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The main problems of corporate governance in Russia and the possibility of resolving such problems through the application of the Corporate Governance Code and associated regulatory mechanisms

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1. INTRODUCTION

1. This paper seeks to analyse the main issues in corporate governance which have a substantial impact on the quality and perception of corporate governance by investment companies. Above all, the issues identified touch on problems associated with respecting the rights and interests of shareholders and investors.

2. Main objectives:

- to define the main problems and issues in corporate governance and protecting shareholders' rights in Russia, including within the confines of the current Corporate Governance Code [4] (hereinafter, the Code).

- to define possible approaches to resolve issues based on the recommendations of the new Corporate Governance Code and regulatory mechanisms (legislative, stock exchange, etc.) assuring their implementation and to establish corresponding corporate practices.

3. The structure of this paper will address corporate governance issues in the following order:

- problems of compliance with the Code's recommendations as a whole;

- the main issues broached by the current Code;

- the main issues not directly resolved in the current version of the Code.

2. CORPORATE GOVERNANCE ISSUES

4. The main issue of the persistent inadequacy of corporate governance in Russian companies, including among the larger companies listed on the Moscow Stock Exchange, is the formal implementation of the many principles set forth in the Code that are voluntary in nature, and the actual lack of enforcement or improper enforcement of the regulations not directly stipulated by law. Moreover, in a number of serious corporate conflicts or infringements of shareholders' rights, certain unscrupulous shareholders or companies are even trying to exploit these very possibilities that are an unambiguous violation of the law, but that are made very difficult to counteract on the part of regulatory bodies or other shareholders due to flawed approaches to their integration into existing arbitral practices, the inadequacy of sanctions or issues of a technical nature.

5. In relation to the foregoing, it is important to bear in mind that the provisions of the new Corporate Governance Code, which will both be implemented in relation to the requirements of the stock exchange listing / premium listing and will be applied voluntarily through the company Articles of Association or internal documentation based on 'opt in' and 'comply or explain' models, cannot be a substitute for improving the most important legislative instruments with a deciding influence on protecting the rights and legal interests of investors. The corporate governance recommendations which will be

exposed below must be fully in-tune with and complement basic legislative provisions, regulator requirements and corresponding court practices.

2.1. Compliance with the Code's recommendations

6. Based on the guidelines of the Federal Securities Market Commission (FSMC), as approved by decree no. 03-849/r dated 30/04/2003 [3] (hereinafter, regulator guidelines), the information on Code compliance is presented in the form of a list comprising 78 points on the following aspects of corporate governance:

- General shareholders' meeting;
- Board of directors;
- Executive bodies;
- Company secretary;
- Significant corporate actions;
- Disclosure of information;
- Controls on financial and business operations;
- Dividends.

7. An analysis conducted on the 2011 annual reports (based on the regulator guidelines [3]) of 40 Russian companies listed under "A1" and "A2" on the Moscow Stock Exchange (hereinafter, A-listed) (as per Appendix) indicated that 75% of companies disclose information on Code compliance in the form proposed by the recommendations. 5% of companies disclose only partial information – less than 30% of the total number of recommendations according to the guidelines. Taking into account the overall result amongst the A-listed companies, in the sampling and corresponding calculations below only the 30 companies filing such accounts will be used (for comparability and to avoid loaded results).

8. The study of corporate reporting in accordance with the recommendations of the regulatory body for 2011 indicates a level of compliance with the Code's recommendations of 66% of the total number of recommendations used for the companies' reports. "Disclosure of information" shows the greatest level of compliance with the recommendations – 79% of the total number, and the outsider is "Significant corporate actions".

9. The reporting analysis showed that companies include information on Code compliance in their annual report in a form that is convenient for them. Often this information does not make it possible to formulate a balanced opinion on the corporate governance system at a company, but is sometimes entirely misleading to the user of the information.

2.2. Main corporate governance issues broached by the current Code

2.2.1. Problems of companies reporting on Code compliance generally and selectively, for example the activities of committees attached to Boards of Directors

The essence of the problem

10. Reports on Code compliance are only guided by recommendations, which leads to incompleteness and distortion of actual data on companies' compliance with the recommendations.

11. Based on Code compliance reports, issuers actively form Committees attached to their Board of Directors and satisfy the requirements of the Code. However, in practice, some committees are not set up, and their powers under the Code are not handed over to functioning committees, which can have a negative impact on the effectiveness of the Board of Directors with regard to certain aspects that are important to the company and its shareholders.

Examples of non-compliance or impact of the issues

12. It follows from the analysis of the sample (Appendix) that one of the leading recommendations of the Code not adhered to is that there be two committees attached to Boards of Directors. Based on the results of the analysis the risk committee attached to the Board of Directors (or any other committee, apart from the audit committee and human resources and pay committee, to which the duties of this committee are entrusted) does not function. 16% of the companies sampled entrusted the duties of the Risk Committee to the Audit Committee. This result is suggestive of two possible causes: 1) a low level of priority attached to the risk management system in key aspects of the Board of Director's activities; 2) the Board of Directors does not consider the risk committee an effective instrument to develop such a system. The latter assertion in part is corroborated by a survey of members of a Board of Directors carried out by the company PWC in 2012 [22], according to which only 39% of respondents mentioned that their companies had a clearly-defined allocation of analysis and key risks monitoring duties between the Board of Directors as a whole and its committees, which might suggest that the role of committees is limited in risk management.

13. Only 10% of joint-stock companies have corporate conflict resolution committees. The Code does not restrict Boards of Directors in terms of creating various committees, and in practice many companies set up additional specialist committees for preliminary scrutiny of certain key issues. For example, interregional distribution grid companies have created technological connection and reliability committees.

14. The 100% implementation of point 28 of the regulator guidelines [3] with regard to supervision of the Audit Committee by an independent director raises some doubt surrounding the accuracy of reporting. A spot check of three companies with the most informative websites showed that actually the Chairmen of the Boards of Directors at "IDGC of Centre, JSC", "IDGC of the Urals, JSC" and "IDGC of Centre and Volga Region, JSC" are members of a joint executive body of the controlling shareholder ("IDGC Holding, JSC") of these companies. In spite of this the companies report compliance with this point.

15. Based on these factors the decision was made to check the compliance of the report information with the actual data on the Chairman of the Human Resources and Pay Committee of "IDGC of the North-West, JSC". In the regulator guidelines [3] there is also a point regarding the supervision of this committee by an independent director. Admittedly, 13% of the sampled companies declared that they did not comply with this point. In fact, the Chairman of the Human Resources and Pay Committee of "IDGC of the North-West, JSC" in 2011 was an employee of the controlling shareholder of the company, but was not part of

the executive body. In this regard, it must be noted that in the report of "IDGC of the North-West, JSC" on Code compliance, in the corresponding column of the point was a footnote to the effect that, for the purposes of compliance with this point, the company has adopted the notion of an independent director within the meaning of article 83 of the Federal Law "On joint-stock companies". Nonetheless, the hypothesis about the implementation of a uniform policy to report compliance with the Code's recommendations within the IDGC companies making up the "IDGC Holding, JSC" group of companies was not corroborated. An analysis of the "IDGC of South, JSC" report (a company which was not included in the sample since it is not A-listed), the controlling shareholder of which is also "IDGC Holding, JSC", indicated that the accuracy with which the report was compiled depends on the judgement of the company employees compiling the report. "IDGC of South, JSC" reported that the Chairman of the Human Resources and Pay Committee was not an independent director since the head of the committee was an employee of the controlling shareholder.

