p> <p>Russian Federation Corporate Governance Project</p> <p>7/5, bld. 2, Bolshaya Dmitrovka Str. 103009 Moscow Russia</p>	<p>The Russia Corporate Governance Project was launched in April 2001 within the framework of assistance to emerging economies. The project is funded by the Swiss and Dutch governments.</p> <p>The Project's main objective is to increase access to capital for Russian regional open joint-stock companies by improving their corporate governance practices. The Project will operate from four regional offices. The first regional office has already been opened in St. Petersburg while the second office will operate soon in Samara.</p> <p>The Project implementation will include the following activities:</p> <ul style="list-style-type: none"> • A series of seminars for open joint-stock companies. • Corporate governance training for board members. • Individual consultations and assistance to open joint-stock companies on corporate governance issues. • Development and dissemination of a manual aimed at implementation of corporate governance practices. • Assistance in financial management within the corporate governance framework. 	<p>Ms. Natalia Kosheleva Deputy Project Manager Tel.: (7095) 755 56 51 Fax: (7095) 755 8296 e-mail: CGPRussia@ifc.org Internet site: www.ifc.org</p>

	<ul style="list-style-type: none"> • Advice to government organisations on improvement of corporate governance legislation. • Assistance to educational institutions in implementation and/or improvement of corporate governance lecture courses. • Mediation in meetings of Russian open joint-stock companies and potential investors. <p>The Russia Corporate Governance Project co-operates, among others, with the Russian State Duma, the Federal Commission for the Security Market, the Institute of Stock Market and Management, the Investors Protection Association, regional administrations and international organisations represented in Russia.</p>	
<p>26. World Economic Forum – Corporate Governance Initiative</p> <p>Address: 91-93 route de la Capite 1223 Coligny - Geneva</p>	<p>In 1999, the World Economic Forum launched a project called “Changing Corporate Governance in Russia”. The Forum created two bodies: 1) a Russia Task Force with members of Russian-owned and Russian-managed companies that it believes are well run and willing to adhere to international accepted business standards and 2) an Emerging Europe Business Council composed of members of the World Economic Forum with a strong exposure to Russia. These bodies became part of a process monitored by the World Economic Forum.</p> <p>In 2000, the World Economic Forum drafted a code of conduct on corporate governance drawn from the work of CalPERS and the OECD. The basic principles were discussed with some members of the Russia Task Force, the Emerging Europe Business Council and various practitioners. The Forum also engaged in a project to evaluate the extent to which the external environment favors or inhibits healthy governance practices at companies. Building upon the work already undertaken in conjunction with Troika Dialog at the corporate level, the Forum focuses on the legal regulatory, information and market infrastructure. This assessment will pave the way for comparing corporate governance standards across countries. The final objective is to derive country ratings that would take into account both micro and macro factors of corporate governance.</p>	<p>Mr. Thierry Malleret Director, Europe and Central Asia Tel.: 41 22 869 1243 Fax: 41 22 786 2744 e-mail: thierry.malleret@weforum.org Internet site: www.weforum.org</p>
<p>27. European Bank for Reconstruction and Development (EBRD)</p> <p>Address: One Exchange Square, London EC2A 2JN, England</p>	<p>EBRD promotes better corporate governance both in its banking operations and in its technical assistance initiatives. Through its Legal Transition Programme the EBRD helps Russia modernise securities and company laws and build independent and effective implementing institutions. Recent technical assistance projects include:</p> <ul style="list-style-type: none"> - the FCSM-led Russia Corporate Governance Code development; - the development by the Institute of Corporate Law and Governance (an NGO) of a corporate governance assessment tool to help investors evaluate their target companies’ behaviour; - the development of the Model Securities Law for CIS; - assisting FCSM with the drafting of the new Joint Stock Company Law, and the draft Investment Funds Law and with the development of concept of Electronic documents/dematerialised securities Law and the concept development of Securities Transactions Law; - assistance to the FCSM to further develop Russian’s legal framework to promote the Rouble denominated bond market; - holding jointly with the FCSM and with the EU support a series of workshops for legislature, officials, academia and market participants to promote and help the passage of the above draft laws. <p>EBRD is also considering a new project to help develop a CIS model Investor Protection law.</p>	<p>Mr . David Bernstein Chief Counsel, Head of Legal Transition Team Tel: 44 20 7338 6820 Fax: 44 20 7338 6150 e-mail: bernsted@ebrd.com</p> <p>Mr. Alexei Zverev Counsel, Tel: 44 20 7338 6370 Fax: 44 20 7338 6150 Email: zvereva@ebrd.com</p> <p>Ms. Louise Campbell Senior Banker Tel: 00 7 501/095 787 1111 Fax: 00 7 501/095 787 1122 e-mail: campbell@ebrd.com Internet site: www.ebrd.com</p>

ANNEX D. RUSSIAN REGULATORY ACTS ON CORPORATE GOVERNANCE

1. The Civil Code of the Russian Federation. Part One of 30 November 1994 № 51-FZ (as amended by the Federal laws of 20.02.1996 No. 18-FZ, of 12.08.1996 No. 111-FZ, of 08.07.1999 No. 138-FZ, of 16.04.2001 No. 45-FZ, of 15.05.2001 No. 54-FZ).

The Code sets the basic principles, legal status and organisational and legal forms of legal persons.

2. The Federal Law "On Joint-Stock Companies" of 25 December 1995 № 208-FZ (as amended by the Federal laws of 13.06.1996 No. 65-FZ, of 24.05.1999 No. 101-FZ, of 07.08.2001 No. 120-FZ)

The Law regulates the legal position of stock companies created in the territory of the Russian Federation, shareholders' rights, decision-making procedure and competence of joint-stock company authorities.

3. The Federal Law "On Equity Market" of 22 April 1996 № 39-FZ (as amended by the Federal laws of 26.11.1998 No. 182-FZ, of 08.07.1999 No. 139-FZ, of 07.08.2001 No. 121-FZ)

The Law regulates relations at issuance and circulation of emissive securities irrespective of the type of issuer and the specifics of creation and activity of professional equity market players.

