NEW CORPORATE GOVERNANCE NORMS FOR RUSSIA – WHAT WILL CHANGE?

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Abstract

Russia just played in the World Cup after a 12-year absence. On the same (time)line, Russia published a new Corporate Governance Code in 2014 that should reflect the changes in Russian Corporate Governance. The paper critically analyses this new code in comparison to its predecessor and global best practices. Implications are given, if the future of corporate governance in Russia should be based on directives or standards.

Keywords: Corporate Governance, Ownership, Russia, Code, Directives, Standards

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1 Introduction

For a proper investigation of the legal corporate governance issues in Russia, understanding the previous corporate structure and legal rights of shareholders is essential (see Ikemoto and Iwasaki, 2004, 21 and Kostyuk et al., 2007).

Although the Russian model of corporate governance has similar features both with Anglo-Saxon and Continental European models, it also differs from them, which makes it specific. The main stages of the development of corporate relations are described in order to follow the formation of the key features of CG in Russian Federation.

Table 1. Development of corporate relations in Russia

Stage (years)	Characteristics
1991 - 1994	Start of privatization, formation of corporations as the primary basis of corporate relations.
1995 - 1998	Formation of the national legislation and shift of emphasis in the regulatory framework from privatization to corporate laws.
1998 - 2004	Completion of legislation formation, redistribution of property transactions, violations of law, growth and real influence of the stock market on corporate relations.
2004 – present time	Transition to state capitalism, intensification of the role of the state and its representatives in the corporate governance bodies, partial monopolization of the most profitable sectors in the national economy by state.

Note: see as well Redkin 2003, Yakovlev 2004)

From the latest improvements having influence on Corporate Governance legislation in Russia, following documents can be highlighted:

- Federal Law "On the Central Depository" (07.12.2011)
- Amendments to the Law "On the Securities Market" (29.12.2012)
- Amendments to the Law "On Joint Stock Companies" (19.04.2013)
- FFMS Order “On the approval of the Regime of the securities admission to organized trading” (30.07.2013)

The key features of corporate governance in Russia include high concentration of ownership and leading role of majority shareholders in companies’ management, with the state often being one of the largest

shareholders. Inconsistency in the development of corporate governance in Russia, in terms of correspondence with a particular model, lies in the fact that practically the whole history of the Russian legal formation followed the German (Continental) model. Recent corporate practice and corporatization, however, have been actively developed in accordance with the Anglo-Saxon tradition.

Institutional investors are more and more promoting a culture of corporate governance among Russian companies. They developed standards, valuation methodologies, tried (and are still trying) to explain to the management of Russian companies the need of corporate governance improvement and the penalties they face neglecting change (Экспертно-аналитический доклад, 2011).

How these changes and corporate governance concepts (out of the new Corporate Governance code) are implemented is one of the focal questions of this paper. In the following the development and features of the new 2014 Corporate Governance Code will be discussed. Section 3 deals with the specific corporate governance problems in Russia. In section 4 the new code will be compared with best practice in the European Union (EU). Implementations for Russia in terms of regulations from the code being directives or standards will be discussed in section 5.

2 Development and features of the 2014 Russian Corporate Governance Code – a comparative analysis

Corporate Governance benefits societies as well as companies and investors (see Braendle 2013 and Krasniqi and Bettcher 2008, 5). These benefits can be seen in the table below.

Table 2. Benefits to society, companies and investors

Benefits to society	Benefits to companies and investors
Encourages investment and sustainable growth	Enhances company performance
Fights corruption	Lowers costs of capital
Promotes competitiveness	Strengthens company reputation
Stimulates productivity and innovation	Improves strategy
Promotes efficiency am reduces waste	Builds stakeholder relationships
Stabilizes financial markets	Growth and preserves shareholder value
Fosters transparent relations between business and the state	Protects investors' rights
	Mitigates risk
Supports public confidence in the market system	Increases liquidity

The OECD laid out years ago that these goals can be achieved by means of internal and external discipline. The 1999 OECD Principles are a set of basic principles designed to guide the functioning of CG in all the countries around the world.

In 2001 the Russian Federal Commission for Securities Market proceeded with development of the Russian Code of Corporate Conduct, adopted on 4th April 2002 (hereafter: Code 2002).

