On Key Discussions Related to the 2014 Corporate Governance Code

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Corporate governance is a key institute in an efficient market economy that is underpinned by clear-cut, precise and transparent ownership rights and their adequate protection. Efficient corporate governance promotes competitiveness, facilitates companies' access to capital markets and thus fosters financial markets and supports economic growth in general. Companies with quality corporate governance are best positioned to perform their economic, environmental and social duties and help sustainable development. At present, corporate governance problems assume state significance; not only investors and lenders but also regulators in different countries require better governance from corporate management.

The Corporate Governance Code developed by the Bank of Russia (hereinafter the "Code") is essential for not only investors but the entire business community. The Code introduction implies for Russian companies the need to implement new information transparency standards, make amendments to current internal documents and develop new ones, as well as to transform the board of directors into a really operating body. It is noteworthy that corporate governance is a permanent process, rather than a one-time-only event. The practically implemented constant and genuine commitment to principles of good corporate governance, rather than one-time actions or events "just to check the box" are important to investors.

The Code is a reliable benchmark for Russian companies in implementing the advanced corporate governance standards, taking into account particular features of Russian law and the existing Russian market practice of relations between shareholders, management and other stakeholders participating in joint stock companies' economic operations.

1.1. General Issues Related to the Corporate Governance Code

The Code division into two parts, with the first part containing the corporate governance principles, and the second one, recommendations and comments on these principles, which describe particular mechanisms of their application and implementation, based, in particular, on best corporate governance practice examples of Russian and foreign companies, is a distinctive feature of the Code.

When implementing the Code, it is important to discreetly and prudently apply those of its provisions that may have a positive impact on a company's operations, rather than to formally comply with all of the Code recommendations, without regard to possible adverse consequences.

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If it is not appropriate for a company to follow any provision of the Code in terms of the business development strategy or its economic efficiency, an open and adequate explanation of this fact to the investment community is deemed as proper corporate behavior, rather than an attempt at giving an impression that the appropriate Code provision is complied with.

1.2. Shareholder Rights. Equal Conditions for Shareholders in Their Exercising of Rights

The recommendation in the Code chapter devoted to shareholder rights, in the second part of the Code, as to the prohibition on voting with "quasi-treasury" shares at a general shareholders' meeting became one of the most actively discussed provisions. For the purposes of this recommendation, "quasi-treasury" shares mean shares held by legal entities controlled by a company. The rational of this Code provision is to make a company communicate a clear and transparent paradigm to entities under its control through appropriate corporate governance mechanisms so that the entities do not exercise their voting right on the shares held (at their disposal) in the company and do not participate in the general shareholders' meeting, and if such participation is necessary for intrinsic reasons (e.g. to secure the quorum), refrain from voting on the agenda issues. Otherwise, when a company does not give instructions to legal entities controlled by it and "quasi-treasury" shares participate in the voting, the company should substantiate its standpoint on the inappropriateness (impossibility) of limiting such voting.

1.3. Corporate Board of Directors

The independent director criteria provisions were the subject of fierce debate when the Code was discussed. According to the best corporate governance practice and the Code, independent directors mean the persons who are sufficiently independent to form their own standpoints and come to unbiased and responsible conclusions, do not depend on the influence of a company's executive bodies, some groups of shareholders or other stakeholders and, at the same time, are professional and experienced enough.

In the Code, all of the independence criteria are subdivided into four groups, depending on which subject (participant in the respective relations) influences or may influence a director's standpoint: the company itself, its major shareholder, counterparty or competitor, the state (the Russian Federation, the Russian Federation constituent) or a municipality. The attributes pointing to particular circumstances that may create the conflict of interests for a director or otherwise influence his/her independence are defined in each of the groups. Among these attributes, such factors as holding a position in a corporate management body and/or employment relations with it, receiving remuneration or any other financial benefits from it,

holding or benefiting from holding of shares (stakes) in a company, and providing or participating in provision of particular services related to gaining access to financial information to it are assessed. Such factors are normally considered applicable not only to the present time but also to previous periods and with respect to not only the director or a candidate nominated for election but also his/her immediate relatives, family members and a common-law spouse.