4. The Federal Law "On Protection of Rights and Legitimate Interests of Investors in the Equity Market " of 15 March 1999 № 46-FZ.

The law sets:

- Terms for the provision of services by professional players to the investors that are not professional players;
- Additional requirements to the professional players that provide services to investors in the equity market;
- Additional requirements to stock floatation among an unlimited range of investors in the equity market;
- Additional measures for the protection of rights and legitimate interests of investors in the equity market and responsibilities of issuers and other persons for violation of such rights and interests.

5. The Federal Law "On Insolvency (Bankruptcy)" of 8 January 1998 № 6-FZ.

The law regulates the bankruptcy procedure for legal persons and bankruptcy prevention measures.

6. The Law "On Competition and Limitation of Monopoly Activity in the Commodity Markets" of 22 March 1991 № 948-1

The law stipulates organisational and legal principles for prevention, limitation and suppression of monopoly activity and unfair competition. It gives a definition of the affiliated person.

7. FCSM Resolution "On Approval of the Regulation of the Procedure for the FCSM Permission to Issue Russian Stock outside the Russian Federation in the Form of Foreign Stock Issued Compliant to Foreign Law and Certifying the Title to Russian Stock" of 13 March 2001 No. 3

The Resolution regulates the access to the circulation of Russian securities issued outside the Russian Federation in the form of depositary securities.

8. FCSM Resolution "On Approval of the Regulation of the Procedure and Scope of Information Disclosure by Public Stock Companies at Floatation of Stock Convertible by Subscription" of 20 April 1998 No. 9

The Resolution regulates the procedure and scope of information disclosure at stock floatation.

9. FCSM Resolution "On Approval of Issuance Standards for Stock, Excess Stock, Bonds and Offering Circulars at Establishment of Joint-Stock Companies" of 17 September 1996 No. 19 (in the version of the FCSM Resolution of 11 November 1998 № 47)

The Resolution regulates the procedure for stock and bond issuance by the joint-stock company.

10. FCSM Resolution "On Approval of Issuance Standards for Stock, Excess Stock, Bonds and Offering Circulars at Reorganization of Businesses" of 12 February 1997 No. 8 (in the version of the FCSM Resolution of 11 November 1998 № 48)

The Resolution regulates the issuance of stock and bonds placed at reorganization of joint-stock companies.

11. FCSM Resolution "On Approval of the Regulation of the Register of Securities' Owners" of 2 October 1997 No. 27 (in the version of the FCSM Resolution of 20 April 1998).

The resolution regulates the maintenance of the register of owners of stock and other emissive securities.

12. FCSM Resolution "On Approval of the Regulation on Disclosure of Information of Significant Events and Actions that Affect Financial and Economic Activity of the Stock Issuer" of 12 August 1998 No. 32

The resolution regulates the disclosure of information of significant facts by the joint-stock company.

ANNEX E: OVERVIEW OF THE JUDICIAL BRANCHES IN RUSSIA¹¹

Introduction

1. The existing judicial system of the Russian Federation was formed and is being developed as a result of a judicial reform carried out over the past decade to create an independent judiciary branch, along side that of the executive and legislative branches of power. The Constitution, federal constitutional laws and other federal laws establish the judiciary system.

2. The judicial system consists of the following branches of Courts:

- ◆ The Constitutional Court of the Russian Federation, and the constitutional (charter) courts of the republics and other subjects of the Russian Federation;
- ◆ Four-tiered system of courts of general jurisdiction: (1) the Supreme Court, (2) Republics, krai and oblast courts, (3) courts of cities of federal significance, (4) and district courts. The general jurisdiction courts handle cases dealing with individual citizens.
- ◆ Three-level system of arbitrazh (commercial) courts: the Supreme Arbitrazh Court, Federal okrug courts and arbitrazh courts of Federal subjects. The arbitrazh courts consider economic disputes, including those related to individuals and other entities that are not legal persons.

The Constitutional Court of the Russian Federation

3. The Constitutional Court of the Russian Federation does not resolve commercial disputes generally or address cases related to corporate governance issues but rather serve as a forum for constitutional review, autonomously and independently exercising judicial authority by means of constitutional judicial proceeding. The Constitutional Court consists of 19 judges appointed by the Federation Council upon nomination made by the President of the Russian Federation. It currently operates on the basis of a 1994 Federal Constitutional Law. The Court has jurisdiction over the following cases:

- ◆ Cases concerning the constitutionality of federal laws and normative acts issued by the President, Government of the Russian Federation, Federation Council and State Duma; the constitutions and charters of the subjects of the Russian Federation, and law and normative acts issued on matters in the joint control of the Federation and its subjects or in an area of jurisdiction belonging to the Federation; treaties and agreements between Federation and its subjects and among the subjects of the Federation; and international treaties of the Russian Federation that have not entered into force;
- ◆ Cases concerning a dispute about competencies between federal bodies, between a federal body and a subject of the Federation, and between the highest bodies of state power of the subjects;
- ◆ Cases concerning a request for and interpretation of the Constitution of the Russian Federation;

¹¹ The information in this annex is essentially based on the "Handbook on Commercial Dispute Resolution in the Russian Federation, U.S. Department of Commerce" and the relevant websites. No original research was undertaken.

- ◆ Cases concerning verification of the constitutionality of a law applied or subject to application in a specific case.

4. The Constitutional Court is a forum to challenge laws and other legal acts applicable to commercial matters that the petitioner believes are not constitutional. During recent years, the Constitutional Court issued a number of important decisions on such issues as confiscation of property by customs authorities, liability for late tax payment, proper procedures for imposition of fines, and other matters. The decisions of the Constitutional Court are binding upon the arbitrazh courts and courts of general jurisdiction, and on all other official bodies.

