Overview

The 2017 Russian Corporate Governance Roundtable, hosted in partnership by the Moscow Exchange and the OECD, brought together domestic and international experts on 15 November at the Ritz Carlton, in Moscow.

Divided in three thematic panels, speakers tracked some of the latest developments in corporate governance in Russia and the world. Large attention was devoted to the evolution from the adoption and update of the Corporate Governance Code, and of corporate governance practices, through to the current stage of wider implementation and continuous evaluation and adjustment. The Roundtable's discussions reflected one of OECD's messages: to deepen the understanding of flexibility and evolution needed vis-à-vis trends and contextual developments in the corporate governance culture, including technological advancements and innovation. This was illustrated with commentaries on trends in equity markets, corporate governance practices, existing legislation, reforms and business integrity.

As mentioned by one of the panellists, corporate governance is not an end in itself but a means to promote better functioning equity markets. The presentations accordingly linked successes in corporate governance to an attractive investment environment and diversification of the market. To reach such end goals, panellists spoke about a range of corporate governance practices, including engagement *of potential investors*, shareholders and boards, accountability of top management and boards, effective internal controls and accurate audit.

Further information and presentations are available on the website, including the day's agenda.

Introductory Remarks

The introductory remarks centred on the need to continue seeking implementation of corporate governance in a changing context – with domestic insights from Mr Shvetsov against an international perspective provided by Mr Isaksson.

Sergey Shvetsov, First Deputy Chairman of the Bank of Russia

Mr Shvetsov highlighted the importance of corporate governance for encouraging continued investment in Russia, and discussed how to develop the mechanisms and the capacity to measure and explain progress to a wide range of existing and potential investors. Mr Shvetsov told the audience of various steps that are being taken to improve the structure of corporate relationships and reporting, and to strengthen and assign appropriate responsibilities to boards. Russia is close to having a law approved for majority shareholders' responsibilities to be shifted to boards of directors, so as to make CEOs more accountable to the boards. Additional reforms are being developed to make audit committees mandatory and to make disclosure more consistent and comprehensive. The Ministry of Finance is drafting a bill which shall transmit the regulation of the external audit and supervision over it to the Bank of Russia, seeking to improve its quality and to ensure trust in auditors' opinions.

Mats Isaksson, Head of Division, Corporate Affairs, OECD

Mr Isaksson spoke to global trends and future directions of corporate governance. He pointed out that the OECD is supporting countries in looking at flexibility and proportionality as a tool to manage the incentives, costs, behaviours and unintended consequences of codes. He highlighted three major developments of recent years that policy-makers have to keep in mind: a change in the asset base and the rise of new corporate forms, including private-public partnerships; a geo-political shift in terms of the holders of equity as well as the dissolving of the model dispersed shareholding with strong management, and; an uptick in institutional investment.

Many of the themes raised by Mr Shevtsov and Mr Isaksson were referred to by the panellists in the sessions that followed.

Panel 1: The corporate governance development of Russia: actual trends, achievements, issues

This panel was moderated by Vladimir Gusakov, Managing Director, Moscow Exchange

Inga van den Bongard, Policy Analyst, OECD

Ms van den Bongard presented the draft findings from the OECD's Equity Market review of Russia – a first at the country level. The descriptive analytical approach taken by the OECD was rooted in the notion that access to equity markets affords sustainability and flexibility. The presentation relayed main findings regarding IPOs, ownership, financial intermediaries and stock markets. Main findings pointed to increase in IPOs, whereby peaks have been driven by privatisation of SOEs and by a few large IPOs concentrated in a few sectors; a transition, like other economies, from dispersed to block shareholding (with 39% having the government as the largest owner); an increase in the share of domestic underwriting by investment banks; and stock markets having an increased role in corporate governance (for instance, issuing in 2014 listing rules).

Vladimir Gusakov, Managing Director, Moscow Exchange

Mr Gusakov complemented Ms van den Bongard's presentation with data, starting from 2011, on equity markets in Russia. He pointed to an inflow of foreign investors, which have a growing share of non-residents in the Moscow Exchange, from 40 to 48% despite internationally imposed sanctions. He also showed data confirming that dividends are growing.

Elena Kuritsyna, Director of Corporate Relations department, Bank of Russia

Ms Kuritsyna spoke about the Bank of Russia's 2017 review of corporate governance practices in Russian public companies, comparing it to 2016 results. Despite expressed challenges in measuring company compliance, the Bank has been able to identify an increase in companies' readiness for improvement in compliance, as well as strengths in internal control. By one measure, 90% of companies showed higher quality explanations to investors between 2016 and 2017. Companies also showed improvements in preparedness to manage cyber-risks. Yet challenges remain with implementation of the Code's chapter on Boards and a sound system of remuneration.