16. It must be noted that corporate practice, including with regard to the experience of independent directors selected with the support of the Investor Protection Association (IPA), shows that strategy committees in grid, communications, retail, pharmaceutical and various other companies, as well as in the banking sector, carry out this role effectively to a sufficient degree. The issues considered at such committees are actually important, and their recommendations are implemented by the Boards of Directors. But such committees, as well as certain industry-specific technical committees, for the most part do not have the significant supervisory and control duties that they should have in accordance with OECD principles and best practices in leading jurisdictions.

The impact of the issues on the rights and legal interests of shareholders, the main reason for non-compliance/improper compliance with the requirements of the Code

17. This issue has an impact on the right of shareholders to receive clear and accurate information on the state of corporate governance, as well as on general confidence in the corporate reporting system.

18. The main reason for improper compliance with the requirements of the Code relates to institutional regulatory weaknesses, the facultative nature of the committees themselves and the low degree of accountability for presenting information that is not in-keeping with the actual situation.

Does the Code touch upon the issue?

19. The issue of reporting compliance with the Code is touched upon in the regulator guidelines [3]. The issue relates to observance of section 3, Chapter 1 and section 4.7 of Chapter 3.

Possible key mechanisms to resolve the issues

Reporting on Code compliance

20. Further attention must be paid by companies, shareholders, investors and the regulator to the issue of guaranteeing accurate and correct reporting by issuers on the subject of compliance with the recommendations of the Code. The list of provisions set forth by the Code within the regulator guidelines is not exhaustive. The study carried out on company reporting shows the need for a substantial modification of the guidelines.

21. The recommendations of Directive EC 2005/162/EC [6], based on the OECD Principles, provide for implementation of the "comply or explain" principle. Such a principle can only be effective provided that the corresponding obligations are duly fulfilled. FFMS Order no. 11-46/pz-n dated 4 October 2011 [24] only obliges issues to include information in their annual report on compliance with the Code in view of the aforementioned principle. But the form and quality of the report at the present time is only regulated

by the regulator guidelines without any corresponding obligations to follow them. Thus, there is a need to lay down a mandatory report format and to reinforce the administrative accountability of public company managerial structures with regard to disclosing information on compliance with the Corporate Governance Code in terms of administrative sanctions from the regulator.

Increasing the effectiveness of committees

22. Stipulate the existence and actual workings of committees within the listing and securities flotation requirements.

23. Recommend that listed companies adopt internal documents that clearly define the powers of committees attached to the board of directors based on best practices and requirements.

24. Should it not be necessary to set up a risks and conflict of interests committee, assign the corresponding powers to existing committees.

2.2.2. Disclosing information to general shareholders' meetings

The essence of the problem

25. According to the law and the Code, shareholders of Russian companies are not able to obtain high-quality materials for shareholders' meetings in the most appropriate form and within timeframes to suit the shareholders.

26. Many Russian issuers disclose information on closing the ledger with a view to holding a shareholders' meeting on the date of its closure. In practice, there are instances when it is disclosed after the ledger closing date (drawing up a list of shareholders with the right to take part in the meeting).

Examples of non-compliance or impact of the issues

27. Companies frequently disclose information on forthcoming shareholders' meetings in strict compliance with mandatory requirements set forth in acting laws (notice of a meeting with an agenda). This issue only concerns A-listed companies to a lesser degree. From the sample of 40 A-listed companies, 10% do not allow shareholders to consult materials over the Internet. A selective analysis of the materials for annual general shareholders' meetings of 15 companies has shown that there is a second issue – the quality of the materials provided for shareholders' meetings. Only 1 company provides detailed explanations regarding the proposed draft decisions, exhaustive information on candidates for the Board of Directors, including information on their status (independent director, executive director, non-executive director), and comparative tables with corresponding explanations on proposed amendments to the Company's internal documentation.

28. 12.5% of the total number of A-listed companies are prepared to provide materials on the official company website at least 30 days before the date of the meeting. All of the other companies, as a general rule, do this at least 20 days beforehand. In practice, there are cases where the materials are provided 14 days before the date of the meeting.

29. Approximately 40% of A-listed companies give notice of the ledger closing on the date of its closure.

The impact of the issues on the rights and legal interests of shareholders, the main reason for non-compliance/improper compliance with the requirements of the Code

30. Shareholders, especially foreign investors, are in fact stripped of the possibility of exercising their voting right at general shareholders' meetings in terms of being able to scrutinise all of the materials and reach a reasoned decision on items on the agenda. The timeframes for providing the materials (including 20 days) do not allow foreign investors with an impressive chain of depositaries (international, regional and local), each of which also have their own internal voting timeframes, to participate in votes by correspondence having adopted a well-founded position regarding each point on the agenda.

31. Shareholders are deprived of the right to prepare for a shareholders' meeting and to formulate their positions on the votes in advance of the time at which the list of meeting participants is drawn up. Furthermore, if the agenda for the shareholders' meeting lists the payment of dividends, the date of closing the ledger, according to current laws, has an effect on the market value of the shares and on the interests of shareholders in terms of receiving their dividend pay-outs.

32. The main reason for complete non-compliance with the principles of the Code guaranteeing effective protection of the interests of shareholders is the compliance by a number of companies solely with the minimum technical legal requirements to disclose information.

Does the Code touch upon the issue?

33. The Code regulates the process for disclosing information whilst a company is making preparations for a general shareholders' meeting, but it does not give recommended timeframes for providing the information or a detailed description of the required quality of the materials.

34. The issue relates to compliance with the recommendations of section 1.4. of Chapter 1, section 1 of Chapter 2 and section 1 of Chapter 7 of the Code.

Possible key mechanisms to resolve the issues

35. The recommendation is that the Code be supplemented with guideline timeframes to disclose materials for general shareholders' meetings online at least 30 days before the meeting date. Supplement the listing requirements with compliance with the recommendations of the Corporate Governance Code in terms of timeframes to disclose materials for general shareholders' meetings online at least 30 days before the meeting date.

36. Ensure the inclusion of criteria to guarantee that high-quality materials are prepared for shareholders' meetings in the regulator guidelines on reporting with regard to compliance with the new Corporate Governance Code.