The new Russian Code of Corporate Governance (hereafter: Code 2014), published on 18 April 2014, like the predecessor, is based on voluntary standards. However, many large issuers have already declared their readiness to follow recommendations of the Code (Газета "Коммерсантъ", №80 (5111), 15.05.2013). Besides, some provisions of the Code, such as those concerning independent directors comply with the listing rules of the Moscow Stock Exchange.

As for the content of the Code 2014, the following chapters are included in the code:

- Introduction
- Principles of Corporate Governance
  1. Shareholder rights and equality
  2. Board of directors
  3. Corporate Secretary of the company
  4. System of remuneration of directors, the executive bodies and other key management employees of the company
  5. Risk management and internal control
  6. Disclosure of information about a company
  7. Material Corporate Actions

Table 3. Main differences of the Code 2014 in comparison with the Code 2002

Issues	Code Edition	
	2002	2014
General Shareholders Meeting	Shareholders have a right to participate in General Meeting	Participation in General Meeting as a fundamental right of shareholders
	Information about General Meeting min 20 days before	+ electronic notification and information availability (via internet)
		Right to gather a meeting with <= 2% of voting shares
		Prohibition of voting for "treasury" and "quasi-treasury" shares
	List of voting modes	+ electronic voting
	Warrant of Repeated Meeting in big companies (min 500 000 shareholders) with participants owing 20% voting shares (joint)	
		Clear dividend policy
Board of Directors of the company	Functions, duties and responsibilities of the board	Clear definition of jurisdiction and functions of the board of directors in the articles of association and differentiation of the powers of the Board of Directors, executive bodies and the General Meeting of shareholders
	Recommendation for independent directors and its definition	More detailed and advanced criteria of independent director definition
	Description of possible committees	Creation of committees is a must for effective functioning of the Board
	Equal Remuneration for all directors	Different approaches to remuneration
		Consideration of interests of such stakeholders as environment
		Establishment of long term oriented goals and perspectives
		Definition of approach for organization of risk management and external audit
	No directorship in other companies except for subsidiaries	No record of directorship prohibition in other companies
		New issues: delegation of powers of the sole executive body to the managing organization
Corporate Secretary of the company	Recommendation of Corporate Secretary position introduction	Corporate Secretary position as a necessity
	Duties of Corporate Secretary	Definition of Corporate Secretary status
		Detailed description of Corporate Secretary functions
Major Corporate Actions	Major (big) transactions, reorganization, liquidation	Listing and delisting of shares, company takeover, increase in the authorized capital of the company
New Chapters		System of remuneration of directors, the executive bodies and other key management employees of the company (different approaches to remuneration)
		System of risk management and internal control.

The standards of the Code are still not obligatory for application, however, in contrast to the first Code, they are presented in such a manner that implies fulfillment of the standards by the companies or explanations of the reasons of non-implication (comply or explain).

- Paying attention to details listed in the Table above, it can be noted, that, in comparison to its forerunner, the new Code defines participation in General Meeting as a fundamental right of shareholders. This might be seen as best practices, but for Russian realities where concentrated ownership prevails and minority shareholders rights are often disregarded, it is a step forward. Furthermore, the Code 2014 prohibits "treasury" and "quasi-treasury" shares voting, what used to be a frequent practice, and lowers the minimum threshold for gathering a shareholders' meeting. IT progress is reflected in electronic means of information disclosure as well as electronic voting opportunity.
- As for the Board of directors, the Corporate Governance Code 2014 clearly defines jurisdiction and functions of the board of directors in the articles of association and differentiation of the powers of the Board of Directors, executive bodies and the General Meeting of shareholders. Existence of committees becomes a prerequisite for effective functioning of the Board. Interests of stakeholders such as the environment are now included. The new Code takes into account current business environment and suggests long term oriented goals and organization of risk management.
- The system of remuneration of directors, executive bodies and other key management employees of the company is also revised in the new Code and a whole new chapter now.
- The section on major corporate actions was increased by more detailed guidelines in each kind of action, paying a lot of attention to listing and delisting of shares and its redistribution. The position of Corporate Secretary acquires practical meaning and changes from the status of "accessories" of the companies' corporate governance system to the guarantor of the minority shareholders right.