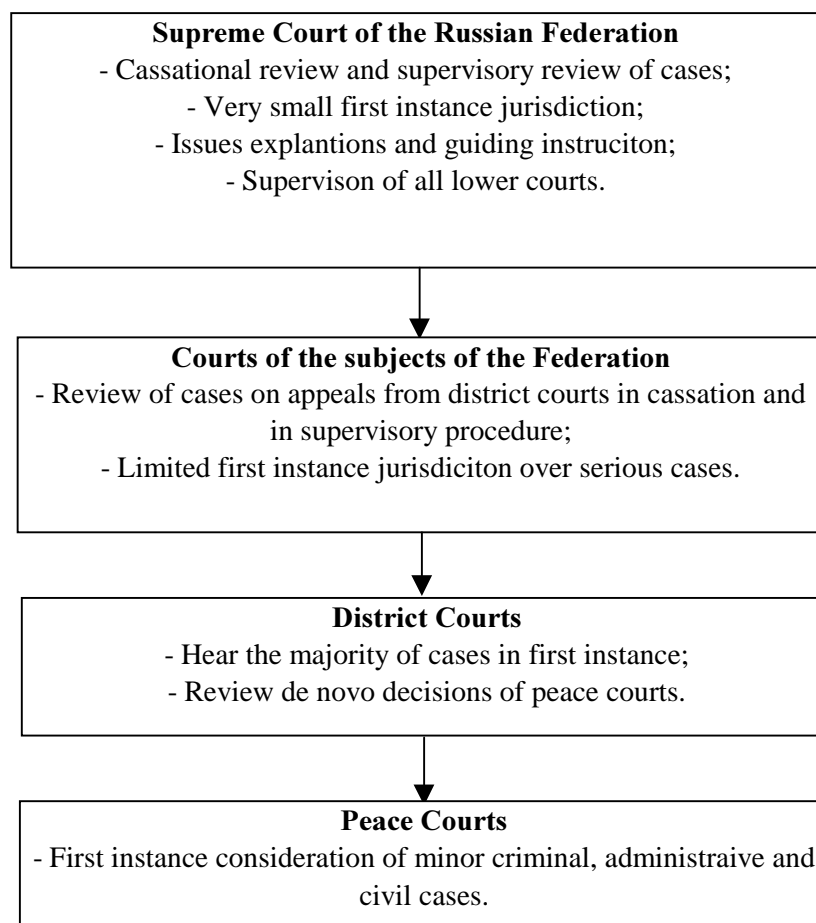
Courts of General Jurisdiction

5. The courts of general jurisdiction have jurisdiction over all cases which may be heard by a court in the Russian Federation and which are not assigned to the jurisdiction of the arbitrazh courts or within the jurisdiction of the Constitutional Court. This includes:

- ◆ All criminal cases;
- ◆ Civil cases involving a citizen who is not an individual entrepreneur as at least one of the parties;
- ◆ Appeals of administrative and other state actions which do not fall within the jurisdiction of the other courts;
- ◆ Cases establishing facts having legal significance with respect to citizens;
- ◆ Cases concerning family matters;
- ◆ Inheritance issues;
- ◆ Cases concerning rights to housing, pensions and benefits, and other matters of social protection;
- ◆ Other types of cases.

6. The structure and organisation of the courts of general jurisdiction have not been finally determined yet, since legislation defining the system in detail has not yet been passed. According to the Law “On the Court System of the Russian Federation” of 1996, the Supreme Court of the Russian Federation is the superior court in relation to the supreme courts of the subjects and military courts. There are also regional courts, which consider cases in the first and the second instance, and to exercise other authority as defined by a federal constitutional law. The specific organisation, authority, and jurisdiction of military courts and of the supreme courts of the subjects of the Federation are also to be determined by the federal constitutional law. The required federal constitutional laws, however, have not yet been passed.

7. Until the new laws are passed, the courts of general jurisdiction operate in the current structure:

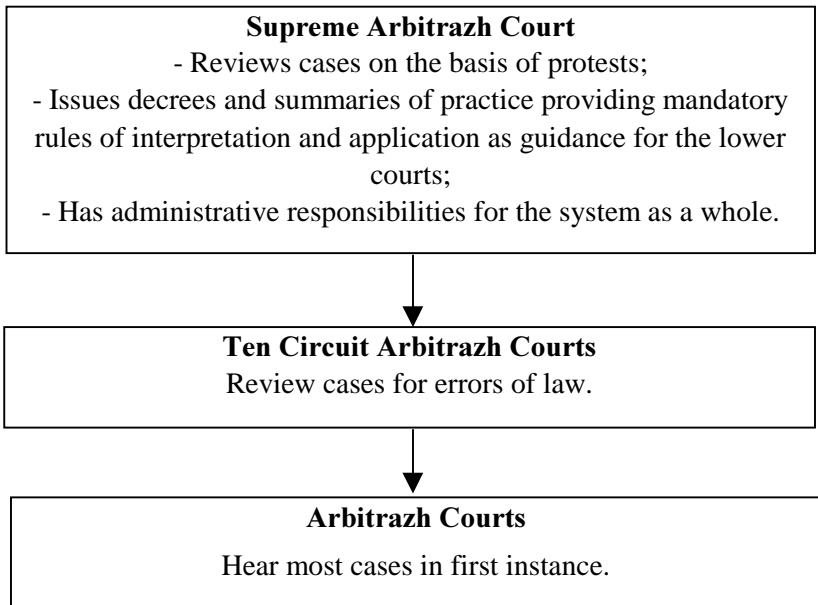


Arbitrazh (Commercial) Courts

8. According to the 1995 Federal Constitutional Law “On Arbitrazh Courts in the Russian Federation”, under which the arbitrazh court system currently operates, the arbitrazh courts have jurisdiction over most commercial disputes and many other cases involving either legal entities or registered individual entrepreneurs. According the 1995 law, the arbitrazh courts are structured as a three-tier system. This system consists of:

- ◆ The arbitrazh courts of the subject of the Federation hear most cases in the first instance and also consider appeals of first instance decisions;
- ◆ Ten circuit arbitrazh courts, each assigned a broad territory, review the decisions of lower arbitrazh courts for errors in the application or interpretation of the law.
- ◆ The Supreme Arbitrazh Court reviews cases on the basis of protests, issue decrees and summaries of practice providing mandatory rules of interpretation and application as guidance for the lower courts.