37. It has been suggested that a minimum timeframe be established to give notice of the ledger closing date at least 10 days before the ledger closing for the purposes of compiling a list of individuals with the right to participate in a general shareholders' meeting.

2.2.3. Problems concerning the activities of the Board of Directors

The essence of the problem

38. The institute of independent directors is undergoing active development in Russia without there being any corresponding changes to the law. The criteria for independence do not correspond with

international and best Russian practices. An independent director is restricted in his rights and tools to exert an effective influence on the strategy of a Board of Directors.

39. The current restrictions regarding independent directors have an impact on the effectiveness of a Board of Directors.

40. In practice, appraisals of the effectiveness of a Board of Directors do not take place or are simply a formality.

Description and level of impact of the problem

41. In Russia currently there is an on-going qualitative process to re-think the role and place of the Board of Directors within the corporate governance system.

42. The President and Government of the Russian Federation have expressed concerns over the state of corporate governance in Russian companies, following initiation of the active development of the institute of independent directors in 2008. Within this context, companies in which the government holds a share of the equity have been actively replacing government officials with professional directors. The scale of this programme is impressive as, in essence, it affects the majority of government-backed joint-stock companies. It must be noted, in this regard, that the federal body responsible for implementing this initiative (the Federal Agency for the Management of State Property, hereinafter, Rosimushchestvo) is striving to choose professional plenipotentiaries for all of the equity holdings that it owns, including in companies where Rosimushchestvo is a minority shareholder. In 2012 Rosimushchestvo voted to appoint 2,113 professional directors at 847 companies with government equity, including 716 companies where a Chairman of the Board of Directors was appointed. In this regard, Rosimushchestvo distinguishes two statuses for professional directors: independent directors and professional plenipotentiaries, who are obliged to vote on directorial matters according to the instructions of Rosimushchestvo.

43. Minority shareholders and portfolio shareholders have also become more active in vote consolidation processes to appoint independent directors. According to the Agency for Direct Investments (ADI) the number of yearly appointments of independent directors and representatives of minority shareholders by ADI-member portfolio investors has increased to 80 public companies per year (data for 2011-2012). In this regard, ADI members are managing to appoint their representatives and/or independent directors at 30-35 public companies. This statistic does not take into account nominations and elections of directors by portfolio investors that are not ADI members.

44. At the same time the company Deloitte [14], having analysed the composition of the boards of directors of 132 Russian companies as of 1 August 2012 and having compared them with the adjusted figures of Standard & Poor's (S&P) analysis for 2006 [20], came to the conclusion that, despite the efforts of the government, the proportion of foreign directors on the boards of directors of state companies over the last six years has increased only slightly: they account for 20% of positions, which is only 3% higher than the indicator for 2006 according to the study by S&P (after recalculation using the research criteria of Deloitte). Thus, the scale of the changes is relatively modest. Firstly, this is linked to the approaches adopted to assess members of a board of directors (foreign and independent directors). For example, currently the government considers the directors of companies with a controlling government equity share to be independent directors on the boards of different state companies, whereas international experts adhere to more strict criteria. An investment company represented by portfolio investors also consider it improper to classify this type of director as an independent director.

Criteria for director independence

The current criteria for independence according to the Code does not satisfy international approaches and current practical realities. In international practice, as a general rule, distinctions are made between executive, non-executive and independent directors. The strictest criteria are applied to independent directors as the key role of increasing effectiveness and objectivity in resolving matters involving the remit of the board of directors are assigned to them. Thus, for example, the largest global company offering corporate governance recommendations to shareholders, Institutional Shareholder Services, recommends that there be no tangible benefit, either indirectly or directly, derived from their involvement with the company board of directors, either from any key company shareholders or from the company itself, excluding remuneration [21].

The current criteria of the Code do not prohibit there being any possible related affiliation between a director and individuals in relation to whom the Company has obligations and/or tangible benefits may be received from the Company, or individuals who may be or may have been employees of the Company. Moreover, directors who are in fact independent according to the Code may be recognised as employees of the majority shareholder (if the shareholder is a legal entity) not belonging to the managerial bodies of the majority shareholder, or as an actual shareholder of the company with the right to dispose of up to 20% of the company's shares. It must be noted that many Russian companies, especially those which have made an IPO/SPO, already use the stricter definitions that meet the international criteria. Rosimushchestvo also uses criteria refined together with corporate governance experts to assess the independence of candidates which eliminate the aforementioned flaws. When submitting an application online through Rosimushchestvo's online portal to sit on managerial and control bodies in a joint-stock company every candidate must confirm whether they comply with the established criteria for independence.

Effectiveness of the board of directors

45. According to the Code independent directors are called upon to form an objective opinion of the Board of Directors. Based on Russian practices independent directors rarely have any influence over the outcome of a decision. The main tools of an independent director in Russia are his or her charisma and skills in terms of persuading the remaining members of the Board of Directors. Extremely rare are situations when the internal documents of a Company serve as an effective mechanism for independent directors to exert an influence on the decision-making process. In part this is due to the lack of desire on the part of the owners to delegate powers to independent directors. A joint study by the company KPMG and the Association of Managers into corporate governance practices in Russia [10] showed that the perception of an independent director among representatives of a Russian business association is biased towards establishing a company's image, and not playing a key role in deciding on strategic matters and balancing the interests of shareholders.

46. Nonetheless, the Code recommends several tools. Point 2.2.3. of the Code recommends that independent directors be elected with the backing of at least one quarter (1/4) of the Board of Directors in order to increase their influence on the decision-making process. It is also recommended that the Company Articles of Association provide that there be at least 3 independent directors on the Board of Directors in line with the criteria laid down by the Code. In this regard it needs to be clarified that the regulator guidelines [3] do not consider the need for issuers to provide information on the presence of such provisions in the company Articles of Association (as a general rule, such provisions do not exist). The recommendations only suggest that issuers provide information on the presence of at least 3 independent directors on the Board of Directors who meet the requirements of the Code.

47. In accordance with point 4.14. of the Code, the recommendation is made that the Articles of Association regulate the procedure for defining the quorum so that independent directors can have an influence on the decision-making of the Board of Directors, especially when deciding on highly important matters. This point is reflected in the regulator guidelines [3]. The analysis of the 40 A-listed companies

has shown a lack of desire on the part of the companies to endow independent directors with such instruments. In the Articles of Association of 20% of the companies there were provisions for determining the quorum of the Board of Directors, making it possible to ensure a mandatory level of involvement of the independent directors in meetings of the Board of Directors.

48. Point 4.15 of the Code recommends incorporating into the Articles of Association or other internal Company documents stricter quorum requirements for the most important matters. In particular, the quorum must be a qualified majority of two thirds (2/3) of the elected members of the Board of Directors in order to approve the priorities of the company's activities and financial and business plan, to approve the company's dividend policy, to discuss restructuring or liquidation of the company at a general shareholders' meeting, to reduce (increase) the company share capital, and to issue recommendations on the value of annual dividends. This provision, in spite of its importance, is not reflected in the regulator guidelines [3]. Accordingly, companies do not report on compliance with such an important recommendation, and, moreover, we know of no practical cases where such provisions have been incorporated in full into the Articles of Association of Russian companies.

