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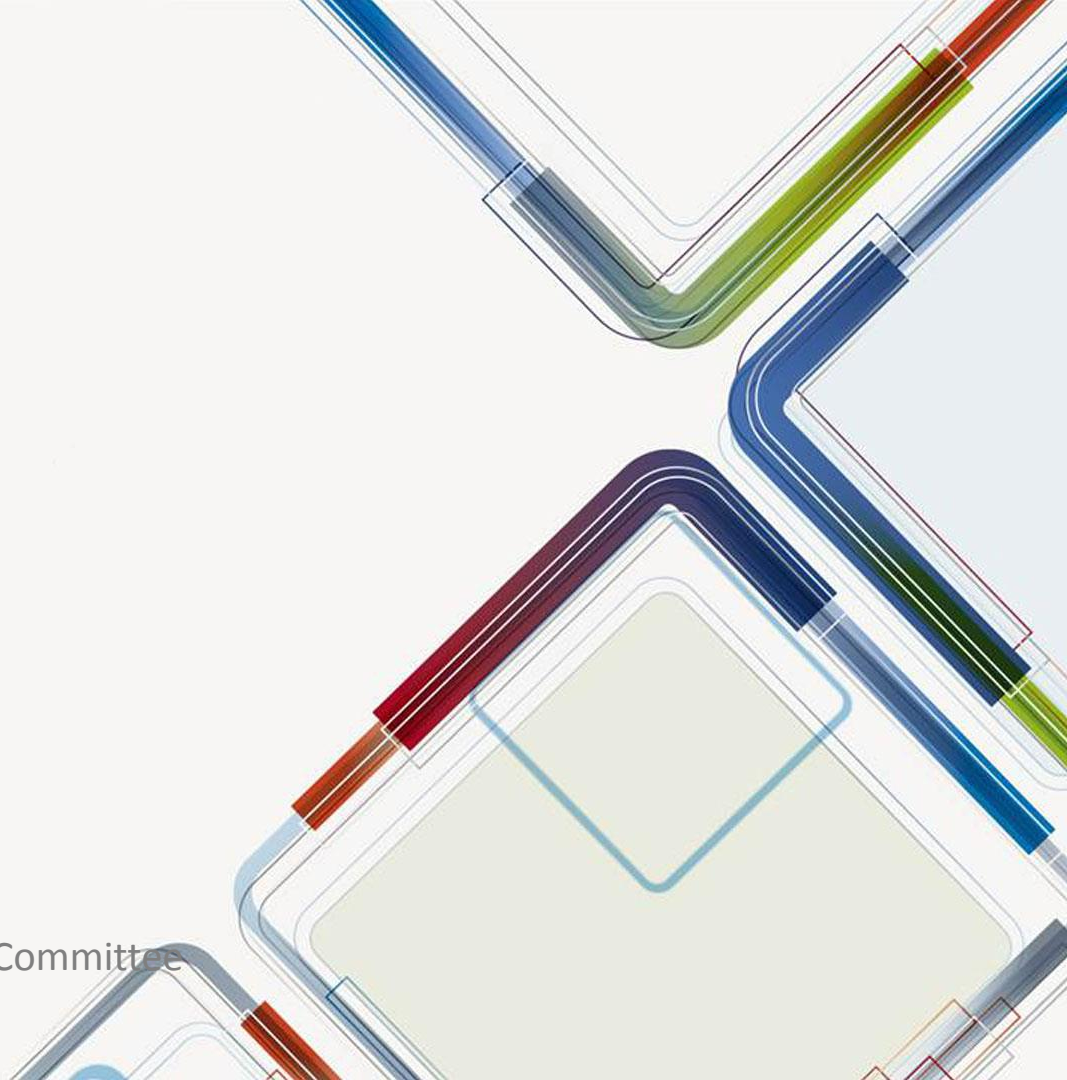
Co-sponsored by the **Siemens Integrity Initiative**