9. Therefore the current structure of the Arbitrazh court system can be presented as follows:



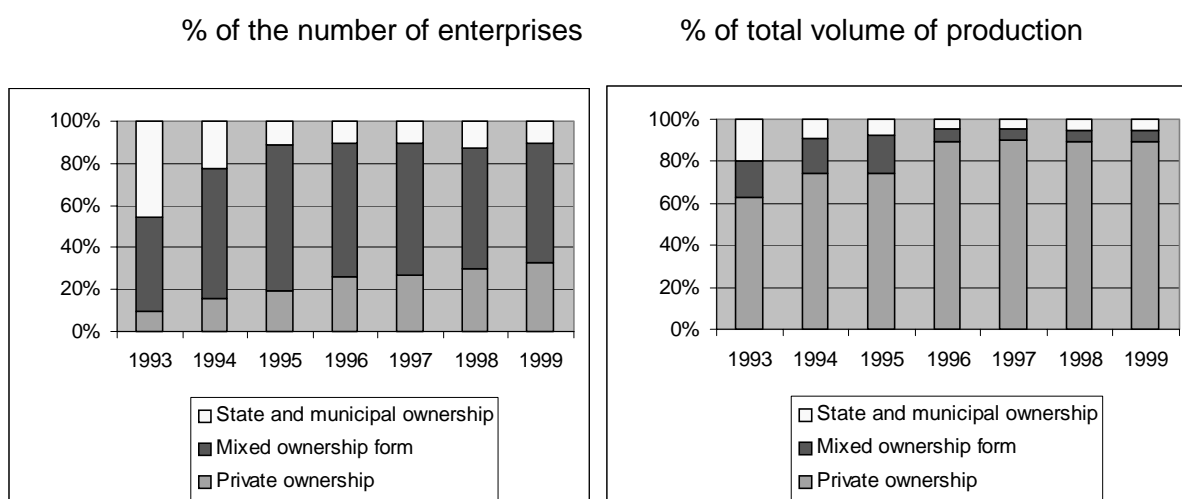
ANNEX F: OWNERSHIP, CONTROL AND FINANCIAL MARKETS IN RUSSIA

I. Ownership and control characteristics in Russia

I.1. Main characteristics

- Following the different waves of privatisation, close to 90% of Russian output is now produced by privately held enterprises, including partly privatised enterprises. Indeed, in terms of number of enterprises, mixed ownership forms (combining state, regional or local and private ownership) are still predominant at the end the 90's.

Graph 1. Classification of the Russian Federation enterprises by ownership forms



State ownership – property, belonging to the RF (federal property) and the RF members (property of the RF members).
Municipal ownership – property, belonging to city and rural settlements and other municipal formations on the right of ownership.

Mixed public and private Russian property

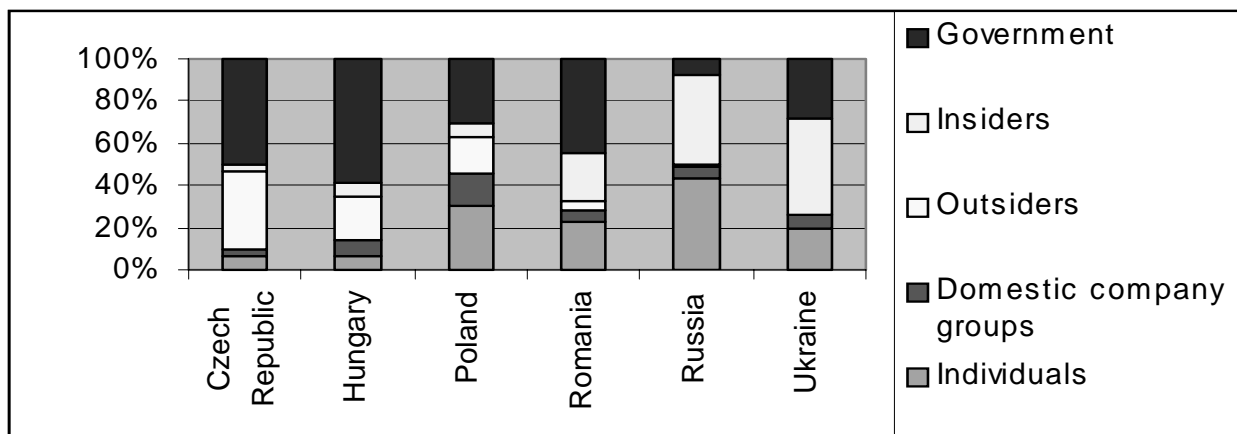
Remainder (up to 100%) – property with foreign participation, social organisations, etc.

Source: RF Goskomstat

Private ownership – any property of individuals and legal entities.

- The predominance of insiders remains a very striking characteristic of Russian ownership structures, in comparison with other transition countries. Indeed, in 1999, insiders remain the most important shareholders in 43% of enterprises. Moreover, the largest shareholder owns another 43% of enterprises, and this individual may well be connected to management in many such cases.

Graph 2. The largest shareholders* in privatised companies in selected transition countries



* This information is thus limited and the definition given to dominant ownership by this EBRD Survey may be considered as unsatisfying. However, it allows international comparison.