49. It is also important to note that in spite of the progressive nature of this provision in its proposed form it is relatively ineffective. Take the following simple example: with an 11-member Board of Directors a meeting without the involvement of the 3 independent directors would be quorate. Moreover, the qualified majority approach to quorum does not allow any influence over the outcome of decisions of a Board of Directors, since the decision itself, provided that quorum has been achieved, unless stipulated otherwise by current joint-stock company laws or internal company documents, is adopted by a simple majority (accordingly, without taking into account the opinion of the independent directors, if their position is not congruous with the tabled motion).

Evaluating the effectiveness of a Board of Directors

50. For Russian companies there are no statistics for Boards of Directors carrying out evaluations of their own effectiveness.

51. At the same time, according to a survey of board members in 2012 by PWC [22], 65% of respondents confirmed that their Boards of Directors carried out their own evaluations, as a rule, by distributing and filling in a specialist questionnaire (35% of respondents use this approach). Out of the respondents to this research 87% were non-executive directors, but admittedly information on the absolute data values of the sample are not available, which makes it difficult to appraise the prevalence of this tendency

The impact of the issues on the rights and legal interests of shareholders, the main reason for non-compliance/improper compliance with the requirements of the Code

52. The lack of desire on the part of majority shareholders to endow all members of the Board of Directors and/or independent directors with instruments to influence the decision-making process of the body in practice limits the effectiveness of the strategic managerial body.

53. The current recommendations of the Code support inaccurate and ineffective tools to increase the role of independent directors and/or members of a Board of Directors in the decision-making process. There are also no provisions regarding reporting compliance with the most important recommendations.

54. The lack of any qualitative evaluation of the effectiveness of a Board of Directors does not allow its members to heighten the productiveness of its activities.

Does the Code touch upon the issue?

55. The issues relate to compliance with the recommendations of section 3 of Chapter 1, and sections 2.2. and 2.3. of Chapter 3 of the Code.

56. The Code does not stipulate any evaluation of the effectiveness of a Board of Directors.

Possible key mechanisms to resolve the issues

57. One suggestion is to supplement the independence criteria to tie in with the aforementioned international and Russian practices and to take into account the need to resolve the problems outlined above.

58. It would seem appropriate to ensure uniformity in the definition of an independent director across the various regulatory and legal enactments of the Russian Federation. The notion of an independent director in article 83 of the Federal Law "On joint-stock companies" requires substantial additions to be made.

59. Another suggestion is to advise companies to stipulate stricter requirements for decision-making on the most important matters. In order to determine the outcome of a vote on important issues a qualified majority of at least three quarters (3/4) of all members of the Board of Directors should be used. In the case of a different number (a greater number of board members) a recommendation needs to be established regarding compliance with the provision to guarantee the appointment of independent directors to constitute at least one quarter (1/4) of the members.

60. It would be advisable to canvass opinions among investors and shareholders in order to append to the proposed Code a list of the most important matters for which more stringent requirements should be necessary for the decision-making process.

61. It would also be wise for companies to establish a monitoring and shareholder information process with regard to the compliance of members of the Board of Directors with the independence criteria: as soon as a list of candidates applying to become members of the Board of Directors has been approved before the next general shareholders' meeting at which the matter of electing the new Board of Directors will be reviewed.

62. The EC Recommendations (2005/162/EC) [6, 7] on the role of independent directors of listed companies and on the committees of Boards of Directors stipulates the need to evaluate Boards of Directors. In the comparative analysis carried out at the request of the OECD of the Russian Code and similar codes of foreign jurisdictions and international enactments [9] it was suggested that a recommendation be incorporated to the effect that a Board of Directors must carry out an evaluation of its work every year.

2.2.4. Controls on financial and business operations

2.2.4.1. Ensuring the independence and effectiveness of the internal controls

The essence of the problem

63. The subjugation of managers and employees of a control and audit service (as defined by the Code) to executive bodies of companies does not allow companies to implement the most effective model of an internal control system.

Description of the problem

64. Out of the sampled A-listed companies, 20% of issuers' control and audit services are directly subordinate to the Chairman of the company Board. The remaining companies, as a general rule, provide accountability to the Audit Committee or to the Board of Directors or administrative subjugation to the head of the company executive body. In practice partial subjugation places further demands on the head of this division in terms of his or her independence from the executive bodies and the possibility of impartial performance of his or her duties, including in respect of auditing the activities of the executive body itself.

The impact of the issues on the rights and legal interests of shareholders, the main reason for non-compliance/improper compliance with the requirements of the Code:

65. These issues do not allow complete independence to be guaranteed and, consequently, an effective internal control is not guaranteed, which is a major problem both for existing shareholders and for potential investors in the company, something which has received considerable attention in the OECD and EU corporate practices and regulatory systems.

66. If the management were to exert a significant influence over the Board of Directors the executive body would be able to subjugate the internal control body directly to itself. In implementing partial subjugation practices, the executive body makes reference to employment law.

Does the Code touch upon the issue?

67. This issue is touched upon by the Code, which requires a due level of independence of the internal control system (for example, section 8, point 1.3.5.).

Possible key mechanisms to resolve the issues

68. The most effective degree of independence of internal control officials would be guaranteed if they were appointed and dismissed directly by the Board of Directors (Audit Committee). In such a setup there would be a quorum involving independent directors (3 or more) – a qualified quorum of independent directors (for example, under the Audit Committee).

69. Such a change would require amendments to the Employment Code of the Russian Federation [25], whereby employment relations fall under the remit of the executive body of the business organisation. One suggestion is to introduce an approved exemption solely for joint-stock companies whose securities are floated on the stock exchange. The scope of such companies could also be restricted to those companies with a premium listing or simultaneous listings on both the Russian stock exchange and international stock exchanges.

70. At the same time, the implementation of similar requirements solely on the basis of internal company documents would be ineffective as it would contravene the Employment Code of the Russian Federation [25].

2.2.4.2. The effectiveness and potential of the Audit Board

The essence of the problem

71. In practice the separate control body in Russian companies, as a general rule, is perfunctory.

Description of the problem

72. Point 2 of article 85 the Federal Law "On joint-stock companies" does not actually restrict the remit of the Audit Board and allows company shareholders to determine the matters that fall under the control of this control body. Moreover, there is not a single element of the internal control system (Audit Committee, control and audit service) that has similar powers in terms of convening a general shareholders' meeting and carrying out an audit at any time.

