Chapter 13

Information Disclosure

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There are two basic forms of market regulation: 1) substantive rules-based regulation, and 2) disclosure-based regulation. Both regulatory approaches seek to protect shareholders and provide for fair and stable financial markets. Rules-based regulation sets down what companies can and cannot do, and seeks to establish a wide-reaching set of regulations that cover a number of potential circumstances. Disclosure-based regulation relies more heavily upon market mechanisms to punish and reward certain types of corporate behavior, and shifts part of the responsibility for protecting investors to market participants, according to the motto *caveat emptor* or buyer beware. Disclosure-based regulation is partly predicated upon the faith that markets are better at policing corporate misconduct than regulatory agencies, and that disclosure is an effective and inexpensive substitute for substantive regulation. In practice, the two approaches are almost always used in combination with one another, though, some countries rely more heavily on disclosure than others.

The effectiveness of disclosure-based regulation must be considered with caution, especially in the Russian context. In the absence of substantive checks upon managers or owners, its value may, in fact, be quite limited. The early years of Russia's financial markets have an unfortunate history of insiders, controlling shareholders, and related parties freely tunneling company assets under the glare of the Russian and international press.

For disclosure-based regulation to work effectively, a number of elements and incentives need to work together. These include a proper legal and regulatory environment, combined with effective enforcement mechanisms such as regulators that screen financial information for misstatements and courts that provide effective redress. Independent External Auditors also play an important role, providing assurance to the markets, as does an active and interested media that questions company strategies and communications. Finally, a competent and vigilant Supervisory Board is crucial. It is broadly accepted that even the best disclosure system cannot thwart individuals who are intent upon defrauding a company and its shareholders. Without a Supervisory Board that is uniformly intolerant of obfuscation, disclosure cannot be fully effective.

While disclosure based-regulation may function imperfectly in an emerging financial market such as in Russia, disclosure is nevertheless important and is only likely to grow in importance as Russia's financial markets mature. Among the broad palette of disclosures, particular importance must be attached to financial and operating results, related party transactions, and ownership structures.

A. An Introduction to Information Disclosure

1. Definition and Rationale

Disclosure is ensuring access to information by all interested parties, regardless of the purpose of obtaining the information, through a transparent procedure that guarantees information is easily found and obtained.[1]

Timely and accurate disclosure is essential for shareholders, potential investors, regulatory authorities, and other stakeholders. Access to material information helps shareholders protect their rights and improves the market participants' ability to make sound economic decisions. Disclosure makes it possible to assess and oversee management, as well as to keep management accountable to the company and shareholders. Disclosure benefits companies since it allows them to demonstrate accountability towards shareholders, act transparently towards the markets, and maintain public confidence and trust.[2] Good disclosure policies should also reduce the cost of capital. Finally, information is also useful for creditors, suppliers, customers, and employees to assess their position, respond to changes, and shape their relations with companies.

The power of a sound disclosure regime is expressed clearly and eloquently in the following quote:

> *"Requiring disclosure of information can be a powerful regulatory tool in company law. It enhances the accountability for and the transparency of the company's governance and its affairs. The mere fact that, for example, governance structures or particular actions or facts have to be disclosed, and therefore will have to be explained, creates an incentive to renounce structures outside what is considered to be best practice, and to avoid actions that are in breach of fiduciary duties or regulatory requirements, or could be criticized as being outside best practice. For those who participate in or do business with companies, information is a necessary element in order to be able to assess their position and respond to changes that are relevant to them."*[3]

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[1] Law on the Securities Market, Article 30, Clause 1.

[2] Federal Commission for the Securities Market's Code of Corporate Conduct (FCSM Code), Chapter 7, Introduction.

[3] Report of the High Level Group of Company Law Experts on a Modern Regulatory Framework for Company Law in Europe, Brussels, 4 November 2002. (See also: http://europa.eu.int/comm/internal_market/en/company/company/modern/consult/report_en.pdf)

2. Principles of Disclosure

A more everyday and practical expression of what constitutes good disclosure follows in these four basic principles:

Best Practices: Good disclosure should be:
1. Provided on a regular and timely basis;
2. Easily and broadly available;
3. Correct and complete; and
4. Consistent, relevant, and documented.

3. Confidential Information

Securities legistation require publicly held companies to disclose a broad range of financial and non-financial information. At times, information disclosure required by regulations can adversely affect a company's business and financial condition because of the competitive harm that could result from the disclosure. Despite the fact that many Russian companies often consider the most mundane information commercially sensitive, in reality, competitive harm only arises under a limited number of circumstances. Some examples of truly sensitive information include pricing terms, technical specifications, and milestone payments. To address potential disclosure hardship, legislators and regulators develop systems for allowing companies to request confidential treatment of information.

In Russia, information is deemed commercially sensitive if:[4]

- It has real or potential commercial value due to its uncertainty to third parties;
- There is no free access to it on legal grounds; and
- The owner of the information undertakes steps to keep it confidential.

However, if left to the interpretation of the company, this definition could yield a never-ending number of exceptions. Fortunately, legislation defines what information can and cannot be treated as confidential.[5] For example, the law

[4] Civil Code (CC), Article 139, Clause 1.

[5] Decree of the RF President No. 188 on the Approval of the List of Information of Confidential Nature.

considers personal data confidential information, and forbids the collection, storage, usage, and dissemination of private information without the person's consent, unless otherwise provided by a court decision.[6] Accessibility to confidential information is limited, its public disclosure is prohibited, and persons who act in breach of rules may be held liable.[7] This provision can be re-enforced by concluding confidentiality agreements with such persons.

➜ *For more information on how to implement confidentiality agreements, see the model contracts with a non-executive director and the General Director in Part VI, Annexes 13 and 14, respectively.*

Best Practices: Today's corporate governance problems are related less to excessive transparency and over-disclosure than under-disclosure and lack of transparency.

Companies should be clear on what truly constitutes confidential information and should not interpret the broad definitions provided for by law so widely as to withhold relevant information from investors. To guide practices with respect to commercially sensitive information, companies are well advised to develop written policies and procedures, and define what should be considered confidential in internal documents or by-laws.[8] These policies must be consistent with the list of confidential information approved by Presidential Decree on the one hand,[9] and the list of information that may not be deemed commercial secrets under Governmental Resolution, on the other.[10]

4. Insider Information and Insider Dealing

Insider trading encompasses both legal and prohibited activity. Insider trading takes place legally, every day, when corporate insiders (officers, directors, or em-

[6] Law on Information and Protection of Information, Article 11, Clause 1.

[7] CC, Article 67, Clause 2; Article 139, Clause 2; Labor Code, Article 81, Clause 5, Section c; Article 243; Law on Joint Stock Companies (LJSC), Article 71, Clause 2, Paragraph 1.

[8] FCSM Code, Chapter 7, Section 4.1.1, Paragraph 3.

[9] Decree of the RF President No. 188 on the Approval of the List of Information of Confidential Nature.

[10] Resolution of the RSFSR Government No. 35 on the List of Information which Cannot be Deemed as Containing a Commercial Secret. [Note: A draft law on Commercial Secrets was being considered, but had not yet been passed by the State Duma as of this Manual's completion.]

ployees) buy or sell shares in their own companies within the confines of company policy, law, and regulation.

There is also an illegal variety of insider dealing. It is the dealing that takes place when those with access to privileged and confidential information use their knowledge to reap profits or avoid losses on the stock market. Investors lacking access to privileged information often pay the costs of insider dealing.