Source: EBRD/Worldbank Business Environment Survey, 1999

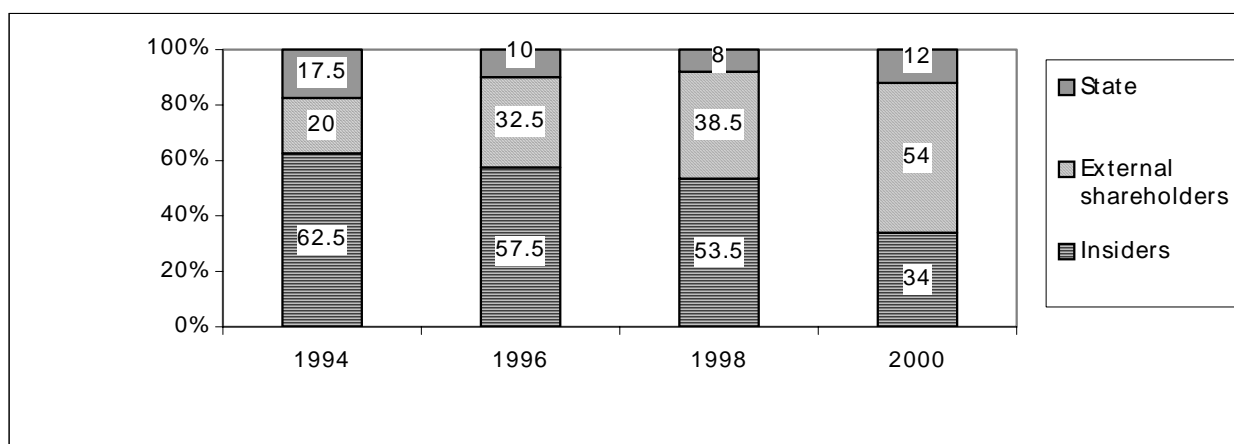
- As far as can be ascertained in the Russian environment, the Russian ownership structure has remained relatively dispersed:
 - In 2000, 62% of the JSCs did not have one single shareholder owning more than 25% of the shares. The remaining companies usually have one and exceptionally (6% of JSCs) two shareholders owning more than 25% of shares;
 - Only 13% of the JSCs have a shareholder owning more than 50% of the shares;
 - Only 4% – a shareholder with a bigger than 75 % stake (Radyguin, 2001).

I. 2. Evolution of the ownership structure during the transition

- The 1992-1994 mass privatisation program led to an ownership structure overwhelmingly dominated by insiders with significant remaining state ownership. As regards outsiders, the two most prominent groups were firstly non-financial firms, and then individuals frequently related to managers. This, combined with control by managers over employees' shares, often gave managers a de facto controlling position in the corporation.
- The post-privatisation redistribution of ownership has demonstrated a constant shift of ownership to outsiders. There has been commensurate decline in shares held by insiders and the State. This has been carried out in Russia through various means such as:
 - the purchasing of shares in the secondary market (from employees, investment institutions, brokers, or banks),
 - the purchasing, under preferential conditions, of blocks of shares previously held by federal or regional authorities (residual privatisation, loan-for-share scheme, trust management and so forth),

- voluntary or compulsory - through administrative means – establishing of holding structures or financial-industrial groups,
- authorised dilution of state interests,
- debt-equity swaps, ...

Graph 3. Evolution of the ownership structure of Russian Medium and Large Joint-Stock Companies 1994-2000, as % of the Charter Capital¹²



Source : IET polls and other surveys

- Consolidation of ownership has been protracted in Russia as large blocks of ownership in the largest and strategic companies remained in State's hand until the second half of the 90's. This consolidation process gave rise to a continuing stand-off and even harsh control battles between powerful vested interests and rivalling groups.
- More specifically, some strategic sectors, such as the oil industry, have undergone a "dual" privatisation process. In the first phase, production companies were privatised in 1992-1993 and holdings were formed gathering remaining state shares in these separate production companies. These holdings were subsequently privatised in 1995-1997. The "second-wave" buyers, who obtained a majority stake in the holding companies, inevitably found themselves in discord with minority shareholders in the affiliated companies of the "first wave." These conflicts lasted in the oil industry for at least three years¹³ and became symbolic of the corporate battles in Russia during 1997-1999.
- Consequently, the structure of share ownership in Russia's largest joint-stock companies differs from graph 3. It is characterized by: a relatively high share of holding companies (including state-owned ones), by a considerably lower share of employees (including managers), and a relatively high share of non-resident owners.
- The most rapid and striking evolution happened following the 1998 financial crisis, which triggered a new and large scale redistribution and consolidation of property in the corporate sector. Three main and inter-related factors have driven this process.

¹² These tables were compiled to illustrate the most important quality trends and cannot be used for strict empirical assessments. The table does not take into account major joint-stock companies (holdings), strategically important companies (where blocks of shares are reserved for the state), or sectorial differences. The actual share of insiders (managers) is usually higher if affiliated companies, regarded here as outside shareholders, are taken into consideration.

¹³ The LUKoil oil company appears to be an exception of sorts, since it switched to a single share as far back as 1995.

- First, the crisis in the stock market prompted further large-scale and spontaneous flight from illiquid blocks of shares. Low prices for these shares created favourable conditions for managers and major shareholders to consolidate control. Moreover, a number of industries were able to find financial resources for consolidating control, both by strengthening the managers' influence and ousting foreign investors¹⁴. The massive flight of foreign investors and selling by domestic financial institutions in difficulty after the crisis further facilitated this consolidation.
- Second, financial-industrial groups (FIGs), primarily those based on banks, were disintegrated. This led to a large transfer of shares, mostly from the large Moscow-based banks, typically through voluntary repayment of banks' debts with shares of industrial companies, attempts to get rid of illiquid and money-losing assets and seizures of debtors' blocks of shares or sale of individual interests through official bankruptcy procedures. The winners were the federal natural monopolies and some of the groups springing up around large corporations.
- Finally, attempts by regional authorities to obtain control over their respective regions' major enterprises grew more visible and successful during the post-crisis period. Particular emphasis was given to the setting up of regional holding companies under the aegis of local authorities. This was accompanied by attempts to withdraw regional companies' blocks of shares from trust management, to invalidate new share issues that threatened to change the regional corporate structure in favour of "outsiders" and to challenge privatisation transactions won by representatives of the centre (federal groups), other regions, or foreign investors.
- The dramatic decrease in employee ownership and the growing power of outside shareholders were thus mainly attributable to the post 1998-crisis process of ownership concentration and the decrease in the officially registered share by managers (from 12-16 percent in 1996 to 7-8 percent now)¹⁵. The latter has occurred either through a direct transfer of shares to outside investors (in the form of sales or debt repayment), or through transfer of existing shares to affiliated companies or registration of newly purchased shares with them. These two latter tendencies led to broader informal control by managers.
- State interests in the equity of most companies does not play *de facto* any essential role, except for strategic industries and a few of the largest joint-stock companies. The recent slight growth in state-owned interests can be attributed to the fact that private companies in arrears with mandatory payments have been declared bankrupt and taken over by the state, especially in the regions during 1998-2000. This trend appears to be mid-term in nature and will continue in the next few years.
- The years 1998-2000 were also characterised by attempts to strengthen and tighten state control over companies in key sectors of the economy¹⁶. This was done by redistributing state ownership in some major Russian corporations by consolidating the government-owned blocks of shares under the aegis of holding companies. This trend has become particularly prominent in 2000 and led to fierce political struggles around the reorganisation of natural monopolies, primarily RAO Gazprom and RAO UES.
- The same trend towards consolidation and upsizing has also emerged in 1999-2000 in private companies. There was also a process of transition from relatively amorphous associations of the conglomerate type towards more technologically and vertically integrated structures with clear-cut