73. Based on a study into the corporate governance practices of 150 Russian companies at the end of 2011 by the Russian Institute of Directors with the involvement of the Russian School of Economics [17], 43% of the companies sampled as a whole and 31% of listed companies have practices where members of the audit board are not individuals with roles on the managerial bodies of the company and are not company employees. In this respect there are no studies into whether independent experts and representatives of minority shareholders sit on the Audit Boards of companies. A simple analysis of the Audit Board pay system at the majority of A-listed companies corroborates the assertion that the approach to organising the activities of such a control body is merely perfunctory. It is also extremely rare that companies disclose such information on the activities of the Audit Board; often the work of the Audit Board simply amounts to preparing findings based on the results of audits of the financial and business activities of the joint-stock company for the accounting year in advance of the general shareholders' meeting. However, it is important to note that in Russian practices you do encounter highly effective Audit Boards which carry out several audits over the corporate year and based on the results of which Boards of Directors adopt executive decisions in relation to the General Directors of companies.

The impact of the issues on the rights and legal interests of shareholders, the main reason for non-compliance/improper compliance with the requirements of the Code

74. Shareholders are deprived of an effective control body to oversee the financial and business activities of a Company. Majority shareholders for one or another reason refuse to use the full potential of the audit board, and minority shareholders are not able to elect their own representatives to sit on it, since candidates for the Audit Board are elected by a simple majority of votes.

Does the Code touch upon the issue?

75. The Code of Corporate Conduct exposes in some detail how the activities of the Audit Board are organised (Chapter 8, Section 3).

Possible key mechanisms to resolve the issues

76. One proposal is to add recommendations to the Code to define an expanded remit for the Audit Board in company Articles of Association and internal documents, as well as to outline the rights of members of the Audit Board and the sphere of audits during inspections.

77. It is important that the Code take note of the pay system for members of the Audit Board as this could be conducive to attracting qualified specialists into the realm of company audits.

78. There also needs to be some regulation of the interaction process between members of the Audit Board and the control and audit service of a company (in particular, the involvement of specialists from the service in audits at the request of the Audit Board).

79. By way of analogy with the Board of Directors, it would be wise to stipulate a minimum number of independent members of the Audit Board whose presence would bring some balance to the activities of the control body and avoid a singular influence from the majority shareholder. To take account of the

opinions of the majority of Audit Board members when adopting decisions a recommendation could be made that the qualified majority system be used when determining the outcome of a vote on agenda items at Audit Board meetings.

80. On a legislative level it would seem reasonable to establish a cumulative method of electing Audit Board members, which would in fact allow minority shareholders to play a role in forming such an important control body.

2.3. The main corporate governance issues associated with general questions of legal regulation not directly touched upon by the Code

2.3.1. The mandatory tender offer when acquiring 30% or more of a company's shares

The essence of the problem

81. This problem can be broken down into the following main issues:

- The absence of obligations for entities having acquired 30% or more of the share capital to submit a tender in an indirect acquisition (including the acquisition of ADR and GDR and the acquisition of a parent company holding 30% or more of the share capital);

- The absence of obligations to submit a tender for entities having obtained the right to not own but to use shares or establish control over the management;

- The lack of understanding regarding the duty to submit a mandatory offer in the event of a reduction of the entity's equity below the legally stipulated threshold of 30%, 50% or 75% of shares after the initial acquisition, but before the expiry of the timeframe for submitting such an offer.

The impact of the issue on the rights and legal interests of shareholders

82. The issue has a significant impact on the rights and legal interests of company shareholders, since in the case of an indirect acquisition corporate control changes also, and the business policy of the company changes, which has an impact on profits, as well as the company's dividend policy.

83. One of the most recent key examples is the acquisition by the national company Rosneft, JSC of 100% of the shares in TNK-BP International LLC, which owns approximately 95% of the shares in TNK-BP Holding, JSC. In this example it is clear to see that there is a need to protect the interests of investors that have invested their funds in a particular business model (receiving high dividend pay-outs) and that have been unable to leave the company without making a loss following the change in owner and, most importantly, following a change in the company's business model (after the deal was announced the new owner officially declared that the dividend pay-outs would no longer be paid out at the same levels as the previous owner). The company's share price after the announcement of the acquisition dropped by more than 50%.

Does the Code touch upon the issue?

84. According to section 2.3. of the Code "It is not recommended during an acquisition to exempt the buyer of their duty to propose to shareholders that they sell the ordinary shares that they own (issued securities converted into ordinary shares)". Thus, the Code implies that shareholders should have a reasonable guarantee, during a change in the corporate control of a company, of divestment at a fair price and procedures that protect their rights.

Possible key mechanisms to resolve the issues

85. The issue of a direct acquisition at levels in excess of 30%, 50%, 75% and more, including jointly with affiliated entities, has been examined in Russian legislation. The obligations laid down by Russian law, and the procedures for such obligations, do not always (especially in relation to indirect and agreed control) tie in with the requirements stipulated by the OECD Corporate Governance Principles on regulating takeovers [8] and the main provisions of the EC Directive 2004/25/EC [4, 11].

86. At the present time an explanation (letter) is being prepared by the Presidium of the Supreme Arbitrazh (Commercial) Court of the Russian Federation on additional measures to protect the rights of shareholders within the context of court practices and the interpretation of the law during corporate takeovers [11]. Moreover, it is examining the possibility of agreements being signed between the buyer and minority shareholders.

87. FFMS Russia has prepared [11] a draft bill on amendments and addenda to chapter XI.1 of the Federal Law "On joint-stock companies", seeking to eliminate current flaws in relation to voluntary and mandatory offers, including indirect equity acquisitions.

88. The main problem currently relates to the protraction of the FFMS draft bill examination and ratification process. As far as financial market participants were aware as of the time of the OECD Corporate Governance Roundtable in October 2012 (hereinafter, the Roundtable) little has changed in terms of the progress of this bill.

89. If the FFMS draft bill as amended by the regulator is approved a whole facet of the problems most troubling investors at present in the field of corporate governance and the protection of shareholders' rights will be resolved.

90. The issue of mandatory offers poses the greatest number of problems which can only be regulated by legislative norms and corresponding court practices.

91. At the same time the new Corporate Governance Code could be supplemented by a section on protecting investors' rights during takeovers, which could include the following points:

92. - safeguarding the right of shareholders to mandatory redemption of their shares if the entity that has single-handedly or jointly with its own associated parties has obtained the right to jointly and severally or subsidiarily disposed of 30% or more of the shares, as a result of which its ownership threshold (disposition below the stated threshold) has fallen within a reasonable timeframe (for example, 50 days);

93. - the stipulation that when examining takeovers it must be guided by the notions of "having the right of disposition", "jointly electing a single-member executive body" and "actually acting in concert". This should be directed at the fact that the responsibility for issuing a mandatory offer lies with any entities whose actions in concert attest to their exercising joint control over more than 30%, 50% or 75% of the voting shares of the company both directly and within a group of not just affiliated by associated entities ("parties acting in concert"), EC Directive 2004/25/EC [4];

94. - guarantees of self-protection of shareholders' rights if the offer has not been made within the deadline, including by them sending such an offer on their own;

95. - a description of the independence mechanisms for defining the redemption price and the inadmissibility of an arbitrary re-appraisal of this price.