The main problem of still insufficient quality of corporate governance in Russian companies, including those listed on Moscow Stock Exchange, is formal compliance with many of corporate governance code's provisions, that are of voluntary adoption character, and practical non-compliance or only partial compliance with the rules not directly prescribed by the law (Kozarzevski, 2007).

Moreover, in case of some serious corporate conflicts or shareholders rights violation, some issuers and companies try to use even such sort of opportunities, which are for sure a violation of legislation. This can happen, for example, in case of imperfection of approaches to the interpretation of the rules in the current arbitration practice, lack of sanctions or technical issues, as it can make it difficult for regulating bodies and other shareholders to counteract violators (Kuznetsov and Kuznetsova, 2009, 453).

3 Specific Corporate Governance problems addressed in the 2014 code

The problems that are directly touched upon in the Code are

3.1 Disclosure

The main point of the problem is that shareholders of Russian companies do not have secured by legislation and the Code the possibility to receive quality materials for shareholders' meetings in the most convenient for shareholders form in comfortable for them time constraints. Many listed companies announce the date of the ledger closing on the date of its closure. The problem is of major importance especially for foreign shareholders, who are practically being prevented from execution of their right to vote on the general meetings at the level, allowing studying all the materials and making a reasonable decision. Companies often disclose information about forthcoming shareholders meeting strictly in accordance with mandatory requirements of current legislation, but these requirements are not sufficient for international investors (McGee, 2009).

Even the notice of 20 days before the meeting does not allow international investors to vote in absentia, having a reasonable position on every matter of the day's agenda, since they may have a long chain of depositories, each of whom also has its internal voting deadlines. The main reason for weak practical shareholder rights protection is compliance by firms with only minimal requirements of legislation on information disclosure.

3.2 Board of Directors (incl. Committees)

Second issue in Russia is that insider directors often do not have required knowledge while independent directors with field-specific experience play rather formal role. Although the institute of independent directors in Russia is actively developing, corresponding changes to legislation are lacking. Criteria of

independence do not correspond with international and best Russian practices. Independent director's rights and instruments of effective influence on the strategy of the Board are limited, which influences the effectiveness of the board of directors. Evaluation of the work of independent directors does not take place in practice or has a formal character (Shevchuk A., 2013, 8).

Currently, the role and place of the board of directors in the system of CG in Russia is being qualitatively redefined. Minority shareholders (portfolio investors) have also became more active in processes of votes consolidation for election of independent directors (Ivashkovskaya and Stepanova, 2011, 607).

According to Russian Boards Survey 2013 made by PWC, only 39% of respondents mentioned clear division of responsibilities for analysis and monitoring of key risks between the board of directors and its committees (PWC, 2013), which can point at limited role of committees in risk management.

Furthermore, results of Deloitte latest research show rather modest improvement in the number of independent directors in state companies. A study shows that in spite of the measures taken, the percentage of outside directors in state companies has increased only on 3% during last years (from 17% in 2006 to 20% in 2012). Especially noticeable is the difference between state-owned and private companies, which can be explained by the presence of directors affiliated with the governance in the Boards (CIS, 2012):

Table 4. Board compositions broken down by ownership type

	State controlled (39 companies; 30% of the sample)	**Privatly-owned (94)**
Inside directors	80%	62%
Representatives of all block holders	70%	33%
Government representatives	60%	-
Management	10%	29%
Outside directors	20%	38%

Source: Based on Survey by the Deloitte CIS Center for Corporate Governance (2012)

Not only the evaluation of the effectiveness of the work of independent directors is missing, but also qualitative evaluation of the Board's effectiveness on the whole, which hinders the board members in increasing the productiveness of their activities. Lack of majority shareholders' hunger for endowment of all members of the board of directors with instruments of influence on decision-making process limits effectiveness of the strategic managerial body.

3.3 Minority shareholders rights protection

When talking about minority shareholders rights protection by the Code, international investors concern following issues:
- Equal rights for all shareholders
- Additional means of shareholders' protection in controlled companies
- Mandatory offer for shares redemption
- Voting of shares, belonging to entities controlled by the issuer
- Preemptive right

Speaking of equal rights for all shareholders, it should be noted that shareholders owning more than 25% of shares have unlimited access to information. However, minority shareholders should also have access to all information, including about subsidiaries and related parties. All shares of the same type should provide for the identical rights.