Another, and far greater, cost of insider dealing is the damage done to the credibility of securities markets. One of the main reasons that capital is easily available in the world's most successful stock markets is that investors largely trust them to be fair. The common belief in some countries that privileged investors should be allowed to profit from their access to confidential information may explain, in part, relatively low public share ownership in these countries. Governments cannot afford to ignore insider dealing if they hope to promote an active securities market and attract international investment. The same holds true for Supervisory Boards that wish to protect shareholders and attract investment.

In Russia, insider information is defined as any information about a company and its securities, which is not easily accessible and which provides privileges to those who have access to it due to their official position, contractual obligation vis-à-vis (or agreement with) the company in comparison to other participants of the securities market.[11] Individuals with access to insider information include:[12]

- Members of the company's governing bodies or securities market professionals with a contractual agreement with the company;
- The External Auditor of the company or securities market professionals having a contractual agreement with the Auditor; and
- Officials of regulatory agencies having legal rights to control or monitor the company.

Best Practices: Disclosure of insider information may substantially affect the market value of shares and other securities of a company. Therefore, per-

[11] Law on the Securities Market, Article 31. [Note: A draft law on Insider Information was being considered, but had not yet been passed by the State Duma as of this Manual's completion.]

[12] Law on the Securities Market, Article 32.

sons who have access to insider information may not use it to execute transactions, nor may they transfer insider information to a third party.[13] Illegal use of insider information can damage shareholder interests and adversely affect the financial position and reputation of the company as well as securities markets overall. The company should have a written insider dealing policy in place, and vigorously enforce it. The Internal Auditor should monitor whether directors, managers, and other officers comply with the law, regulation, and internal rules on insider dealing.[14]

5. Disclosure in Listed *Versus* Closely Held Companies

Disclosure requirements are different for publicly listed companies, open and closed joint stock companies, and private companies. Private and closed joint stock companies usually need only to comply with minimal disclosure requirements. More stringent rules apply to listed open joint stock companies. Tight regulation of disclosure among listed companies is needed because of the greater impact of potential fraud when a company may have many thousands of shareholders. Given the importance of capital markets in a modern economy, governments are, understandably, keen on ensuring the integrity of the financial system. The increased number of disclosure obligations for listed companies is the price to be paid to access the large funds available on the capital markets.

Russia's two leading stock exchanges, the Russian Trading System (RTS) and Moscow Interbank Currency Exchange (MICEX) have specific listing rules. For example, companies listed on Tier-A, Level 1 on any of these exchanges must provide documents confirming their full compliance with the FCSM Code (or, if listed on MICEX, with their internal company-level code of corporate governance that is based on the FCSM Code). Companies listed on RTS' Tier-A, Level 1 are further required to disclose their financial statements according to both Russian and International Financial Reporting Standards. On the other hand, companies listed on Tier-A, Level 2 must simply provide documents confirming their compliance with Chapter 7 of the FCSM Code on information disclosure. RTS requires that companies additionally report on specific material events, for example, on issuing, splitting, consolidating, or retiring securities; on transferring the register to

[13] Law on the Securities Market, Article 33, Clause 1.

[14] FCSM Code, Chapter 4, Section 4.2.

another External Registrar; on the date of the General Meeting of Shareholders (GMS); on the record date; and on the total number of shareholders.[15]

➜ *For more general information on the differences between forms of joint stock companies, see Part I, Chapter 2, Section A.2.*

6. Disclosure *Versus* Transparency

Disclosure is sometimes confused with transparency. Unfortunately, these two terms are frequently and erroneously used interchangeably. While disclosure and transparency would, at first glance, appear to be the same, they are not. Companies may disclose an enormous amount of information that is of no particular value to the users of such information. Important pieces can be withheld. Disclosure can be irrelevant or, worse, appear to be manipulated in such a way as to conceal the true picture of the state of the enterprise.

Company Practices in Russia: The disclosure of ownership in Russian companies highlights how disclosure and transparency may diverge. While most companies properly disclose their ownership, the true owners and the extent of their control often remains hidden behind complex legal structures such as Special Purpose Entities (or Vehicles), off-shore holding companies, and trusts. For example, most companies in Russia's regions comply with general disclosure requirements. However, 91% fail to provide information on a variety of issues, including major shareholders.[16] Few companies thus have transparent ownership structures.

7. Personal Liability for Non-Disclosure

As a rule, companies are liable for damages caused to shareholders denied legitimate access to information. Companies are also liable when they cause damages to third parties by providing false, incomplete, or distorted information.[17] Members

[15] To view the complete set of listing rules, visit RTS's and MICEX's websites under: www.rts.ru and www.micex.ru.

[16] IFC Survey on Corporate Governance Practices in Russia's regions, Section 2.2.1, page 25, August 2003 (see www.ifc.org/rcgp).

[17] CC, Article 1068.

of the company's governing bodies, in particular the executive bodies, are personally liable for losses caused to the company through their fault.[18] The company (or a shareholder owning 1% or more of common shares) may seek compensation for losses.

The failure to disclose information to the securities markets, provide reliable information, and/or follow disclosure procedures is also subject to liability.[19] Persistent non-disclosure of information or provision of false information causing material damage to individuals, legal entities, or the state is subject to criminal prosecution.[20]

Executive bodies, typically the General Director, are legally responsible for proper disclosure.[21] Some documents, such as the prospectus and quarterly report, must be signed by more than one person, e.g. by the General Director and the Chief Accountant, financial consultant, and the External Auditor. These persons are jointly and severally liable for the reliability and completeness of the disclosed information. They also bear subsidiary (secondary) liability with the company for any damages caused to shareholders due to incorrect, incomplete, and/or false information in such documents.

B. Disclosure Items

The OECD Principles of Corporate Governance (OECD Principles) suggest that

> *"…timely and accurate disclosure be made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company."*[22]

The key concept that underlies the OECD's recommendation is the concept of materiality. Material information is information, the omission or misstatement of which could affect economic decisions taken by the users of information. Materiality may also be defined as a characteristic of information or an event that makes it sufficiently important to have an impact on a company's share price.

[18] LJSC, Article 71, Clause 2.

[19] Law on the Securities Market, Articles 22.1, Clause 3; Article 30, Paragraph 11.

[20] Criminal Code, Articles 185 and 185.1.

[21] LJSC, Article 88, Clause 2.

[22] OECD Principles, Principle IV on Disclosure and transparency. See also: www.oecd.org/dataoecd/32/18/557724.pdf.

The application of the materiality concept allows companies to avoid overly detailed disclosure that is ultimately irrelevant to shareholders. For example, damage to RUR 150,000 (approximately U.S. $ 5,000) worth of paper in a large, publicly traded company is, clearly, of little importance to the investor. It may, on the other hand, be material to a small family-owned print shop. Materiality is, consequently, a relative concept that depends on the context. It is often difficult to define with great precision in practice. Companies and auditors may sometimes apply certain numerical thresholds (such as, for example, 5% of earnings) to simplify its application. However, these thresholds can only serve as a starting point for a more rigorous application of the concept of materiality.

Best practices: The OECD Principles call for disclosure of all material information in the following areas:

- Financial and operating results of the company;
- Company objectives;
- Shareholdings and ownership structure;
- Directors and key executives, as well as their remuneration;
- Material foreseeable risk factors;
- Material issues regarding employees and other stakeholders; and
- Governance structure and policies.

This list is comprehensive, if general. The Technical Committee of the International Organization of Securities Commissions (IOSCO) has developed more detailed, high-level principles for ongoing disclosure and material development reporting for listed entities. These principles are:[23]

- Materiality of information for an investor's investment decision;
- Disclosure on a timely basis — immediate or periodic;
- Simultaneous and identical disclosure in all jurisdictions where the entity is listed;
- Dissemination of information by using efficient, effective, and timely means;
- Disclosure criteria fairness, without misleading or deceptive content and containing no material omission;
- Equal treatment of disclosure — no selective disclosure to investors and others before public disclosure; and
- Compliance with disclosure obligations.