96. Problems of a technical nature (evading acceptance of shares in an account, late payment for shares, the problem of 'accelerated delisting', with a view to establishing an unfavourable redemption price etc.) can in part be resolved by incorporating corresponding provisions in the new Corporate Governance Code together with stock exchange regulations and legislative measures.

2.3.2. The performance of obligations to buyout shares from the remaining shareholders at an equitable price by entities having acquired 95% or more of a company's shares

The essence of the problem

97. This problem can be broken down into the following main issues:

- The lack of any explicit obligations to issue an offer for entities having acquired 95% or more of the share capital of a company in an indirect acquisition (including the acquisition of ADR and GDR and the acquisition of a parent company owning 95% or more of the share capital);

- The active use in practice of mechanisms to underestimate the equitable price by exploiting legislative flaws (for example, establishing an artificial acquisition price by means of transactions between technically independent parties but parties that are in fact acting in concert).

The impact of the issues on the rights and legal interests of shareholders, the main reason for non-compliance/improper compliance with the requirements of the Code

98. This problem has a significant impact on the rights and legal interests of company shareholders involved in squeeze-outs.

99. In particular, there is the well-known case of Sedmoi Kontinent, JSC, the controlling shareholder of which, according to FFMS and the minority shareholders, did not in fact acquire the necessary number of shares in the voluntary offer, and as a result of which came to have the right to squeeze-out the shares from the remaining minority shareholders. According to the regulator, all of the preliminary takeover transactions were carried out with entities controlled by the majority shareholder, as a result of which the acquisition price was markedly lower than the valuation that the market gave for the corresponding period. The regulator sided with the minority shareholders and in accordance with an order issued by FFMS the majority shareholder was prohibited from carrying out steps required for the squeeze-out. Corresponding orders were issued to the depositaries and registrars of the issuer. However, the issuer and controlling shareholder, having replaced the registrar to which the order was sent, continued to write-off the shares. The regulator filed a claim in court against the majority shareholder, but was unable to prove the affiliation between several shareholders of Sedmoi Kontinent, JSC and offshore companies involved in the share sale/purchase during the voluntary offer, resulting in giving rise to the right of squeeze-out.

100. Current laws lack the notion of "actions in concert", which makes it significantly more difficult to prove the affiliation between offshore companies.

Does the Code touch upon the issue?

101. The issue is not touched upon in the Code.

Possible key mechanisms to resolve the issues

102. As a whole, the measures set forth in the draft Letter by the Presidium of the Supreme Arbitrazh (Commercial) Court of the Russian Federation and the amendments and addenda to section XI.1 of the Federal Law "On joint-stock companies" with regard to these issues would make it possible to solve the

majority of these pressing issues and to harmonise practices in the Russian Federation with those of the EU.

103. This problem does not relate entirely to the introduction of the Corporate Governance Code.

104. At the same time, it would be advisable to supplement the new Corporate Governance Code with a section on protecting the rights of investors during takeovers, which would take into consideration the recommendations of the comparative analysis of the Code with similar codes of foreign jurisdictions and international enactments [9, section 6].

105. The Code needs to establish:

- the powers of the Board of Directors in terms of supervising essential corporate actions during takeovers;
- requirements to establish uniform conditions for all shareholders during share acquisitions, both in public offerings and in other contexts;
- the need to make an offer based on an equitable share acquisition price.

106. It would also be advisable for companies to be bound by these conditions when taking on listing obligations.

2.3.3. The fairness for shareholders of transactions during issues, restructuring, large-scale transactions and non-arm's length transactions where non-monetary valuations are used

The essence of the problem

107. The absence of a supervisory role on the part of the Board of Directors and independent directors with regard to:

- the participation of independent directors in selecting an independent appraiser to determine the value of assets invested in the share capital or subject to a transaction;
- resolving disputes if independent directors do not agree with the value of an asset as determined by an independent appraiser.

Description of the problem

108. The Federal Law "On joint-stock companies" (article 77) regulates these issues in detail, including for non-arm's length transactions, where the prerogative to determine the price lies with the company Board of Directors, or even with independent directors not involved in finalising the transaction (for companies with more than 1000 shareholders). Moreover, article 75 establishes the quotation in the case of voluntary delisting of a company as a guide for the share redemption price. In addition to this, if between 2% and 5% belong to the state the competent state body will be involved in resolving this issue.

109. Thus, the essence of the problem lies not in the lack of a requirement to involve an independent appraiser or in the procedure used by a company's competent bodies to determine the price, but rather in the notion of an independent director, as explained above, and their powers to carry out preliminary controls on the transactions are not sufficient to effectively protect the rights of shareholders.

110. This paves the way for the management and/or representatives of the majority shareholder to elect a *de jure* independent, but *de facto* subordinate appraiser, or an appraiser without suitable experience.

The impact of the issues on the rights and legal interests of shareholders, the main reason for non-compliance/improper compliance with the requirements of the Code

111. Persistent defects in regulating the approval of non-arm's length transactions and large-scale transactions, as well as court practices in terms of challenging such transactions, including those finalised without approval, do not make it sufficiently possible to prevent transactions being concluded at prices not in line with the reasonable expectations of investors.

Does the Code touch upon the issue?

112. The Code only offers recommendations on the involvement of an independent appraiser for large-scale transactions and absorption transactions.

Possible key mechanisms to resolve the issues

113. The solution to this problem lies with an improvement in legislation and voluntary regulation in the appointment of independent directors, determining a procedure to recognise a party as having an interest in a particular transaction, and establishing a decision-making procedure for large-scale transactions.

114. With regard to court arbitration of transactions concluded without the approval of the Board of Directors, or where there are disputes over the essential terms and conditions of such transactions, preparations are under way at the present time to incorporate into the Civil Code of the Russian Federation a range of amendments to classify transactions and to provide a procedure to challenge them are recognise them as invalid, as well as to provide a procedure to enforce the consequences of them being recognised as invalid.

115. In the Code's recommendations there perhaps ought to be provisions whereby the appraiser selection procedure in a number cases should also be carried out by the Board of Directors or independent directors. Companies with an interest in a premium listing may potentially take on such obligations themselves.

2.3.4. The involvement of "quasi-treasury" shares in decision-making by a general shareholders' meeting

The essence of the problem

116. The involvement in voting at a general shareholders' meeting of legal entities under the control of the company and its management with company shares on their balance sheet.