OECD Russia Corporate Governance Roundtable

Moscow, 22 October 2015

**Challenging questions
of corporate governance in Russia**

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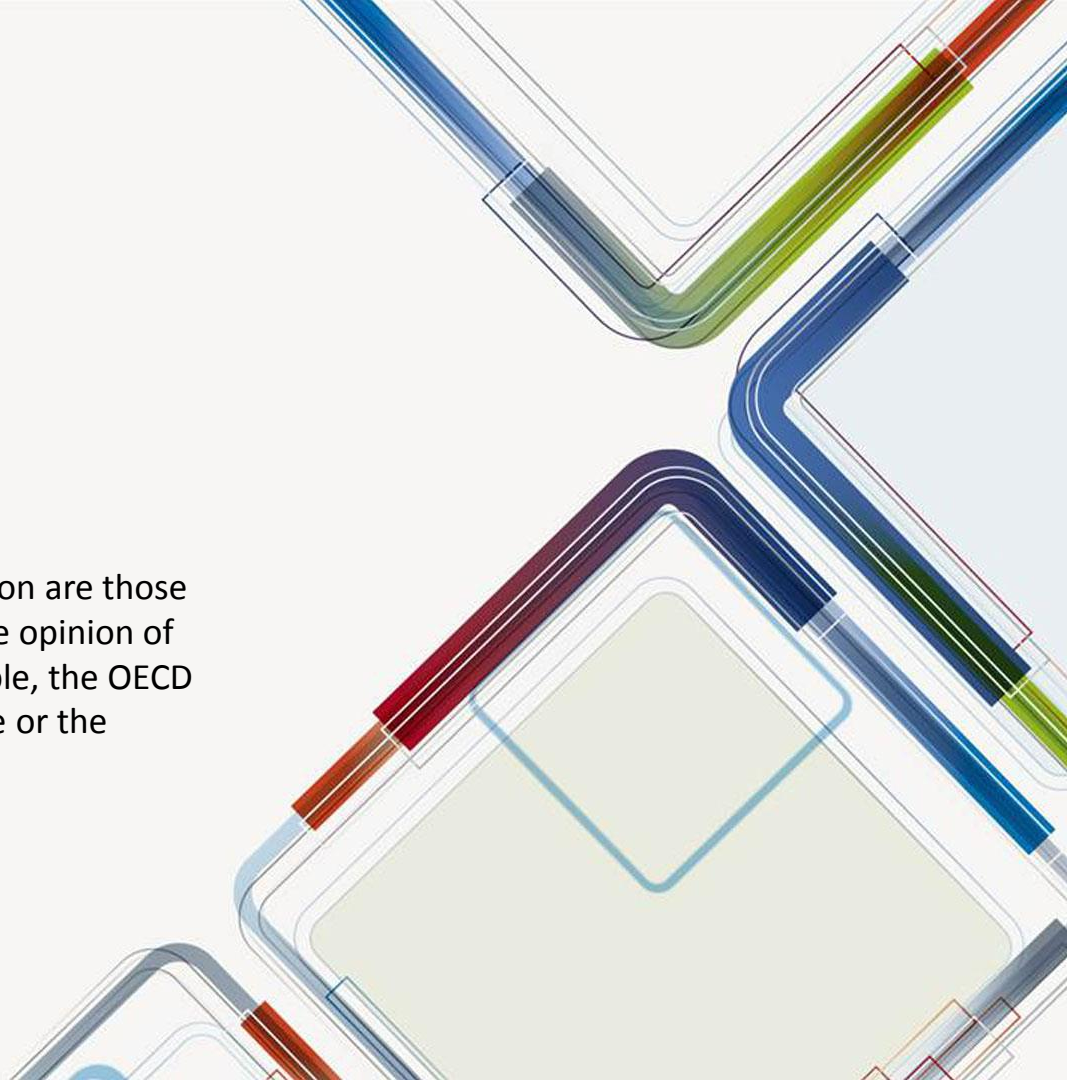
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What do we mean by corporate governance

Corporate governance is a concept covering the system of relations among executive bodies of a joint-stock company, its board of directors, shareholders and other interested parties. Corporate governance is an instrument for defining aims of the company and means of achieving the aims, as well as efficient control for the company activities by shareholders and other interested parties. Main targets of corporate governance are creation of efficient system of preservation of funds provided by shareholders and its efficient usage, decreasing risks...

The Corporate Governance Code

Corporate governance is the system by which companies are directed and controlled. Boards of directors are responsible for the governance of their companies. The shareholders' role in governance is **to appoint the directors and the auditors** and to satisfy themselves that an appropriate governance structure is in place. The responsibilities of the board include setting the company's strategic aims, providing the leadership to put them into effect, supervising the management of the business and reporting to shareholders on their stewardship. The board's actions are subject to laws, regulations and the shareholders in general meeting.

The Cadbury Committee

Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined.