[23] Principles for Ongoing Disclosure and Material Development Reporting by Listed Entities, OICU-IOSCO, October, 2002. See also: www.iosco.org.

Russian legislation covers these essentials in considerable detail. The following sub-sections discuss Russian requirements and disclosure practices with respect to the above-mentioned OECD disclosure items.

1. Financial and Operating Results

a) Presenting Financial Information

Information about financial results, performance, and situation, as well as operations of the company, is of utmost importance for shareholders, potential investors, creditors, and other stakeholders. The following list constitutes the most typical forms of, and additions to, financial reporting:

- *The balance sheet* provides a snapshot of the company's assets, capital, and liabilities on a particular date. To skilled analysts, it provides important information on, *inter alia*, the degree of risk an investment in the company carries or the company's ability to pay creditors.
- *The income statement* provides information on the company's performance over a specified period of time. Income statements may be organized in a number of different ways. According to internationally recognized practice, income statements must show: 1) revenues or sales; 2) the results of operating activities; 3) financing costs; 4) income from associates and joint ventures; 5) taxes; 6) profit or loss from ordinary activities; and 7) net profit or loss. The income statement demonstrates business sustainability.
- *The statement of changes in owners' equity* shows all changes in the charter, additional paid-in, and reserve capital, as well as retained earnings. In addition, it provides information on changes in statutory and additional funds, and briefs on net assets.
- *The cash flow statement* illustrates a company's sources and uses of cash. It lists all changes affecting cash in three areas: 1) operations; 2) investments; and 3) financing. For example: net operating income increases cash; the purchase of a plant is an investment that decreases cash; and the issuance of shares or bonds is a financing activity that increases cash.
- *The notes to the financial statements* help explain the company's financial statements by providing important details and insight into how the company prepared its accounts.
- *Explanations to financial statements* briefly describe features of the company's activities, its main performance indicators and factors that affected the

company's financial results, as well as decisions of the review of financial statements and distribution of net profits. This refers to any relevant information that would enable users to receive a complete and objective picture of the company's financial condition, financial results for the reporting period, and any changes in its financial position.

Best Practices: International practice also calls for the Management's Discussion and Analysis (MD&A), which provides management's view of the performance and future prospects of the company. The MD&A, which is typically disclosed in the company's annual report, should: 1) complement as well as supplement financial statements; 2) have a forward-looking orientation; 3) focus on long-term value creation; 4) integrate long- and short-term perspectives; 5) present information that is significant to the decision-making needs of users; and 6) embody the qualities of reliability, comparability, consistency, relevance, and understandability. The MD&A presents a more analytical and qualitative view than the rest of the financial statements.

Finally, *the External Auditor's report with conclusions* enables an independent External Auditor to express an opinion on whether or not the company's financial statements are prepared, in all material respects, in accordance with an identified financial reporting framework, and whether they are reliable. This provides shareholders, managers, employees, and market participants with an independent opinion about the company's financial position and — if performed properly — should attest to the accuracy of the statements. Russian companies are further required to publish the Revision Commission's report.

➜ *For more information on the role of the External Auditor and Revision Commission, see Part IV, Chapter 14, Section B and A, respectively.*

b) Preparing Financial Information

Russian legislation regulating financial reporting recognizes the following basic concepts and principles:[24]

- **Accrual based accounting**, according to which revenues and expenses are booked over time and not at the point of payment or receipt of funds. This requires that sales and expenses relating or pertaining to a particular period

[24] Russian Accounting Standard 1/98, Accounting Policy of the Company, Section 6.

be recorded in the period of occurrence irrespective of when the amount was received or paid;

- **Going concern assumption**, i.e. that financial statements are prepared on the assumption that the company is operating and will continue to operate for the foreseeable future, and that it has neither the intention nor the necessity of liquidation or of materially curtailing the scale of its operations. The going concern assumption is a fundamental principle in the preparation of financial statements. For this reason, it is recognized that management has a responsibility to assess the entity's ability to continue as a going concern. However, management's assessment may not always involve detailed analysis, particularly when there is a history of profitable operations and ready access to financial resources.

Company Practices in Russia: Not all companies in Russia follow the going concern principle when preparing financial statements. Some are on the verge of bankruptcy, while others cannot guarantee the stability of company's operation in the future. Additionally, a poor financial picture is often presented to minimize tax payments.

- **Consistency**, which states that the presentation and classification of items in the financial statements shall be retained from one period to the next unless a change is justified either by a change in circumstances or a requirement of a new accounting standard; and
- **Separation of assets and liabilities**, meaning that the assets and liabilities of the company shall be separated from those of its owners and other organizations.

In addition, company accounting policies should ensure:[25]

- **Completeness of information disclosure**, meaning that information contained in the company's financial statements should disclose all material business facts and results (actually and potentially) influencing economic decision-making by the users of these financial statements both from the standpoint of materiality of such information and from the standpoint of the cost of its preparation (an omission can cause information to be false

[25] Russian Accounting Standard 1/98, Accounting Policy of the Company, Section 7. Russian Accounting Standard 4/99, Financial Statements of the Company, Section 33.

or misleading and thus unreliable and imperfect from the standpoint of its relevance);

- **Timeliness**, i.e. the company needs to publish reports quickly, as up-to-date information is of much more value to users than older information that may have been superseded by events;
- **Conservatism**, requiring a company to make prudent accounting choices and estimate when future events would have negative effects on its financial conditions;
- **Substance over form**, meaning that for the faithful presentation of information in the financial statements it is necessary that transactions and events are accounted for and presented in accordance with their substance and economic reality (which should prevail) and not merely their legal form;
- **Analytical**. The sum of analytical accounts should be equal to the synthetic account;
- **Balance between benefit and cost**, which, given the complexity and breadth of certain reporting requirements, allows smaller companies to tailor their financial information to be cost-effective. This concept, however, should not be used to deny information to users. The presumption must be that information required by law and accounting standards should be provided to users unless there is a clear indication that the cost outweighs the benefit; and
- **Matching**. Expenses are matched to related revenues in determining earnings for the period.

Legislation, accounting, and other standards will determine the specific content and format of financial statements. Taken together and compared over time, the financial statements and the MD&A should provide a well-rounded picture of the company's operations and financial position.

Best Practices: If companies plan to access international capital markets or, simply, to improve upon the quality of financial reporting, they will need to prepare financial statements according to an internationally accepted body of accounting standards. The two most recognized standards are the International Financial Reporting Standards (IFRS) and U.S. Generally Accepted Accounting Principles (U.S. GAAP).[26]

[26] U.S. GAAP are available on the Financial Accounting Standard Board's website under: http://www.fasb.org. A summary of IFRS is available on the International Accounting Standard Board's website under: http://www.iasb.org.

In addition to standard financial reporting according to the Russian Accounting Standards (RAS), a company should consider reporting in accordance with IFRS for the following reasons:

- IFRS have clear economic logic and provide better information to the company's management than the current RAS do, allowing for a better comparison with a peer group of international companies;
- There is global convergence of national standards towards IFRS;
- Russian companies will likely need to report using IFRS in the future due to the convergence of Russian standards with IFRS;[27] (The Russian Ministry of Finance has issued statements regarding its intent to adapt RAS to IFRS.)
- All listed companies in Europe with consolidated accounts will be required to present their consolidated financial statements using IFRS as of 2005;[28]
- Unification of standards will allow users of financial statements to "read" financial statements under common rules; and
- Implementing IFRS could help Russian companies decrease expenses in attracting investment.