The impact of the issues on the rights and legal interests of shareholders, the main reason for non-compliance/improper compliance with the requirements of the Code

117. In Russian company practice quasi-treasury shares have been used in votes and have had a significant impact on the decision-making process (for example, at GMK Norilsky Nikel, JSC). Currently, quasi-treasury shares are held by a number of oil companies, but how they are used is unknown. The main reason why companies are still able to use quasi-treasury shares is the lack of corresponding legislative norms, even the law explicitly forbids treasury shares from exercising rights.

Does the Code touch upon the issue?

118. The Code does not directly address this issue.

Possible key mechanisms to resolve the issues

119. The solution to this problem lies with an improvement in legislation in terms of the recognition of affiliated entities and groups of entities (with regard to defining which shares are actually under the control of the company) and an explicit ban on such shares being able to vote at general shareholders' meetings. The Code could express the widely-recognised principle that voting with shares under the direct control of the company should not be allowed. However, for this to be effective, this provision needs to be laid down in a binding document.

2.3.5. The approval of non-arm's length transactions in accordance with best corporate governance practices

The essence of the problem

120. The problem of determining which parties with an interest in a particular transaction, and in particular employees of subsidiary or parent companies (with 20% ownership), should not be recognised as disinterested parties.

121. The need to inform the Board of Directors of any employees with a conflict of interests when approving or concluding such a transaction, and the need to establish clear rules to prevent interested parties from voting.

Description of the problem

122. In practice Russian joint-stock companies have firmly adhered to the letter of the law regarding non-arm's length transactions. Therefore, all of the failings in shareholders' actual control over observing the expediency and rationality of such transactions for the Company are on the following levels:

- the lack of any obligation for an official sitting on an executive body of a company preparing a transaction to inform the Board of Directors or an internal controller of a potential conflict of interests with regard to the transaction;

- even when the law stipulates that a transaction must be approved by a majority of votes by members of the Board of Directors without any interest in the transaction, the group of interested parties is rather narrowly defined. For example, employees of subsidiary and dependent businesses not constituting a majority in the governing board of the partner are recognised as having no interest in the transaction, even though their dependence on the management of the parent company due to the presence of a direct hierarchy in their working relationship is obvious. For both legal entities and natural persons the notion of affiliation ties in with competition law and does not fully correspond to recognised international practices on associated parties and parties acting in concert;

- when a transaction must be approved by a majority of arm's-length independent directors, the various regulatory documents offer differing notions of the independence of directors (as noted above, companies are only guided by the relatively narrow norms set forth in article 83 of the Law "On joint-stock companies").

The impact of the issues on the rights and legal interests of shareholders, the main reason for non-compliance/improper compliance with the requirements of the Code

123. These imperfections in the legislation and the voluntary regulation of internal corporate conflicts of interests have a considerable impact on shareholders' interests. Non-arm's length transactions, especially in holding companies, like many major Russian public companies are, have a significant effect on the results of their activities. Also, a portion of large-scale transactions and contracts under investment programmes are non-arm's length transactions.

Does the Code touch upon the issue?

124. In the Code the question of non-arm's length transactions is not directly broached (even though there is a provision on general conflicts of interests among members of Boards of Directors, [2] point 3.1.4).

Possible key mechanisms to resolve the issues

125. As indicated in the report on the OECD Russia Corporate Governance Roundtable held on 25-26 October 2012 [18], the most serious problem is the lack of a suitable definition of affiliated entities. As suggested, the amendments to the Civil Code currently at the second reading stage with the State Duma seek to resolve this problem.

126. Furthermore, work is currently on-going to consolidate the proposals in the draft bill developed by FFMS Russia on amendments to the Federal Law "On joint-stock companies" regarding the definition of, procedure to elect and powers of independent directors.

127. The inclusion in the Code of provisions regarding voluntary commitment to obligations (as part of the listing requirements or in internal documents), which will require all company officials to report conflicts of interests, would be an important step towards improving corporate practices.

2.3.6. The approval of large-scale transactions in accordance with best corporate governance practices

The essence of the problem

128. Since the law requires members of a Board of Directors to unanimously approve large-scale transactions, or to refer them to a general shareholders' meeting, there is a need to ascertain that when such transactions are approved there are no conflicts of interests among members of the Board of Directors. At the present time such rules have not been established.

129. The law only requires transactions involving over 25% of the balance-sheet value of the company's shares to be approved as large-scale transactions.

130. For transactions involving 25 to 50% of the balance-sheet value of the company's shares, when they are tabled at a general shareholders' meeting, the requirement is a simple majority of votes, and for transactions over 50% a 3/4 majority.

131. In order to value large-scale transactions the appraiser is enlisted by a company in accordance with the standard procedure, i.e. the appraiser may be commissioned with the approval of the Board of Directors or directly by the management depending on the company's regulations.

The impact of the issues on the rights and legal interests of shareholders, the main reason for non-compliance/improper compliance with the requirements of the Code

132. These issues substantially infringe the interests of the company and its shareholders. At the same time, if large-scale transactions are non-arm's length transactions they are only subject to approval as non-arm's length transactions.

133. A number of companies, for example, in the energy and telecommunications sectors, reduce the value of transactions recognised as large-scale in their articles of associations, and such beneficial practices are already coming into play in many companies exhibiting the best corporate governance. The proactivity of minority shareholders and independent directors plays a large role in this.

134. The approval of a large-scale transaction by a shareholders' meeting (balance-sheet value of up to 50%), as before, is still a question of a simple majority. The majority shareholder can approve the transaction, so long as it is not a non-arm's length transaction, essentially without any obstruction.

Does the Code touch upon the issue?

135. Section 6.1.2. of the Code recommends extending the procedure for approving large-scale transactions to a greater number of transactions that are significant to a company.

Possible key mechanisms to resolve the issues

136. The recommendation is to lay down in law a definition for articles of association of a qualified quorum to approve arm's-length large-scale transactions.

137. For already listed companies it would be advisable to incorporate into the New Corporate Governance Code provisions whereby:

- any management or member of a Board of Directors preparing a transaction must declare if he or she has conflict of interests with regard to the large-scale transaction (including arm's-length transactions);
- independent directors or the Board of Directors must be given powers to employ the appraiser;
- there is a recommendation that independent directors and experts recommended by them have a role on company purchasing bodies to be involved in large-scale deals.

2.3.7. Parent company control over the activities and transactions of subsidiary and dependent companies

The essence of the problem

138. Information disclosure in relation to the activities (significant facts, key decisions of the Board of Directors, etc.) of subsidiary and dependent companies (hereinafter, SDC) is not consistent with the volumes and quality of information disclosure by the parent company (excluding IFRS reporting where required by law). Despite the fact that large-scale companies have risk management systems and internal control departments, information on their activities in relation to SDCs for minority shareholders of a parent (holding) company is practically unavailable.

139. The Federal Law "On joint-stock companies" ([1], Article 65, point 1, sub-point 18) places the solution to this issue at the discretion of the Company itself.

140. In Articles of Association and provisions on the Board of Directors at many large companies the Board of Directors does not have any direct powers of control over the key decisions and transactions of SDCs (the acquisition and disposition of SDC assets).