¹⁴ The increase in oil prices starting from March 1999 allowed the oil industry to mobilise the necessary resources to consolidate control. As for the metal industry, resources were tapped from the dramatic fall in its dollar costs coupled with stable prices of its outputs. In addition, turf wars escalated dramatically in 1999-2000, with an increased use of fictitious bankruptcies and debt schemes, resulting in a squeezing out of foreigners.

¹⁵ See: A. Radygin, R. Entov. *Institutional Problems of Corporate Sector Development: Ownership, Control, Securities Market*, Moscow, IEPP, 1999, p 65-66.

¹⁶ Against the backdrop of the overall crisis in the State property management system, this was also made necessary given the need for technological integration, the upsizing required by international competition, and the unavoidable stepping up of pressure on companies to force them to pay their arrears in the budget.

organisational and legal boundaries. This has been particularly manifest in the oil and metallurgy industries¹⁷. However, there have been similar examples in the chemical and food industries, as well as in civil aviation construction and several sectors of the military-industrial complex.

- The underlying rationale for such consolidation has also changed, compared to the previous financial-industrial groups. There is now a real technological, economic and financial integration. These new structures are characterised by a considerably higher level of corporate control over affiliated companies (up to 75 percent or higher). They experience effective organisational and legal transformation, including mergers, consolidation within and between holdings, switch to a single share. The new practice of consolidating a company's shares has resulted in numerous conflicts with minority shareholders, even though these conflicts have often been resolved at the negotiation stage.
- In terms of creating *actual* control centres in corporations, narrow groups of *partners* – or real owners – continue to consolidate their levers of power and control on effective management, not necessarily on the basis of share ownership. Thus, explicit or disguised consolidation of ownership and control in Russian corporations remains a key mid-term trend.

II. The low access to external finance

- Since the 1998 crisis, the Russian economy has enjoyed positive economic dynamics, especially at the macro level, with growth in output, budget surplus, reduced inflation and a stabilised exchange rate. Indeed, GDP grew by 15% in 2000-2001 and caught up with its 1993 level. These positive trends can be largely explained by favourable external factors, mainly the significant improvement in the terms of trade triggered by the evolution of world prices (especially oil and gas) and the four-fold depreciation of the rouble since the 1998 crisis. But they also resulted from a real acceleration of structural and institutional reforms (OECD, 2001 EDRC Russia Survey).
- These positive macro-economic trends and structural reforms were accompanied by positive dynamics registered in most industries, including those that remained chronically depressed for years. The rising profitability and return on investment in Russian companies prompted a significant increase in gross capital investment of 25% in the two years of 2000-2001.
- This has resulted in a revival in the issuance of depository receipts¹⁸. A resurgent interest in the market of corporate bonds and a certain upturn in reinvested capital also marked the period of 1999-2000¹⁹. However, the level of external financing remains dramatically low. Neither the banking sector nor the financial markets provide enterprises with significant financing.

II. 1. The stock market

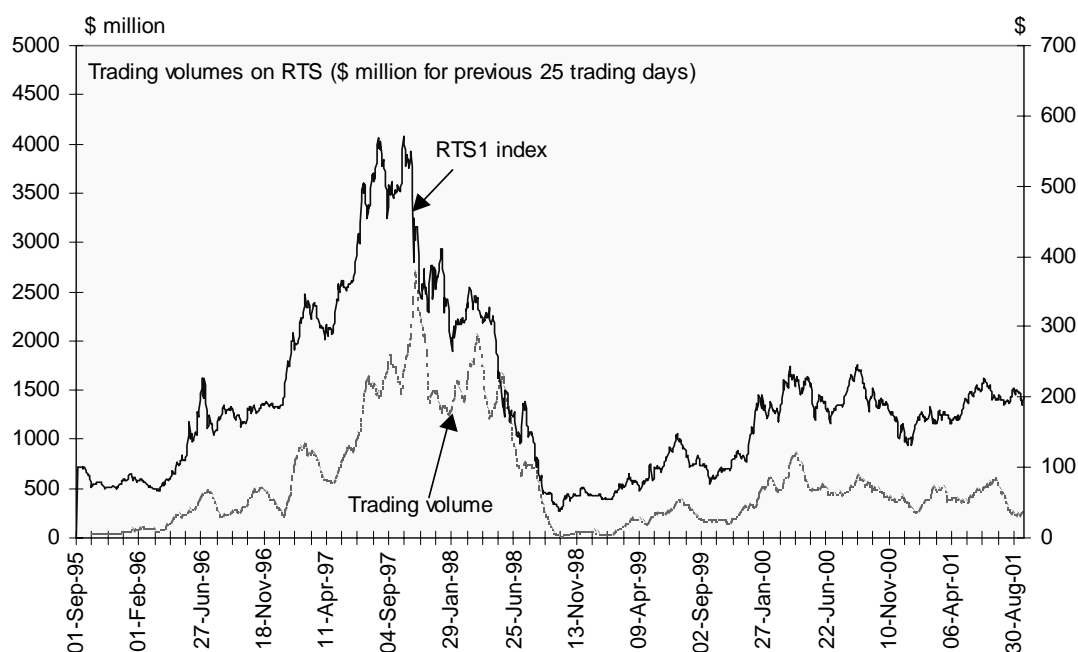
- The Russian stock market has not fully recovered from its 1998 collapse. After a slight recovery at the end of 1999 and the beginning of 2000, stock prices have since then decreased. Three years after the crisis, traded volumes are still three-fold inferior to their pre-crisis level, while the RTS1 Index is still around 200, at its 1997 level.