Denis Spirin, Member of the Expert Council under the Open Government

Mr Spirin presented findings on state-owned companies' intention to implement the Russian Corporate Governance Code – noting risk aversion to its implementation, and seeking to point to underlying factors that facilitate their implementation. Where internal audit and compliance representatives demonstrated a willingness to enact change, they were more successful in nearing 100% compliance. The study identified particularly visible issues in SOEs, where efforts may be made at lower levels but are not enacted in full at the higher level – whether by heads of internal audit or compliance, or more often by an uninterested management board. Cases of non-compliance were often linked to unmotivated management boards – notably, a lack of group review of individual transactions, a lack of independent members for specialised boards committees that are not the audit committee and distant or no involvement in risk management. The latter hampers effectiveness of formalised risk management systems that do commonly exist. A similar story can be told with regards to internal audit.

Alex Williams, Non-executive Director, PAO DIXY, PAO Enel Russia

As a non-executive director in the panel, Mr Williams focused in his presentation on board's fulfilment of responsibilities and on the rights of shareholders. He suggested that board members be required to sign that they have read and understand their responsibilities as per article 71 of the Joint-Stock Companies Act. With a concentration of shareholders in Russia, he expressed that voting against the majority shareholder can be very hard. For Mr Williams, cumulative voting is an important tool in this context. Finally, he reiterated the need for independent directors on audit committees, with the authority to use independent experts that are truly isolated from the company.

Panel 2: Corporate law and regulation in OECD countries and in Russia: recent trends and prospects, changes in legislation and practice of their implementation

This panel was moderated by Mr Rostislav Kokorev, Head of Division, Moscow Exchange

Andrey Yakushin, Head of Corporate relations and information disclosure division, Bank of Russia

Mr Yakushin discussed the issue of shareholder activism, and efforts to increase engagement by institutional investors. He considered the merits of stewardship codes that recommend to institutional investors how to structure relationships with companies, and that instruct on policies relating to voting and disclosure amongst others. The Bank aims to support minority investors in being more active. He questioned the audience as to whether investors could be punished for neglecting participation in governance of their company, though warned that such incentive-based approaches could have unintended repercussions.

Alexander Shevchuk, Executive Director, Association of Institutional **Investors (API)**

Mr Shevchuk presented findings from API study on corporate governance of 13 companies, integrating also perspectives of institutional investors. It sought, in part, to answer the question that followed the international financial crisis: "where were all the shareholders?". Generally, the study pointed to an insufficient level of activity of shareholders, including the government as owner. The study also looked at good practices in responsible investment such as adequate preparation for meeting, and having clear two-way relationship between investors and independent directors. In illustrating, he mentioned ALROSA's practice whereby the board of directors work with investors and independent directors, and Sberbank whose board works well with minority shareholders. He pointed to the opportunities and potential benefits of boards taking a greater role in corporate governance.

Vladimir Potapov, CEO, VTB Capital Asset Management

Mr Potapov theorised, from his company perspective, why shareholder activism is underdeveloped. He spoke to the fact that (i) Russia, like many other countries, has big shareholder blocks, (ii) that equity shares for institutional investors is changing, (iii) that decision-making for mergers and acquisitions, and for related party transactions is often unclear, and (iv) that the market is not that liquid and many shareholders are not keen to share information.

David Nicholls, Analyst, East Capital International

Mr Nicholls presented the ESG scorecard that East Capital International uses to encourage responsible investment. In essence, it is an impact evaluation resulting in an ESG score that weights governance at 75%, environment and social at 12.5% each, to rank companies as strong, good or laggard in ESG practices. He highlighted that the Ministry of Economic Development is working on a bill to improve public non-financial reporting, including requirements for JSC's. Four stages will be required to transfer to this reporting standard, meant to eventually incorporate all listed companies. He argued that the forthcoming disclosure requirements may overlap with those currently in place as established by the Bank of Russia, and warned the audience of the risk of over-reporting and the impact it may have on companies.