141. Directives on voting at SDC general shareholders' meetings are often issued by the company's management without the approval of the Board of Directors at the holding company. In practice there are also instances when the management of the holding company, for example, puts forward (nominates) members of the Board of Directors and even after the appointment issues to the Board of Directors of the parent company for approval a list of the elected candidates, not offering any option to make corrections.

The impact of the issues on the rights and legal interests of shareholders

142. These problems have a significant impact on the interests of minority shareholders, since SDCs are often the hubs generating the profits and expenses and are engaged in key asset acquisition and disposition transactions. This practice does not tally with the OECD Corporate Governance Principles 2004 ([8], in particular the provisions set forth in Chapter 4, Chapter 6 point D etc.)

Does the Code touch upon the issue?

143. The Code only offers general recommendations linked to the existence of a risk management and internal control system.

Possible key mechanisms to resolve the issues

144. The provisions on the necessary disclosure of information on the activities of subsidiary and dependent companies could be regulated by regulator enactments and listing regulations.

145. The requirements regarding the control powers of the Board of Directors (including independent directors) of a parent company could be made binding on companies included on the quotation lists of a different level. Such obligations should be incorporated into the Articles of Association and internal documents of the parent company. In this regard, corresponding recommendations should be included in the Code.

146. Such requirements could relate to:

- the approval and selection of nominations from the parent company to the Board of Directors and Audit Board of SDCs (taking into account the opinions of independent directors);

- the approval of nominations for director-general (managing director) of a SDC;

- a request by the Board of Directors (independent directors) for full documentation for the holding company to audit the activities of the SDC, including SDCs where the parent company has 25% of the shares or where it can amass 25% for such an audit together with other shareholders;

- establishing the "key" principle – mandatory approval of directives for members of the Board of Directors of subsidiary and dependent companies selected from the parent company to vote on the most important matters relating to the SDC's activities, including on questions of disposing of and acquiring assets (the directives must be approved taking into account the opinion of independent directors).

3. CONCLUSIONS AND RECOMMENDATIONS

147. Based on data from research into the Russian market over the period from May 2008 to November 2012 carried out by analysts at Sberbank CIB [23], excluding a short interval (2006), the Russian market is continuing to trade at a discount to emerging markets, regardless of the macroeconomic conditions. According to employees at Sberbank Investment Research/Troika Dialog, based on numerous investor surveys, corporate governance is one of the main factors behind this discount. The maximum discount over the research period was 77% to emerging markets, and the average was approximately 30%.

148. Thus, corporate governance touches on strategic questions of economic development and serves as an indicator of the investment appeal and maturity of the Russian market to portfolio and strategic investors.

149. A key document describing in detail the corporate governance functioning and interaction mechanisms is the current Code.

150. The 2002 Code takes the form of recommendations, but despite this many internal documents of Russian companies have been significantly revised in accordance with the Code's recommendations. They have become a reference for both subjects of corporate governance systems and for representatives of regulatory bodies, ratings agencies and investment companies. In practice there are even instances where the recommendations are used in court proceedings between shareholders and issuers. After more than a decade of the Code's existence many of its recommendations now require substantial additions and amendments, some of which, taking into account the addenda, require legislative regulation and establish an absolute obligation to implement the recommendations.

151. In this regard the changes and additions to the 2002 Code and its amendments need to be incorporated into the up-to-date Corporate Governance Code. The new Corporate Governance Code needs to become an effective mechanism to institute the very best corporate practices and resolve the problems brought to light. This mechanism presupposes implementation of the following measures:

- the introduction of changes to legislation and regulatory documents by supplementing the provisions of the existing Code;
- changing the requirements regarding compliance with the Code by the stock exchange for companies on the quotation list on various levels;
- the adoption of voluntary commitments to comply with the Corporate Governance Code.

152. The main tendencies and issues to be resolved are as follows:

- reinforcing requirements in terms of reporting on compliance with the Code, including the reliability of reporting;
- reinforcing requirements to create and actually operate Committees attached to the Board of Directors;
- reinforcing requirements in terms of the volumes, timeframes, format and means of disclosing information for shareholders at general shareholders' meetings, including information on ledger closing;

- broadening and clarifying the rights and powers of independent directors with regard to the most important issues concerning the activities of the Board of Directors in accordance with best international practices;

- establishing uniform criteria on the independence of independent directors;

- establishing obligations for members of the Board of Directors to report conflicts of interests and voting regulations in such instances;

- establishing obligations to evaluate the performance of the Board of Directors;

- guaranteeing actual independence and the effectiveness of a company's internal control system, including by using the powers of the Board of Directors, Committees, and independent directors;

- increasing the effectiveness of the Audit Board, including by laying down in law the possibility of electing its members by cumulative voting;

- implementing changes to regulation to firmly guarantee the rights and interests of shareholders with regard to voluntary and forced redemptions of company shares;

- implementing changes to regulation to prohibit the involvement of "quasi-treasury" shares when general shareholders' meetings adopt decisions;

- implementing changes and additions in the regulations and recommendations of the Code on non-arm's length and large-scale transactions, in accordance with best corporate governance practices;

- adopting a set of measures through the stock exchange requirements and provisions of the Code to guarantee effective control by the parent company over the activities and transactions of subsidiary and dependent companies.

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APPENDIX. LIST OF COMPANIES SAMPLED IN THE RESEARCH AND A1 OR A2 LISTED ON THE MOSCOW STOCK EXCHANGE

1. AK ALROSA
2. UTair Airlines, JSC
3. Aeroflot, JSC
4. Bank Vozrozhdenie, JSC
5. Bank VTB, JSC
6. GMK Norilsky Nikel, JSC
7. PIK Group of Companies, JSC
8. LSR Group, JSC
9. Cherkizovo Group, JSC
10. INTER RAO EES, JSC
11. Irkutskenergo, JSC
12. KAMAZ, JSC
13. Kvadra, JSC
14. LUKOIL, JSC
15. Magnit, JSC
16. Mechel, JSC
17. Mosenergo, JSC
18. MOESK, JSC
19. IDGC of Volga, JSC
20. IDGC of North-West, JSC
21. IDGC of Urals, JSC
22. IDGC of Centre and Volga Region, JSC
23. IDGC of Centre, JSC
24. MTS, JSC
25. Nizhnekamskneftekhim, JSC
26. NOVATEK, JSC
27. NOMOS-BANK, JSC
28. OGK-2, JSC
29. Rostelekom, JSC
30. RusGidro, JSC
31. Sberbank of Russia, JSC
32. Seligdar, JSC
33. V. D. Shashin Tatneft, JSC
34. TGK-1, JSC
35. TGK-7, JSC
36. TMK, JSC
37. Uralkaliy, JSC
38. FosAgro, JSC
39. IDGC Holding, JSC
40. Enel OGK-5, JSC