¹⁷ For instance, the creation of Russian Aluminium in 2000 on the basis of two former private competitors gave birth to Russia's largest aluminium holding company accounting for 70 percent of the domestic market.

¹⁸ In 2000 about 15 large Russian corporations announced their intention to issue depository receipts. It is also noteworthy that most Russian corporate borrowers in the Eurobond market tried to comply with their current payment obligations on time. The period of 1999-2000 was also marked by a resurgent interest in the market of corporate bonds.

¹⁹ This does not mean, however, that the problem of "capital flight" has lost its urgency. This is, more precisely, a growing inflow of what was previously siphoned off from the country in the form of pseudo-foreign loans etc.

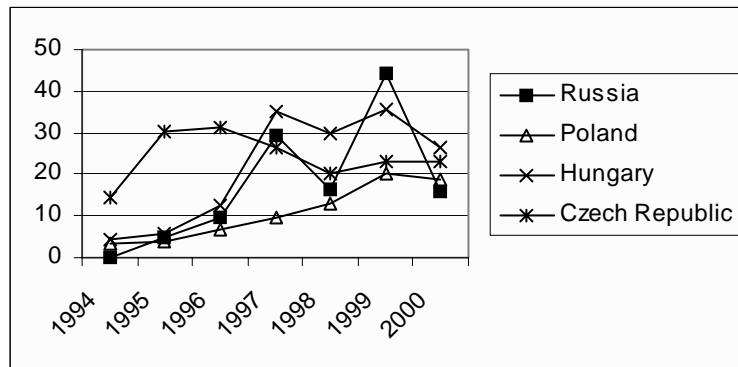
Graph 4. Trading Volumes and RTS1 index on the Russian stock market



Source : RTS Website

- The Russian stock exchange is characterised by its low market capitalisation (Graph 5), very low liquidity and free floats. Consequently, the Russian market has not served as a source of financing for Russian companies. There has never been a significant volume of IPOs, and since the crisis these IPOs are almost non-existent.
- The strong upsurge in the Russian stock market in 1997 was driven by an influx of foreign capital. Foreign investors were attracted by the newly achieved macro-economic and political stability and the high risk premiums against the background of the general boom in emerging markets. Moreover, the strong increase in ADRs and GDRs, fuelled by positive anticipations based on the increase of oil and gas prices, triggered a re-evaluation of Russian domestic stocks. These two phenomena were not related to an improvement in fundamentals, and the liquidity of a stock was a decisive factor in investors' decision.
- The significant widening of the gap between the stock market performance and Russian overall macroeconomic improvements highlights structural weaknesses in the institutional framework of the stock market. Consequently, Russian stocks are significantly undervalued. Moreover, there seems to be a strong correlation between firm level valuation and their corporate governance behaviour, as evidenced by the recent study by B. Black (2001).

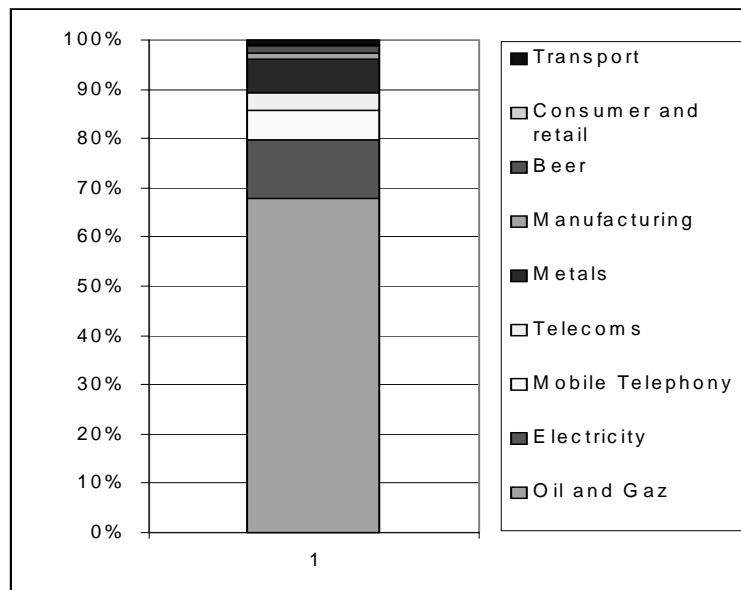
Graph 5. Market capitalisation in % of GDP



Source : EBRD Transition Reports

- Moreover, this market is even more than ever dominated by oil and energy companies, as reflected in the distribution of their market capitalisation (Graph 6).

Graph 6. Distribution of market capitalisation by sector on the RTS in 2000



Source: Troika Dialog / Russia - Market Overviews

II. 2. The bond market

- The corporate bond market is a relatively new segment of the Russian market. It was launched in 1999 after issuers were allowed to deduct interest payments from taxable profit. In the first 2001 quarter, between R 2 and 3 billion worth of corporate bonds have been issued every month, which is comparable to government bond issues. It is expected that the corporate bond market should reach the size of the government bond market in the beginning of 2002.
- Its main advantages for investors are higher yields than the government bond market and a more structured market. Moreover, corporate bonds may be traded on the market or over-the-counter (OTC). The issuance procedures require a thorough disclosure process. Finally, banks do not have to provision