G20/OECD Principles of Corporate Governance

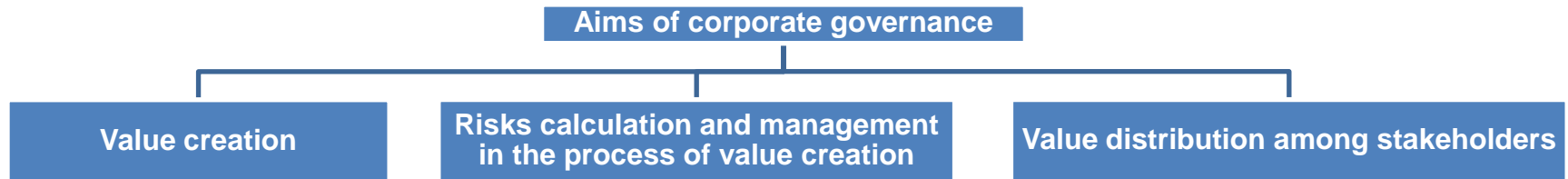
Challenging issues of corporate governance in Russia

Demand from investors and shareholders for better corporate governance has decreased somewhat :

- A. Decrease in the number of actively managed funds and an increase in the number of ETF and computer trading funds
- B. Inability of investors to nominate board members because of risk perception by their compliance
- C. Delegating of authority to vote from analysts and portfolio managers to internal compliance / corporate governance or external consultants
- D. Decrease in the number of sell-side analysts that cover companies because of lower fees from the buy-side (e.g. LUKOIL was covered earlier by over 60 analysts, and now by under 20, further decline is expected)

Conclusion: decrease in commitment of asset management companies' to their fiduciary duty

Challenging issues of corporate governance in Russia (continued)



Adoption of new Russian Corporate Governance Code (CGC) – positive event and important milestone in corporate relations development. However, practice shows new challenges that require looking for answers:

1. Continuously changing rules that govern relations among major subjects, in particular managers, shareholders and investors (creation of new legislative acts and rapid increase in the number of legislative initiatives in the field of corporate governance)
2. Existence of a large number of platforms instead of a consolidated (basic) platform for development of corporate governance **with proper representation of minority investors**
3. Copying western models as a base for development and establishment of corporate governance in Russia without adaptation to particular circumstances
4. Increasing the role of non-government institutions in establishment of corporate governance system
5. Russian Corporate Governance Code (CGC) with its rigidity improves corporate governance only with reasonable approach “**comply or explain**”. Mechanism of implementation of this principle is not developed and introduced.
6. Functions of corporate secretary, as well as the requirements of CGC, should be explained in detail and with the participation of an expert group consisting of representatives of the regulator, issuers and investors.

Challenging issues of corporate governance in Russia (continued)

7. Russian issuers, taking into account realities, will finish activities on bringing corporate procedures into accordance with corporate governance requirements not earlier than 2nd-3rd quarter of 2017. Requiring compliance with all requirements of the CGC by issuers before this could lead to a situation in which regulators would be obliged to begin delisting procedures against a significant number of issuers.
8. Affiliation (affiliation indicators and their legislative approval)
9. Independence of directors (independence criteria and principles of forming of board of directors)
10. Quasi-treasury shares (definition of legal status of possession of these shares)
11. Dividends and taxation (legislative definition of tax rates and conditions for their implementation for dividends taxation, as well as processes of dividend realization by shareholders)
12. Participation in general shareholders' meetings (legislative approval of shareholders' rights mechanisms for participation in company management)
13. Insider information (legislative regulation of countermeasures to unlawful usage of insider information)
14. Information disclosure (forming legislative norms that define issuers actions on information disclosure)
15. Corporate actions reform (method of conducting corporate actions, rights provided by securities, electronic voting, etc.)

Corporate governance platforms

MOSCOW
international financial centre



Corporate relations
committee



Bank of Russia Expert council
on corporate governance



Issuers committee



Chamber of Commerce and Industry
of the Russian Federation
For the benefit of business. For the benefit of Russia.



- General aim: participation in improvement and development of corporate governance in Russia and ultimately increasing international reputation and investment attractiveness
- None of these platforms include representatives of the 20 largest institutional investors on the Russian stock market because of their inactivity

Composition and activities of the Moscow Exchange Issuers Committee

- Stock issuers committee unites 24 Russian issuers
- Since September of 2013 there have been 17 sessions of the Committee and 8 sessions of working groups of the Committee on different significant questions of corporate governance



Opportunities of the stock issuers Committee in development of corporate governance in Russia

- **Tasks**

One of the tasks of the Committee is preparation of suggestions on changes to the legislation and other legal acts, including those regulating corporate governance

- **Influence**

Market capitalization of companies represented in the Committee covers 65% of those with shares trading on the Moscow Exchange

- **Representation**

The Committee includes both government and private companies with shares in the first or second quotation lists, representing both production (energy, metals, transport, telecoms) and services (banking, consulting)

- **Competencies**

The Committee members directly involved in the processes of corporate governance in their companies and can attract internal resources to solve the tasks. Support of the Committee from the Moscow Exchange and the Bank of Russia.