Applying IFRS typically has the following impact on the balance sheet of a standard Russian company:

- The need to prepare consolidated financial statements (IAS 27.7/11);
- Inventories can no longer be generally carried at cost, but at the lower of cost or net realizable value (IAS 2.6);
- A significant change in the value of fixed assets;
- Use of fair market valuation rather than the historical cost approach for many assets and liabilities;
- The appearance of new financial instruments, derivatives in particular; and
- Recognition of assets and liabilities, the control over which does not stem directly from participation in equity.

Additional items are included in the income statement, such as fair value adjustment for financial instruments, and recognition or recovery of asset impairment, among others. Disclosures also become more informative and user-oriented.

Depending on where the company intends to list, statements will likely need to be prepared according to one of these two standards.

[27] Research released by the world's six largest accountancy firms shows that an overwhelming majority of countries — over 90% of a total 59 countries surveyed — intend to converge with IFRS; see GAAP Convergence 2002 from http://www.ifad.net.

[28] Regulation (EC) 1606/2002 of the European Parliament of the Council of 19.7.2002 on the Application of International Accounting Standards. See also: http://europa.eu.int/eur-lex/pri/en/oj/dat/2002/1_243/1_24320020911en00010004.pdf.

c) Disclosing Financial Information

Financial information will typically be presented in different forms and at different times throughout the financial year. Financial and operating results will appear in the prospectus, and annual and quarterly reports. The Law on the Securities Market requires that the following information on the last five operating years and the last reporting period be disclosed in these documents:[29]

- Major areas of company activity;
- Results of the financial and business activity, as well as any major factors affecting revenues;
- Financial and economic ratios of the company;
- Market capitalization, liquidity, and its obligations;
- Capital structure, including working capital;
- Composition, structure, and value of fixed assets;
- Total amount of export; and
- Inventory of the company's property.

Best Practices: Companies should disclose all material information, and do so on a timely basis and in such a manner as to make the information as clear and understandable to users as possible. Companies should adhere to the spirit of the law, not just the letter, and should not limit themselves to the minimum standards of statutory disclosure. Some examples of additional disclosures that are encouraged by the FCSM Code:

- The quarterly report for the fourth quarter should include additional financial information, in particular data about the company's operations over the entire previous reporting year rather than for the fourth quarter only;[30]
- The annual report should also disclose information that will enable shareholders to understand the results of the company's activities during the reporting year;[31] and
- Any of the material events defined by the FCSM Code.[32]

[29] Law on the Securities Market, Article 22, Clauses 4 and 6.

[30] FCSM Code, Chapter 7, Section 2.2.

[31] FCSM Code, Chapter 7, Section 3.3.

[32] FCSM Code, Chapter 7, Section 2.3, Paragraph 6.

d) Financial Information in Groups of Companies

Complete disclosure of intra-group relations, transactions, and their financial terms, and consolidated accounts is a crucial pre-requisite to make the group's functioning transparent.

Best Practices: When preparing consolidated accounts, companies should follow uniform accounting policies for the parent and its subsidiaries or, if this is not practicable, the company must disclose that fact and the proportion of items in the consolidated financial statements to which different policies have been applied. In the parent's separate financial statements, subsidiaries may be shown at cost, at revalued amounts, or using the equity method. According to IFRS, a company's consolidated accounts should include, *inter alia*:[33]

- The name, ownership, and voting percentages for each significant subsidiary;
- The reason for not consolidating a subsidiary;
- The nature of the relationship if the parent does not own more than 50% of the voting power of a consolidated subsidiary;
- The nature of the relationship if the parent does own more than 50% of the voting power of a subsidiary excluded from consolidation;
- The effect of acquisitions and disposals of subsidiaries during the period; and
- In the parent's separate financial statements, a description of the method used to account for subsidiaries;

➜ *For more information on the importance of disclosing financial information in groups of companies, see Part V, Chapter 15, Section B.2.*

2. Company Objectives

It is important for markets, shareholders, and other stakeholders to be aware of the company's objectives. The communication of company objectives can be either in response to legal requirements or it can be voluntary.

Legislation requires that company objectives (such as the issuance of securities, acquisition plans, replacement and sales of assets, or research and development) be disclosed in the prospectus.[34] In addition, quarterly reports must contain forward-

[33] Excerpt from International Accounting Standard No. 27. See also: http://www.iasb.co.uk.

[34] Law on the Securities Market, Article 22, Clauses 4, 6 and 9.

looking information including sources of revenue, plans for new production procedures, expansion or reduction of production, new product development, substitution of old products, modernization or repair of fixed assets, and modification of the types of company activities.[35] In addition, the annual report must outline the company position in the industry, priority areas of activity, and development trends.[36]

Voluntary disclosure may cover issues such as a company's policies concerning corporate governance, business ethics, environmental issues, and other public policy commitments. This information can help to properly evaluate the prospective performance of the company, its relationship with various stakeholders and communities in which it operates, and the steps that the company has taken to implement its objectives. As with other types of disclosure, the quality of information provided to the public is greatly enhanced by adhering to a widely accepted standard.[37]

Best Practices: Companies may choose to voluntarily disclose their objectives in the charter, company-level corporate governance code, and/or ethics code, as well as annual report. Regardless of the form, companies should ensure that this information is readily accessible to the public, for example, on their websites.

3. Major Share Ownership and Voting Rights

a) Major Share Ownership

It is important that shareholders are informed about company ownership structures to understand their rights, role and authority in governing the company, and influence its policy. Depending on the size of ownership, shareholders have varying degrees of influence over decision-making in a company. Legislation provides greater rights to shareholders with larger holdings.

➜ *For more information on the rights of shareholders according to their ownership percentage, see Part III, Chapter 7.*

[35] FCSM Regulation No. 03-32/ps on the Disclosure of Information by Security Issuers (FCSM Regulation No. 03-32/ps), Annex 11, Section 3.4.

[36] FCSM Regulation No. 17/ps on Additional Requirements to the Procedure of Preparation, Calling, and Conducting the General Meeting of Shareholders (FCSM Regulation No. 17/ps), 31 May 2002, Section 3.6.

[37] For a general discussion of non-financial disclosure, see the OECD's Guidelines for Multinational Enterprises. See the OECD website at www.oecd.org or consult the Guidelines directly under: www.oecd.org/dataoecd/62/58/2438852.pdf.

Clearly, it is vital to know who is in a position to make (or influence) decisions within a company. For this reason, full information on the amount of the issued capital, its increases and decreases, the rights attached to shares of different types and classes, and the number of shareholders is crucial.

Shareholders with large stakes have the opportunity to exercise control over decision-making in a company. These opportunities are summarized in Table 1.

Table 1: The Influence on Decision-Making Relative to the Ownership

Ownership	Influence on decision-making
25% plus 1 vote	The shareholder can block major decisions that require 3/4-majority, e.g. to amend the charter or reorganize the company.
50% plus 1 vote	The shareholder can unilaterally take decisions that require a simple majority, e.g. to declare dividends and approve the External Auditor.
75% plus 1 vote	The shareholder can unilaterally decide all issues.

In practice, lower thresholds may suffice to exercise control over a company. In particular, in companies with dispersed ownership it is not necessary for a shareholder to hold the percentages of votes outlined in Table 1 above since the quorum for decisions of the GMS is counted based on votes cast. Since it is rare for all shareholders to vote at the GMS, a lesser percentage of shares usually provides the same degree of influence. In any event, the larger the ownership stake, the greater the ease with which shareholders can control the company.