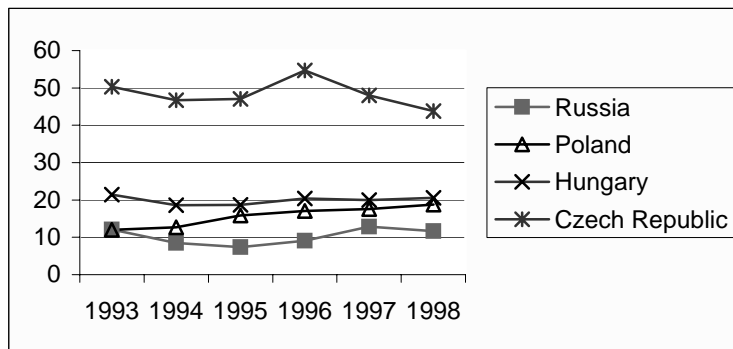
for bad debt on these bonds, unlike for the credit they grant to enterprises. Consequently, the development of the corporate bond market could partially compensate for the drastically low level of banking credits. Nevertheless, such a development will suffer for a while from the low liquidity of its secondary market, combined with the classical difficulty of evaluating credit risk.

II. 3. The banking sector

- The Russian banking sector has not yet redressed from its collapse during and after the 1998 crisis, even though the most recent trends show some positive signs and a number of indicators have reached their pre-crisis levels. While the most problematic banks' licenses have been removed, banks that have been restructured by ARCO (Agency for Restructuration of Credit Organisation) have still to be sold (SBS-Agro, AvtoVAZbank and other regional banks) and the enforcement of prudential regulation may still be considered as "lax". The sector is currently undergoing a series of mergers or acquisitions, as a number of small banks are facing a liquidity crisis. Aggregate net result is still negative. The monitoring power of the Central Bank has been increased in 2001 through amendments to the Law on Central Bank and the Law on the Insolvency of Credit Organisations. However, the establishment of a deposit insurance system, the adoption of international financial reporting standards as well as the waiving of restrictions on foreign banks' activities are still much-needed crucial steps in strengthening the banking system.
- The banking sector remains quite small in terms of size (with aggregate capital representing only 4% and assets 33% of GDP) and dominated by two state-owned banks, Sberbank and Vneshtorbank Bank, whose capital now represents 22% of aggregate banking capital. It is nevertheless highly fragmented (1300 banks in total) and also highly concentrated, with 50% of banking capital in the top five banks. Banks working with exporting companies (subsidiary or joint-owned banks mainly working as Treasuries) are enjoying the fastest growth and the highest rate of liquid assets. They show a rapid capital growth and are the main source of recent positive trends in the banking sector recovery.
- Trust in the banking sector remains quite low, as evidenced from the very low level of deposits (6.6% of GDP), due partly to the absence of a deposit insurance scheme. It is estimated that \$ 30 billion in savings remain "under the mattress". Moreover, these deposits are mainly short term (only 12% over one year) and highly concentrated in Sberbank, which controls 75% of the deposit market. Consequently, private deposits in commercial banks cover only 6% of their assets (in comparison with 31% for Poland and 48% for the Czech Republic). Interbank volumes were still 30 % below their pre-crisis level at the beginning of 2001 and correspondent links remained broken.
- More globally, the Russian banking system remains insufficiently capitalised. Capital represents only 13% of assets and half of the largest banks are close to the ceiling capital-adequacy ratio of 10%.
- Consequently, banks contribute very little to the financing of enterprises. If new credit to the non-financial sector has recently increased significantly in real terms, it has overwhelmingly and increasingly a short-term maturity²⁰. In 1999-2000, banks have contributed to only 3% of total investment and commercial bank loans represented 14,6% of GDP, which is quite low even in comparison with other transition economies.

²⁰ This increase has been especially remarkable as for the Sberbank, with an over 200% increase in 1999-2000.

Graph 7. Commercial banks loans in % of GDP



Sources: EBRD Data

- Lending represents slightly less than 30% of their assets, an equivalent level to liquid assets kept on correspondent accounts²¹. The lending portfolio is excessively short-term (73% of loans mature within one year and 82% of rouble denominated loans), and used mainly to finance working capital. Only the oil industry seems to have an easy access to banking loans. Globally, lending is usually granted within groups of the energy sector industries and their affiliated banks.

²¹ This low lending to industry results in high excess liquidity, as \$ 1bln were kept in CBR correspondent accounts and \$ 3 bln in deposit at the CBR at the end of 2000.

**Appendix: Ownership structure of privatised companies in the Russian industry,
different survey data**

Survey/ date	Worldbank Sample ^a (1994)	Nottingham Sample ^b (1995/96)	Radygin ^c (1996)	Blasi ^d (1996)	Russian Economic Barometer Sample ^e (1997)	Radygin (2000)
Own						
INSIDERS	66.1	59.6	56	58	52.1	27.6
Managers	19.6	14.0	16	18	15.1	7.2
Workers	46.2	45.6	40	40	37.0	20.4
STATE	15.0	9.3	10	9	7.4	12.8
OUTSIDERS	18.9	31.3	34	32.1	38.9	55.4
Individuals	5.9	6.5	9	6	13.9	15.2
Non-financial firms	6.7	10.3	<i>All</i>	15.3	14.7	22.7
Banks	1.0	1.5	<i>other</i>	1.6	0.9	2.2
Investment Funds	4.5	4.6	<i>Outsiders:</i>	5	4.3	4.4
Foreigners	0.4	1.0	25	1.6	1.8	4.7
Holdings/Inv. Comp.	-	5.4		2.6	3.3	6.2
Others	-	1.7	-	0.9	1.6	4.2**
Sample size	235	314	see remarks*	357	139	201

Data sources: ^a Earle/Estrin (1997), ^b Filatotchev et al. (1999), ^c Radygin (1999), ^d Blasi et al. (1997), ^e Aukutsionek et al. (1998), ^f Radygin (2001)

* average of 4 surveys conducted by the RF State Property committee, Federal Commission for securities Markets (FCSM), the Securities Market Monitoring Group of FCSM and the Institute of the Economy in Transition; sample sizes were 400, 250, 889, 174 respectively.

** including, '.2% of shares held by the FCSM itself. These shares could be considered as insiders' share.+