The Moscow Exchange Issuers Committee is a unique platform for discussion of relevant problems of corporate governance in Russia

Statistics of issuers compliance to corporate governance requirements

Indicator	First level	Second level
Total number of issuers	61	39
Completely comply to corporate governance requirements	6.6%	12.8%
Comply to the number of independent directors requirement	49.2%	46.2%
Average number of independent directors in the board	2.61	1.49
Average share of independent directors in the board	25.6%	16.2%

Source: Debevoise & Plimpton (according to Moscow Exchange for 2nd quarter of 2015)

Russian Corporate Governance Code Requirements Are Frequently Too Tough: Examples of Application to LUKOIL



Directors stop being independent because of term of service in the Board of Directors

- Elected in June 2014, independent directors of LUKOIL Mark Mobius (a pioneer of investment into emerging markets from Franklin Templeton, and their most recognized advocate) and Richard Matzke (former Vice-chairman of Chevron and active participant in investor meetings) ceased being considered independent

Director not considered independent because of “large” equity stake

- Independent director of LUKOIL Ivan Pictet (from the family that founded and continue to manage the large private bank – investor in Russia Pictet et Cie) stopped being independent having 0,01% of LUKOIL shares: this stake is considered to be too large compared to his compensation



Will the absence of these independent directors, recognized by minority investors, improve corporate governance and investment attractiveness in Russia?

Russian listing requirements are the only ones in the world with detailed functions of CS

Area for comparative analysis	Russia CGC 2014	UK (CG Code)	US (NYSE CG Guide)	Germany (CG Code, 2014)	France (CG code of listed corporations 2013)	Spain (Code, 2015)	Italy (Code, 2015)	General CG principles ISGN, 2014	OECD CG principles (2004/2014)
Functions and role of CS									
Support of efficient BoD work	✓	✓	×	×	×	✓	×	×	×
Participation in organization of preparation and holding of AGM	✓	×	×	×	×	×	×	×	×
Interaction with regulating bodies, trading organizers, registrar	✓	×	×	×	×	×	×	×	×
Regular/ current interaction with shareholders	✓	×	✓	×	×	×	×	×	×
Consulting support to BoD members and chairman	×	✓	✓	×	×	×	×	✓	✓
Coordination of actions to protect shareholders rights and interests	✓	×	×	×	×	×	×	×	×
Participation in prevention of corporate and interests conflicts	✓	×	×	×	×	✓	×	×	×
Information exchange/ information policy implementation	✓	✓	✓	×	×	×	✓	×	×
Storage of BoD minutes/ corporate documents	✓	×	×	×	×	×	×	×	×
Implementation/ monitoring of normative requirements compliance	✓	✓	×	×	×	✓	×	×	×
Improving corporate governance system and practices	✓	×	×	×	×	×	×	×	×
Independence and reporting of CS									
Independence of CS from executive bodies	✓	×	×	×	×	×	×	×	×
Reporting and subordination of CS to BoD	✓	✓	×	×	×	×	×	✓	×
Prevention of concurrent positions for CS (separate regulation on CS, etc.)	✓	×	×	×	×	×	×	×	×
Publicity of CS									
Trust of shareholders to CS	✓	×	×	×	×	×	×	×	×
Disclosure of information on CS in public access/ annual report	✓	×	×	×	×	×	×	×	×

Source: PricewaterhouseCoopers

Large International Organizations that Develop Corporate Reporting Standards

FASB (Financial Accounting Standards Board)	US GAAP financial reporting standard
IASB (International Accounting Standards Board)	IFRS financial reporting standard
SEC (Securities and Exchange Commission)	US public companies reporting standard
FRC (Financial Reporting Council)	UK accounting reporting standard
➤ These standards comprehensively describe all the reporting components	
IIRC (International Integrated Reporting Council)	Integrated Reporting standard
➤ Describes general reporting principles, with ESG* emphasis, but no details	
SASB (Sustainability Accounting Standards Board)	ESG reporting standard
➤ A young standard created in 2013	
UN PRI (United Nations Principles of Responsible Investing)	ESG oriented investing standard
➤ General description of investors actions to account for ESG factors in investing process	
CFA Institute (Chartered Financial Analyst)	financial analysis standard
➤ Comprehensive and detailed description of investors needs in reporting	

* ESG - environmental, social, governance

Conclusions

- More involvement of large, long term investors into corporate governance decision making process is required
- It can be achieved via interaction of investors, issuers and the regulator
- Much more caution is required in making corporate governance compulsory requirements instead of recommendations
- Issuers and investors should cooperate in developing methods of interaction, including as regards reporting standards

Thank you for attention!