It is noteworthy that the criteria for independent directors are intended to highlight the most obvious and evident circumstances that are capable of influencing an unbiased standpoint of a board member. At the same time, the impossibility of establishing an exhaustive (closed) list of such circumstances is admitted in the Code. The recommendation is that the board of directors and its nomination committee should be tasked with analyzing whether or not the nominated candidates and the board members elected as independent directors meet the independence criteria. As part of this assessment, in certain cases that must be exceptional, the board of directors may recognize a candidate or a board member as independent, even though he/she has formal signs of being related with the company, its major shareholder, counterparty or competitor, if such relatedness does not influence the person's ability to make independent, unbiased and responsible judgments.

When the Code was discussed, the focus was on the recommended minimum number of independent directors in a company's board of directors. All factors taken into account, the Code recommends that independent directors represent at least one third on the board of directors.

To summarize the discussions concerning independent directors, it should be emphasized that, as compared with the 2002 Corporate Conduct Code, the 2014 Code does not only significantly increase the recommended independent director representation on the board of directors but also – and more importantly – the quality standards a candidate nominated to the board of directors or a director should meet to be recognized as independent.

The institute of a senior independent director that is appointed out of independent directors if the board chairman does not meet the independence criteria is another important novel in the Code. A senior independent director may and must play a key part in consolidating independent director efforts to shape an unbiased, weighted and impartial standpoint on issues reviewed by the board of directors. He/she is also qualified to play an important part in assessing the performance of the board chairman who is not independent, ensuring objectiveness and appropriateness of such assessment, eliminating the conflict of interests arising among the board members in this case.

The Code recommendation to transfer powers to form executive bodies to a company's board of directors means, on the one hand, strengthening of the board role and, on the other, making the board more accountable to shareholders, which is another important novel.

1.4. Remuneration System for Members of the Boards of Directors, Executive Bodies and Other Senior Managers of a Company

The Code recommends introduction of the remuneration system that should apply to members of the board of directors, executive bodies and other senior managers of a company. The remuneration system is intended to regulate all types of payments, benefits and privileges these persons receive for performance of their duties. The Code-recommended approach to the board member remuneration differs from the remuneration approach for members of executive bodies and other key managers of a company. For instance, while fixed annual cash remuneration is the preferential form for the board of directors members and development of short-term incentives for them is not recommended, the remuneration comprising a fixed portion and a variable portion that depends on the company's performance and the company's employee individual contribution to the ultimate corporate performance and development and implementation of short- and long-term incentive programs are recommended for members of executive bodies and other key managers. The Code recommendations envisage that a company's remuneration policy is elaborated by the remuneration committee and approved by the board of directors.

The Code provisions recommending remuneration payments in the form of a company's shares became another aspect of the remuneration practice. The Code urges that precise and transparent rules of holding shares be elaborated for a company, to promote stake accumulation and long-term shareholding within a limited term, upon expiry of which such shares (their bulk) may be sold.

1.5. Material Corporate Actions

The Code includes such actions that significantly influence or may significantly influence a company's share capital structure and financial standing and, consequently, shareholders' position into material corporate actions.

The Code recommends that corporate reorganization, purchase of 30 and more percent of another company's voting shares (merger), entering into major transactions, share capital increase or reduction, share listing and delisting as well as any other actions that may trigger a significant change in shareholder rights or a violation of their interests be recognized as material corporate actions. The recommendation is that a company's articles of association prescribe the list (criteria) of transactions or any other actions that are material corporate actions and refer consideration of such actions to the competence of the company's board of directors.

The fundamental corporate governance principles set forth in the Code for taking material corporate actions are:-

- Material corporate actions must be taken upon fair conditions that secure shareholder and other stakeholder interests;
- The procedure for entering into material corporate actions must ensure that shareholders are able to timely obtain comprehensive information on such actions, enable shareholders to influence taking of these actions and guarantee observation and adequate protection of their interests.

The Code adoption is an important step in corporate governance improvement and development in the Russian Federation. The novels contained in it cover the most topical aspects of corporate governance in Russian companies today. The Code discussion in different formats and on different sites enabled a qualitative expert assessment of its provisions, elimination of gaps and drawbacks found, which ultimately helped make its provisions more convenient in implementation and use. Most of the constructive comments and proposals voiced in the discussions were reflected in the 2014 Corporate Governance Code.