Legislation requires disclosure of ownership once its size reaches or exceeds specific thresholds. What, where, when, and to whom disclosure needs to be made depends upon ownership thresholds. These thresholds are summarized in Table 2.

Table 2: Ownership Disclosure Thresholds

Threshold	Who Should Disclose	What Should be Disclosed	To Whom and Where to Disclose
One share	Nominal holders	Beneficial owners	Notification to the Registrar of the company.[38]

[38] Law on the Securities Market, Article 8, Clause 2.

Table 2: Ownership Disclosure Thresholds			
Threshold	**Who Should Disclose**	**What Should be Disclosed**	**To Whom and Where to Disclose**
5% of the charter capital or 5% of common shares[39]	The company	Personal data, the size of the stake in the charter capital, and the amount of common shares, the dynamics of changes in the list of owners of 5% and the size of holdings	To the FCSM. In the prospectus and quarterly reports, and on the company website.
5% of the charter capital or 5% of common shares if shareholders are legal entities	The company	Information on the owners of 20% of the charter capital or common shares in the company-shareholder, as well as the size of the stake in the charter capital and the amount of common shares (chain shareholding)	To the FCSM. In the prospectus and quarterly report, and on the company website.
20% of voting shares	The company	Information on the owners of 20% of voting shares	To the FCSM. In the List of Related Parties and on the company website.
20% and more of securities other than non-convertible bonds[40]	The owner	The holding of securities/the acquisition of securities	To the FCSM, not later than five days after the thresholds are reached;[41] as well as to the antimonopoly body.[42]
20% of voting shares	The legal entity — owner	On legal entities that own 20% of voting shares in the company	To the Supervisory Board, Revision Commission, and External Auditor.
The acquisition of any 5% of securities above 20% as well as the sale of 5% if the remaining stake is higher than 20%	The owner	On the acquisition and/or sale	To the FCSM not later than five days after the thresholds are reached. A special notification form is used for this purpose.
Owning 25% of securities of any type[43]	The company	The holding of securities	To the FCSM. In the material events reports.

[39] Law on the Securities Market, Article 22, Clause 8; Article 30, Clause 5.

[40] Law on the Securities Market, Article 30, Paragraph 14.

[41] Law on the Securities Market, Article 30, Paragraph 15.

[42] Law on Competition, Article 18, Clause 1.

[43] Law on the Securities Market, Article 30, Paragraph 12.

Information about the identity of "formal" shareholders is a prerequisite since they can exercise voting and dividend rights related to the shares they hold. But it may not be sufficient to work out the actual ownership and control structure because, if the "formal" shareholder is controlled by another person (the beneficial owner), it is the beneficial owner who can influence the behavior of "formal" shareholders and eventually control voting rights. Even more important, several "formal" shareholders can be controlled by the same beneficial owner. In such case, the real voting power of the beneficial owner consists of the sum of voting rights held by several "formal" shareholders. It is therefore necessary to know the identity of the beneficial owner and then attribute all the stakes held by the "formal" shareholders to him.

Best Practices: Companies seeking to disclose their ownership structure may wish to follow examples under U.S. and EU regulations.

U.S. regulations define a beneficial owner as any person who, directly or indirectly, through any contract arrangement, understanding, relationship, or otherwise has or shares:[44]

- Voting power, which includes the power to vote, or to direct the voting of, such a security; and/or
- Investment power that includes the power to dispose, or direct the disposition of, such security.

U.S. securities law states that any person who is directly or indirectly the beneficial owner of more than 5% of any equity security of a class, shall notify the issuer and each exchange where the security is traded of such acquisition within 10 days, as well as of any increase or decrease by 1% of more.[45] If the beneficial owner acts in concert with other institutions or persons, their names and the relationship with the beneficial owner must be disclosed.

The EU Transparency Directive of 2001 provides a framework for disclosure.[46] In summary:

1. Article 9 stipulates that investors must disclose the acquisition or disposal of major shareholdings in listed companies, based on thresholds starting at 5% continuing at intervals of 5% until 30% of voting rights, or charter capital or both.

[44] 17 Code of Federal Regulations (CFR), 240/ 13d-3(a).

[45] U.S. Securities and Exchange Act 1934, Sec. 13d-1,2; 17 CFR 240, 13d-2.

[46] See also: http://europa.eu.int/eur-lex/en/consleg/pdf/2001/en_2001L0034_do_001.pdf.

2. Article 11(2) shortens the reporting obligation of the acquirer to the company and the competent regulatory authority from seven calendar days to five business days on the one hand and, on the other, of the company to the public from nine calendar days to three business days.
3. Article 2 extends the definition of "security holder" to include custodians and those holding securities for clearing and settlement purposes.
4. Finally, Article 11(5) extends notification requirements to various classes of shares, such as warrants and convertible bonds if the holdings reach or fall below the thresholds defined in Article 9.

Six Member States have already introduced this Directive by law or regulation. In addition, the EU Takeover Bids Directive's Article 10 regulates transparency issues, including the disclosure of beneficial ownership structures, and listed companies in the EU are thus required to disclose information in their annual report on, *inter alia*:

1. The structure of their capital;
2. Any restrictions on the free transferability of securities;
3. Significant direct and indirect shareholdings (including pyramid schemes and cross-shareholdings);
4. The holders of any securities with special control rights;
5. The system of control of any employee share scheme where the control rights are not exercised directly by employees;
6. Restrictions on voting rights;
7. Shareholder agreements that are known to the company;
8. The rules governing the appointment and replacement of Supervisory Board members;
9. Significant agreements made by the company that take effect upon a change of control; and
10. Compensation agreements between the company and its directors in the case of a successful takeover bid.

Russian legislation requires timely disclosure of information regarding beneficial owners. In particular, the Company Law requires the nominal shareholder to disclose information to the company on persons on whose behalf he holds shares for the purposes of compiling the shareholder list for the GMS and distributing dividends.[47]

[47] LJSC, Article 51, Clause 2; Article 42, Clause 4, Paragraph 2.

Best Practices: Opaque ownership structures continue to preoccupy the corporate governance debate since a considerable percentage of shares of Russian companies remain offshore with their true — or beneficial — owners hidden.

Offshore structures can have legitimate uses. However, they are often used to conceal the identity of the owners of interests in underlying pools of assets and related parties, and tend to be associated with perceptions of tax-fraud, self-dealing, money laundering, illicit capital export, and other generally recognized unsavory business practices. International accords are making it increasingly difficult to use such structures for illegitimate purposes.

Russian companies wishing to comply with good corporate governance practices should disclose their ownership structure, including beneficial owners, in a transparent manner.

b) Indirect Control

Shareholders owning less than the majority of shares can exercise indirect control over the company through pyramid structures and/or cross shareholdings. Relationships with related parties may also alter the control structure of the company. For these reasons, information on indirect ownership, related parties, and related party transactions should be fully disclosed, specifically in the annual report,[48] quarterly reports,[49] material events report,[50] and other notifications to regulators or creditors.[51] Legal requirements are summarized in Figure 1.

[48] FCSM Regulation No. 17/ps, Section 3.6.

[49] Law on the Securities Market, Article 22, Clauses 8 and 11; FCSM Regulation No. 03-32/ps, Annex 13.

[50] Law on the Securities Market, Article 30, Paragraph 12; FCSM Regulation No. 03-32/ps, Section 11.4.

[51] LJSC, Article 15, Clause 6, Paragraph 1; Law on Competition, Article 18, Clause 1.