Main concerns of international investors, which could be solved by additional means of shareholders' protection in controlled companies, add up to a widespread of controlled entities' ownership structures. First of all for the reason that such structures are often associated with inequality of minority shareholders in comparison with major shareholders. Therefore, the Code should include provisions calling for controlled companies to provide for additional means of protection of minority shareholders' rights and interests.

One of the positive issues about the new Code is that it clearly urges companies to follow its principles and not just to comply with the formal requirements of the law, as well as to fill in the gaps in legislation focusing, in particular, on important transactions involving controlled companies (Paragraph 7.4 of the Code, page 104). According to the Code, the board of directors is to be a leading hand when deciding on validity and fairness of the transaction's price for minority shareholders.

Another positive issue concerns principles, related to delisting of shares. They require transparency for this action. According to the best case scenario, the buyer should send a voluntary buyout offer on fair conditions and should not allow a mandatory delisting (Serve et.al, 2012, 3). The paragraph 7.1 of the Code includes another good recommendation: it prompts the boards to enlist the services of independent estimator for market price determination of the assets in case of big transition or transaction with related parties even when a legislative requirement for such an action is lacking.

In general the Code consists of a number of recommendations, capable of lessening old and serious concerns of investors. If its provisions will lead to visible practical changes, it will be a positive step on the way to restore investors' confidence.

3.4 Other issues

Apart from the weaknesses of the Code, directly related to its text, there are Corporate Governance problems, not directly touched upon in the Code of Corporate Conduct, that influence the equality of CG and decisions of potential investors:

- Mandatory tender offer when buying 30% and more of the shares
- Fulfillment of obligations by the entities, acquired 95% and more shares of the company, to buy out the shares of remaining shareholders at a fair price
- Participation of "quasi-treasury" shares in the decision-making process during general shareholders' meeting
- Approval of related party and large-scale transactions in accordance with the best corporate governance practices
- Control of parental company over activities and transactions of subsidiary and dependent companies (Shevchuk 2013, 3)

4 Where does Russian Corporate Governance stand? A comparative analysis

In order to get a better idea if the state of corporate governance in Russia keeps up with modern international standards, we have to review the latest developments in Corporate Governance. We want to use the European Union as the major trading partner of Russia as the point of reference.

After the De Larosiere Report (February 2009) on financial supervision in the EU, that identified corporate governance as one of the most important failures of the present crises, EU Commission started a review on Corporate Governance with its so called Green paper 2010 (Green Paper on Corporate Governance and Remuneration policies for financial institutions). Although this paper was meant in the first line for financial institutions, a number of issues touched upon in the document were just as relevant for all listed companies.

A year later Green Paper 2011 (Green Paper on the EU CG Framework) for listed and (if desired) non-listed companies was published. Most important topics in the focus of the paper are: boards of directors, engagement of shareholders and "comply or explain" approach. Correspondence of the Russian 2014 Code with the Green Paper is presented in the table 5.

From the table 5 we can see that the new 2014 Code of Corporate Governance does only comply with the basic provisions of the Green Paper. When it comes to some more advanced requirements, there is either no information about it in the Code.

Table 5. Comparison of the EU Green Paper 2011 with the Russian Code of Corporate Governance 2014

Issue	Criteria of the Green paper 2011	Compliance of new 2014 Code
Board composition	Professional diversity	Yes
	International diversity	No information
	Gender diversity	No information
Availability and time commitment	Limited number of board mandates	Yes
Board evaluation	Annual performance evaluation	Yes
	External facilitator	Yes, every 3 years
	Quality and confidantiality of information	Yes
Directors' remuneration	Disclosure of remuneration policy	Yes
	Shareholders´ vote on the remuneration statement	Yes
	Independent functioning remuneration committee	Yes
Risk management	"Set from the top" policy	No information
Shareholders	Conflicts of interests	Yes
	Proxy advisors' issues	No information
	Shareholder identification	No information
	Protection against potential abuse (for minority shareholders)	Not in all issues, e.g. reserved seats for minority shareholders in companies with dominant/controlling shareholder.
	Employee share ownership	No such practice as in EU