Héctor Lehuedé, Senior Policy Analyst, OECD

Mr Lehuedé reflected on previous speakers' presentations and audience questions related to shareholder engagement by elaborating on trends from international context. Beyond Russia, retail investors have walked out of direct holdings and into large assets managers looking for lower costs. These large institutional investors selectively engage with part of their portfolio as part of a shift from active to passive investment, services by proxy advisors. At the same time, stewardship codes have not had the effects that were anticipated for encouraging responsible investment. Mr Lehuedé warned that such a set-up may have impact on competition and opportunities for investments that could worsen income distribution. Mr Lehuedé then presented a quick overview of OECD's recent work on flexibility and proportionality applied in the implementation of the G20/OECD Principles of Corporate Governance, which will be published next year.

Maxim Bunyakin, Head of legal practice, Branan Legal

Mr Bunyakin spoke against a backdrop of new regulation of large transactions and related party transactions in Russia. He considered whether approval for transactions should have its own formula for flexibility. He noted that the number of approved transactions has increased, and that boards have increased their thresholds. Suggesting it is better to be 'cautious than sorry', Mr Bunyakin pointed to methodological recommendations for approving transactions, against which the Bank can check during compliance assessments.

Panel 3: Trends and practices on business integrity, auditing activity regulation and preventing unfair practices

Hans Christiansen, Senior Economist, OECD

Mr Christiansen informed the audience that the OECD is laying groundwork for developing anti-corruption and integrity guidelines for the state as owners of SOEs. He presented key findings from a recent OECD study on integrity and anti-corruption in state-owned enterprises (SOEs), highlighting that 43% of SOE respondents in 29 countries reported seeing corruption and other irregular practices in their company in the last 3 years. Namely this occurs in sectors that tend to be less competitive, or by companies that are involved in public procurement, management of resources or that are shielded behind unclear secondary objectives. Comparisons with the private sector show that SOEs may be less risk averse than private companies, as they may be less able to turn away from a risky situation because of policy objectives. Mr Christiansen noted that 4 responses were from Russian SOEs.

Aygul Abdullina, Senior Manager, Forensic Fraud Investigations, Deloitte CIS

Ms Abdullina presented the 2017 “compliance practice survey results” of 11 companies, developed through the Companies Circle for the Development of Corporate Governance in collaboration with the Moscow Exchange. Only one of 11 companies did not have a specialised compliance division. Company internal assessments of corruption risks are done annually (5/11), as needed (5/11) or every 2 years. The majority of all companies provide compliance training, have background checks on employees, and all companies seek to identify conflicts of interest when working with counterparties, or consider their reporting channels to be anonymous. Overall, this points to improvements from 2016, though direct comparison is difficult given the difference in sample.

Gian Piero Cigna, Senior Counsel - Corporate Governance, EBRD

The EBRD has been working with the Bank of Russia, noting its commitment to compliance on the side of the regulator. Mr Cigna sought to better define the boundaries between internal control, internal audit and risk management that can often be blurred. He elaborated on the 3 lines of defence of the Institute of Internal Auditors. He added that external audit acts as an important defence, particularly given the shift in Russia, and elsewhere, from adopting policies and practices to their evaluation and adjustment. Internal audit should make forward-looking evaluations of policies and procedures, while external audit takes a historical look at financial data. These non-duplicative roles should be objective, independent and complementary, guaranteed by the audit committee which too should be independent and well qualified. He noted that effective external audit can be hampered by external auditors that are too involved in the company, or knows it too well. This challenges their ability to form objective audit opinion and to detect red flags whether willingly or unwillingly. He finished by reminding that the Bank of Russia will be taking over supervision of adequacy of external audit.

Viktoria Stepanenko, Deputy Director of Corporate Relations department, Bank of Russia

Ms Stepanenko spoke about reform of regulation of audit activity, and the Bank’s responsibility to improve the quality of the audit profession in Russia. The Bank is seeking to increase demand for quality audit and to educate about its benefits that include improved transparency, sustainability of business, an attractive investment environment and compliance with exchange rules. To reap these benefits, companies need quality external audit as well as adequate board engagement and deliberation of audits. The Bank intends to create a register of external auditors that facilitates transparent, open tender selection processes, and sufficient turn-over (changing auditors once every 5 years maximum). Two requirements of the reforms will be (i) broader audit reports and (ii) audit disclosure, bringing Russia closer to international good practice.

Closing remarks

Closing remarks were made by Mr Vladimir Gusakov and Mr Mats Isaksson, who thanked the Moscow Exchange for their ongoing collaboration, the panellists for sharing their expertise and the audience for their participation. Both made references throughout the day to future Corporate Governance Roundtables.