Figure 1: Disclosure of Indirect Ownership, Related Parties, and Related Party Transactions

	Quarterly Report	Material Events Report	Annual Report	Notification of Regulators and Creditors
Interest of Supervisory Board and executive body members in the charter capital	✓	Acquisition of securities (see Table 2)	✓	Buyback of securities (see Table 2)
Dependent companies with 5% or more participation	✓	Not applicable (n/a)	n/a	n/a
Owners of 20% + of shares in a company — shareholder who, in turn, own 5% + of the company's charter capital or common shares (chain shareholding)	✓	n/a	n/a	n/a
Reorganization of the company, its subsidiaries, or dependent companies	n/a	✓	n/a	To creditors: reorganization of the company
Related party transactions	✓	n/a	✓	n/a
Related parties	Only if related parties are debtors of the company	n/a	n/a	n/a
Acquisition of the company's assets or rights to determine the conditions of the company's business activities	Transactions that impose obligations covering 10% or more of the company's assets	• Acquisition of assets entailing a one-time increase/decrease in the value of the company's assets by 10% and more; • A one-time transaction involving 10% and more of the company's assets	List of extraordinary and similar transactions	• Acquisition of assets if their book value exceeds 10% of the book value of the selling company's fixed and/or intangible assets; • Acquisition of rights providing the possibility to determine the conditions of the company's business activity or to act as its executive body

Source: IFC, March 2004

Best Practices: In addition to the above-mentioned statutory requirements, companies should disclose the following material events related to beneficial shareholdings:[52]

- Transactions involving company property, the value of which is equal to, or in excess of, 2% of the non-current assets and/or which can materially influence the market price of the company's shares;
- Buyback by the company of its shares (unless connected with the reduction of the charter capital); and
- Other transactions that can materially affect shareholder interests.

Companies should further disclose information regarding the buyback of company shares and the most important transactions in the annual report.[53]

Finally, a list of the company's related parties should be submitted by the company to the FCSM on a quarterly basis.[54]

➜ *For more information on the procedure to disclose the company's related parties, see Section C.5 of this Chapter.*

c) Shareholder Agreements and Voting Caps

Shareholder agreements, voting caps, and caps of shareholdings can also affect control. Shareholder agreements typically oblige parties to vote as a block and may give first-refusal rights for the purchase of shares to another shareholder. Shareholder agreements can cover many issues including which candidates to nominate for the Supervisory Board or the selection of the Chairman.

Best Practices: Russian legislation does not provide for the disclosure of shareholder agreements. Shareholder agreements, however, are clearly of material interest to shareholders. While difficult to detect, companies should make reasonable efforts to obtain information about the existence of shareholder agreements and to disclose such information to all shareholders.[55] In principle, parties to shareholder agreements should voluntarily disclose this information themselves.

[52] FCSM Code, Chapter 7, Section 2.3.

[53] FCSM Code, Chapter 7, Section 3.3.2 and 3.3.4.

[54] LJSC, Article 93, Clause 4; FCSM Regulation No. 03-19/ps on the Disclosure of Information about Affiliated Persons of Open Joint Stock Companies (FCSM Regulation No. 03-19/ps), Section 4.

[55] FCSM Code, Chapter 7, Article 2.1.4

Voting caps limit the number of votes that a shareholder may cast regardless of the number of shares he actually possesses. As such, caps go against the principle of one share — one vote and control that is proportional to ownership. Voting caps are often used to either entrench the position of existing controlling shareholders or management, and are rarely supported by good faith investors.

Russian law allows voting caps and caps of shareholdings to be established, however, requires the company to disclose such caps in its charter.[56] Caps should also be disclosed in the prospectus and quarterly reports.[57]

4. Information on Directors and Executives

a) Personal Data

Investors and shareholders should have access to relevant information about Supervisory Board members and key executives to evaluate their experience and qualifications. Educational background, current occupation, and professional experience of directors and senior executives should be disclosed and readily accessible to interested parties. It is also important that shareholders and investors have information about any (existing or potential) conflicts of interest that may affect the independence and decision-making capacity of the Supervisory Board and Executive Board.

Shareholders should also be able to assess whether or not Supervisory Board and Executive Board members dedicate sufficient time to their duties and properly carry out their responsibilities. Accordingly, companies should disclose all other Board positions held by Supervisory or Executive Board members in other companies (domestic and foreign), and the meeting attendance records.

Table 3 summarizes the legal disclosure requirements for members of the Supervisory and Executive Boards in the quarterly report,[58] annual report,[59] the list of related parties,[60] and in notifications to regulators.[61]

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[56] LJSC, Article 11, Clause 3.

[57] Law on the Securities Market, Article 22, Clause 8.

[58] Law on the Securities Market, Article 22, Clause 7; Article 30, Paragraph 5; FCSM Regulation No. 03-32/ps, Annex 11, Section V.

[59] FCSM Regulation No. 17/ps, Section 3.6.

[60] FCSM Regulation No. 03-19/ps, Section 4.

[61] Law on Competition, Article 18, Clause 6.

Table 3: Disclosures on Supervisory and Executive Board members				
	Quarterly Report	**Annual Report**	**List of Related Parties**	**Notification of Regulators**
Full name of all individuals	✓	✓	✓	n/a
Current positions	✓	n/a	n/a	Election of an individual into executive bodies and Supervisory Board of two or more companies
Positions for the last five years	✓	n/a	n/a	n/a
Brief biographical data	n/a	✓	n/a	n/a
Kinship of Supervisory and Executive Board members and the Internal Auditor	✓	n/a	n/a	n/a

Best Practices: Legal disclosure requirements clearly fall short of best practices. According to the FCSM Code, companies should also disclose the following information in its annual report:[62]

- Other key officials of the company, including their curriculum vitae;
- Information about all transactions between these other key officials and the company;
- Age, profession, employment, and citizenship of each Supervisory Board member, as well as all other positions, the date of initial appointment, and the current term of appointment; and
- Information on all claims filed in Russian or foreign courts (or arbitration tribunals) against Supervisory and Executive Board members and/or the General Director.

b) Remuneration

Incentive remuneration schemes are common in many countries and come in many varieties. Few companies have such arrangements that are identical to one another.

Executive remuneration plans are usually put in place in an effort to motivate executives, and better align their interests with the interests of shareholders. They

[62] FCSM Code, Chapter 7, Article 3.3.3.

normally include performance based bonuses. Incentive remuneration schemes may not be the most effective way of alleviating inherent conflicts of interests and, in any event, should always be subject to careful legal and financial examination and the approval of both the Supervisory Board and the GMS.[63] Remuneration plans for non-executive directors will differ considerably.

In Russia, companies must disclose aggregate data on the amount of remuneration for each governing body during the last completed fiscal year in the prospectus and quarterly report, as well as existing agreements regarding such payments in the current fiscal year.[64]

Best Practices: The remuneration of Supervisory Board members and key executives is disclosed on an individual basis in some countries, putting shareholders in a better position to assess the extent to which an individual's remuneration is justified in view of his responsibility and/or performance. It also allows shareholders to hold executives and Supervisory Board members fully accountable for the performance of their duties.

- With respect to executive remuneration plans, shareholders and investors should have sufficient information to properly assess their costs and benefits to the company, and the relation between the performance of the company, on the one hand, and the level of executive remuneration, on the other.
- At some point, the independence of non-executive directors may be compromised if they earn a significant amount of their total income from their Board activities. Some countries have monetary thresholds that serve as convenient "rules of thumb" or warning signals. While numerical thresholds may be a reasonable starting point, judgments on independence will, of course, require a much more sophisticated analysis. The disclosure of a non-executive director's remuneration remains critical in order to judge the extent to which their independence may be compromised.

Companies should not only be transparent with respect to the levels of remuneration but also the methods for determining remuneration. The criteria for determining the amount of remuneration for Supervisory Board members, the General Director and/or Executive Board members — as well as the total amount

[63] FCSM Code, Chapter 4, Section 5.1.2.