Source: Based on the Green Paper 2011, Russian Code of Corporate Governance 2014

5 Implications for Russia – Directives vs Standards

The reactions to the new 2014 Code were positive. The new code has a lot of improvements against the Code of 2002. However many things still have to be included into the new code for to fulfill its ambition about Moscow being a new international center by the year 2020. To do so, the (code) principles of good governance should be underpinned by effective laws and regulations (see Litvack, 2013 and Kostyuk et al., 2007). The question therefore is if directives or standards in laws and regulations are the way forward for Russia.

Directives are legal commands which differentiate wished from unwished behaviour in a simple and clear way. Standards, however, are general legal criteria which are unclear and fuzzy and therefore require judiciary decision making and classification (Kaplow, 1992). In the most uncomplicated sense, directives and standards can be differentiated by the level of complexity. Directives are inherently simple, clear and based on a command-like system of "tell and do". An incomplete corporate governance report leading to a liability for the management is a directive whereas a norm for the management body to "disclose investor relevant data" without defining relevance is a standard. Such principles leave open what exactly the right level of disclosure is and how a violation of this standard is evaluated by a judge. A standard is therefore less straightforward in a basic sense of the word, only creating a point of reference.

There are systematic factors affecting the relative costs of directives and standards. A standard may have lower initial specification costs, but higher enforcement and compliance costs than a directive (Schaefer, 2001). For instance, promulgating the standard "to take responsibility for all stakeholders" is easy and does not generate any cost at all. However, applying this standard in practice would generate significant costs for both judges who have to determine whether the accused company has complied with the standard and for the defendants who have to determine the relevant stakeholders and the level of responsibility ex ante in order to escape liability. Directives, however, are more expensive to implement due to higher negotiation costs in the legislative process (because of active lobbying on behalf of different interest groups, for example). But clear rules have lower enforcement and compliance costs than standards. The table below illustrates the respective (dis)advantages of directives and standards.

Table 6. Comparison of the benefits and challenges of directives and standards

	Directives	Standards
Benefits	− clear − simple − reduce monitoring and enforcement costs	− low initial costs − decrease central authority − adoption easily possible
Challenges	− high initial costs − possible contradictions within complicated laws − over- or undercomplexity	− unclear, interpretation dependent on judiciary decision − high enforcement and compliance costs − leave more room for corruption

For countries with a long established corporate governance system, standards seem to be the accurate means to deal with issues. For Russia directives might be better against the background of their specific corporate governance problems such lack of investor protection, transparency and weak board of directors. Under these circumstances directives seem to be a better means to attract investors and guarantee good corporate governance.

Directives make a monitoring of companies (and judges) easier as directives give little scope for interpretation. The companies exactly know the rules and cannot claim ex post that they misunderstood. Standards, however, leave more questions open as far as interpretation, implementation and compliance within the judiciary system are concerned (Raja and Schaefer, 2004).

Less than 20% of listed companies fully comply with provisions of the Russian Code of Corporate Governance 2002 with no explicit reporting obligation and no sufficient power of the Exchange to verify reported information (Shevchuk 2013, 25). This cannot be found attractive by investors, therefore it is necessary for Russian listed companies to lift governance standards.

Sunstein (1995) contends that because authorities have little room to interpret a rule, they are perhaps better in protecting individuals’ rights. This idea can easily be transferred to shareholders’ rights. If their rights are violated, these actions can be easily seen. Because decisions concerning standards are unique to each case, it would be more likely that decision makers are apt to abuse their power and act in a questionable way. Without strict guidelines, decisions can be tainted by personal preferences of the judge instead of concrete legal policies. In addition, if there is no list of strict directives, a standard may be too vague and difficult to monitor, thus encouraging corrupt behavior even more. For this reason, legal areas concerning corporate governance are particularly subject to possible corruption.

Against this background of Russia‘s specific challenges and possible higher costs in the initial phase Russia will be better off by passing clear-cut directives on corporate governance topics out of their code in order to provide an explicit signal for investors and gain their confidence.

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