[64] Law on the Securities Market, Article 22, Clause 7; FCSM Regulation No. 03-32/ps, Annex 11, Section V.

of remuneration paid or to be paid depending on the results of the reporting year — must be disclosed in the annual report.[65]

Best Practices: To adhere to the spirit of full disclosure of remuneration, companies may find it necessary to disclose information regarding the remuneration of other company officials who are not part of the Executive or Supervisory Boards.[66]

➜ *For more information on non-executive and executive remuneration practices, see Part II, Chapter 4, Section H and Chapter 5, Section G, respectively.*

5. Material Foreseeable Risk Factors

Risk (along with return) is one of the most important considerations for any investor. Risks may include particular industry risks as well as political, commodities, derivatives, environmental, market, and interest and currency fluctuation risks. In short, risk is an omnipresent feature of business activity.

Risk is, by its very nature, forward looking and extremely difficult to quantify. Nevertheless, companies are required to describe material risks in their annual reports.[67] Specific industry, country and regional risks, as well as financial and legal risks all need to be disclosed in prospectuses and quarterly reports.[68]

➜ *For more information on how to manage risk, see the model by-law on risk management in Part VI, Annex 27.*

6. Employees and Other Stakeholders

Russian law requires the prospectus and quarterly reports to contain information on the following issues regarding employees, creditors, and other company stakeholders:[69]

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[65] FCSM Regulation No. 17/ps, Section 3.6.

[66] FCSM Code, Chapter 7, Section 3.3.3.

[67] FCSM Regulation No. 17/ps, Section 3.6.

[68] Law on the Securities Market, Article 22, Clause 4; FCSM Regulation No. 03-32/ps, Annex 11, Article 2.5.

[69] Law on the Securities Market, Article 22, Clauses 7–8; FCSM Regulation No. 03-32/ps, Annex 11, Sections 5.7, 5.8, 2.1, 2.3.

- Number of employees, and any material changes in that number;
- General or aggregated data on educational background, composition of personnel, salaries and wages paid, and social insurance;
- Employee share ownership and stock option plans;
- List of debtors whose debts exceed 10% of accounts receivable; and
- Amount and structure of accounts payable.

Company employees and creditors are further entitled to access information on reorganization, bankruptcy, and liquidation issues.[70]

Strictly speaking, most of the information on employees and other stakeholders may not be "material" according to the accounting or financial definitions of the term. On the other hand, information about the company's employees, creditors, and suppliers, as well as the company's relationship with local communities, can be "material" to other constituencies. Employees are also users of information, and disclosure helps them to make better employment decisions, protect themselves in the workplace, and participate in other aspects of company life. Stakeholder disclosure is becoming increasingly common as an issue of interest and attention worldwide.

Best Practices: While some forms of stakeholder disclosure are required by law, it is good practice to provide stakeholders with other relevant information. For example, stakeholder disclosure might include the health protection of employees, safety conditions in the workplace, and environmental or community impact statements.[71]

➜ *For more information on the importance of stakeholder issues, see Part I, Chapter 1, Section A.2. See also Part VI, Annex 5 for a model company code of ethics.*

7. Corporate Governance Structures and Policies

When assessing a company's governance structure, market participants may want to obtain information on the company's governing bodies, including the division of authority between shareholders, directors, and executives, as well as on the

[70] On information disclosure to employees, see Labor Code, Article 53.

[71] FCSM Code, Chapter 7, Section 3.3.5.

company's corporate governance policy, its commitment to corporate governance principles, and compliance mechanisms.

The charter is the document that sets the rules and procedures of the company's governance system. It is a fundamental document of the company that is to be made publicly available. Company-level corporate governance codes also serve to highlight general corporate governance concepts and structures. By-laws finally provide more detailed guidance on processes.

➜ *For more information on the charter, see Part I, Chapter 3, Section A. See also Part VI, Annex 2 for a model company charter.*

Most recently, Russian companies are required to disclose whether they follow FCSM Code provisions in their annual reports on a "comply or explain" basis.[72] Comply or explain means that while compliance is not mandatory, the reasons for non-compliance with the FCSM Code should be explained.

Best Practices: It is necessary to disclose information about corporate conflicts resulting from improper implementation by the company of those FCSM Code recommendations that the company declared binding upon itself in one form or another.[73]

a) Commitment to Corporate Governance

Markets are keenly interested in understanding the level of a company's commitment to good governance practices. They wish to determine whether a company sees governance as a public relations, "box-ticking," or "window-dressing" exercise, or whether the company is in fact willing "to do right" by shareholders, and to institute and implement real change as necessary and appropriate. While good disclosure, in and of itself, is not sufficient to consistently and uniformly ensure good corporate governance, it is clearly one way of demonstrating the commitment a company is willing and able to make to its shareholders and to its other stakeholders.

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[72] FCSM Regulation No. 17/ps, Section 3.6; FCSM Instruction No. 03-849/r on Methodological recommendations on the content and the form of disclosure of information on the compliance with the Code of Corporate Conduct in Annual Reports of joint Stock Companies, 30 May 2003, Section 5; FCSM Code, Chapter 7, Section 3.3.6.

[73] FCSM Code, Chapter 7, Section 3.3.6.

➜ *For more information on how a company can properly express its commitment to corporate governance, see the IFC corporate governance progression matrix in Part VI, Annex 1.*

b) Corporate Governance Structures

Companies must describe their governance structures, including the authority of each governing body and internal control mechanisms, in their prospectus and quarterly reports.[74] Companies must also describe the procedures for calling and conducting their GMS in these documents,[75] and disclose GMS decisions in material events reports.[76]

Best Practices: Companies should disclose information about changes in the identity of (or contractual arrangements with) the company's External Auditor, Registrar, or depository in their material events reports.[77]

c) Corporate Governance Policies

Companies should disclose their corporate governance policies, and provide interested users with easy and inexpensive access to this information.

Best Practices: The FCSM Code recommends companies to develop disclosure policies that should be approved by the Supervisory Board and be binding upon the company.[78] Some of the provisions suggested by the FCSM Code for inclusion in company policies include:[79]

- List of information the company intends to disclose;
- Rules for communicating with the mass-media, as well as the sources and regularity of communications;
- Media contacts, including press conferences, publications, brochures, and booklets;

[74] Law on the Securities Market, Article 22, Clause 7; FCSM Regulation No. 03-32/ps, Annex 11, Section 5.4.

[75] FCSM Regulation No. 03-32/ps, Annex 11, Section 8.1.4.

[76] Law on the Securities Market, Article 30, Paragraph 12; FCSM Regulation No. 03-32/ps, Section 6.2.1.

[77] FCSM Code, Chapter 7, Section 2.3.

[78] FCSM Code, Chapter 7, Section 1.1.1.

[79] FCSM Code, Chapter 7.

- The requirement for executive bodies to conduct meetings for shareholders and analysts;
- Procedures for answering questions from all shareholders;
- List of information, documents, and materials to be provided to all shareholders for the GMS;
- List of confidential information; and
- Procedures for the identification and treatment of insider information.

In addition, companies should consider disclosing other internal policies or by-laws such as a code of ethics, environmental policies, and the by-laws for the Supervisory Board and its committees among others.

➜ *For more information on company policies and by-laws, see Part I, Chapter 3. For a model code of ethics, see Part VI, Annex 5. For a set of model by-laws for the Supervisory Board, as well as its committees, see Part VI, Annexes 6 through 10.*

C. Mandatory Disclosure

Russian legislation provides different forms and procedures for mandatory disclosure. Companies will, at various times, have to report to regulatory authorities, respond to information requests from shareholders or other stakeholders, or disclose the occurrence of specific events. This section describes the procedural requirements for the following forms of mandatory disclosure:

- Disclosure during securities placement, specifically the prospectus;
- Quarterly reports;
- Material events reports;
- Providing documents and information to shareholders through the annual report;
- List of related parties;
- Notification of regulators;
- Notification of creditors; and
- Providing information to the company's employees.

1. Disclosure During the Placement of Securities

a) The Prospectus

Companies must prepare and register prospectuses under certain circumstances.[80] A prospectus provides material information on the company so that investors can make informed decisions on the merits of potential investments. Prospectuses set forth the nature and object of shares, debentures, or other securities, and the investment and risk characteristics of the issue. Investors must be furnished with a prospectus before purchasing securities.

➜ *For more detailed information on the prospectus, see Part III, Chapter 11, Section C.*

b) Decisions and Events to Be Disclosed

Russian legislation and regulations impose certain disclosure requirements on companies when issuing securities. The FCSM requires a number of events to be disclosed in the mass media:[81]

- The decision to place securities;
- The decision to issue securities;
- State registration of the issue;
- Start and completion of the placement; and
- State registration of the report on the results of the issue.

Figure 2 summarizes events that the company must disclose on its corporate website,[82] website ticker,[83] in the mass media,[84] and to interested parties.[85] Similar requirements apply to the disclosure of amendments or suspension of issues.[86]

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[80] Law on the Securities Markets, Article 19, Clause 2.

[81] FCSM Regulation No. 03-32/ps, Section II.

[82] FCSM Regulation No. 03-32/ps, Sections 1.6, 2.2.2, 2.3.2, 2.4.2, and 2.5.2.

[83] FCSM Regulation No. 03-32/ps, Section 1.4. The FCSM has authorized the Interfax and AK&M agencies whose website tickers must be used for disclosure.

[84] FCSM Regulation No. 03-32/ps, Section 1.7. In the case of an open subscription, the company must publish an announcement in a journal with a circulation of not less than 10,000 copies. In the case of closed subscription, in a publication with a print run of not less than 1,000 copies. Additionally, the announcement must be published in the Supplement to the Vestnik of the FCSM.

[85] FCSM Regulation No. 03-32/ps, Section 1.9.

[86] FCSM Regulation No. 03-32/ps, Section 2.5.

Figure 2: Disclosure During Security Placements

Events	Website Ticker	Mass Media	Corporate Website	Access to Copies
Decision to place securities	One day after the date of the minutes	Not later than five days after the date of the minutes	Not later than three days after the date of the minutes	Within seven days of the request
Decision to issue securities	One day after the date of the minutes	Not later than five days after the date of the minutes	Not later than three days after the date of the minutes	Within seven days of the request
State registration of securities issue	One day after the date of state registration	Not later than five days after the date of state registration	Not later than three days after the date of state registration, incl. prospectus	Within seven days of the request
Start of the placement	Not later than five days before the date of placement	Not applicable (n/a)	Not later than four days before the date of placement	n/a
Completion of the placement	Next day from the date of placement of the last security or the last day of placement	Not later than five days after the date of placement of the last security or the last day of placement	Not later than three days from the date of placement of the last security or the last day of placement	n/a
State registration of the report on the results of the issue	One day after the date of the report's registration	Not later than five days after the date of the report's registration	Not later than three days from the date of the report's registration	Within seven days of the request

Source: IFC, March 2004

2. Quarterly Reports

Companies that have registered a prospectus must file quarterly reports.[87] The content and amount of information in the quarterly report must be consistent with the requirements established for prospectuses. The law does not require the quarterly report to include information regarding the procedure and the terms of placement of securities, as such information is included in the prospectus itself.[88]

[87] Law on the Securities Market, Article 30, Paragraph 4.

[88] Law on the Securities Market, Article 30, Paragraph 5.

a) Signatories of the Quarterly Report

Both the General Director and Chief Accountant must sign quarterly reports to attest to their reliability and completeness.[89]

b) Filing Quarterly Reports

Quarterly reports must be submitted to the FCSM or its regional agencies no later than 45 days after the last day of the reporting quarter.[90] The company must also provide access to a copy of the quarterly report at the location of its executive bodies. Copies of quarterly reports must further be provided to the owners of the company's securities at their request, within seven days from the day of the request, for a charge not exceeding the costs of copying.[91] Finally, the company must also publish the quarterly report on the company's website no later than 45 days after the last day of the reporting quarter.[92]

3. The Material Events Report

Companies that register a prospectus must file material events reports when significant incidents, circumstances, or events affect their activities.[93]

a) Signatories of the Material Events Report

The General Director must sign the material events report. The Chief Accountant should also sign reports on material market transactions, changes in net profits; or changes in company assets.[94]

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[89] Law on the Securities Market, Article 30, Paragraph 11; FCSM Regulation No. 03-32/ps, Section 5.4.

[90] Law on the Securities Market, Article 30, Paragraph 10; FCSM Regulation No. 03-32/ps, Section 5.6.

[91] Law on the Securities Market, Article 30, Paragraph 11; FCSM Regulation No. 03-32/ps, Section 1.9.

[92] FCSM Regulation No. 03-32/ps, Section 5.7.

[93] Law on the Securities Market, Article 30, Paragraph 4; FCSM Regulation No. 03-32/ps, Section 6.

[94] FCSM Regulation No. 03-32/ps, Section 6.1.4.

b) Codification of Material Events

Each material event should be reported separately.[95] For statistical purposes, the FCSM codifies material events reports and requires that every report be marked with a relevant code.[96]

c) Filing Material Events Reports

Companies must file the material events report with the FCSM within five days of the event's occurrence. The report must also be disclosed on the website ticker the day after the event, on the corporate website no later than three days after, and in the mass media no later than five days after the day of its occurrence.[97]

Companies must provide access to a copy of material events reports at the location of its executive bodies. Copies of reports must be provided to the owners of the company's securities at their request within seven days from the day of the request, for a charge not exceeding copying costs.[98]

4. Information for Shareholders Through the Annual Report

Companies are obliged to provide shareholders with access to corporate documents, regardless of the number of shares owned.[99]

Arguably, the most important document to be provided to shareholders is the company's annual report. It is a formal record of a company's financial condition that must be distributed to shareholders under the Company Law and FCSM regulations. Included in the report is a description of company operations as well as a balance sheet, income statement, and the other items listed above (in this Chapter's Section B.1 on Financial and Operating Results).

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[95] FCSM Regulation No. 03-32/ps, Section 6.1.6.

[96] FCSM Regulation No. 03-32/ps, Section 6.2.

[97] Law on the Securities Market, Article 30, Paragraph 13; FCSM Regulation No. 03-32/ps, Sections 6.3.1 and 6.3.2. Additionally, the report must be published in the Supplement to the Vestnik of the FCSM. (FCSM Regulation No. 03-32/ps, Section 1.7).

[98] Law on the Securities Market, Article 30, Paragraph 11; FCSM Regulation No. 03-32/ps, Section 1.9.

[99] LJSC, Article 91.

The annual report is a shorter and more easily digestible version of more detailed financial information filed with the FCSM. Annual reports increasingly include forward-looking and qualitative information that is important to readers. They must be signed by the company's General Director and the Chief Accountant, and must receive the preliminary approval of the Supervisory Board before being submitted to the GMS for final approval.[100]

➜ *For more information on shareholder rights and the GMS, see Part III, Chapters 7 and 8 respectively. For more information on the annual report, see Part VI, Annex 29.*

5. The List of Related Parties

All companies must disclose information on related parties on a quarterly basis, including personal data, grounds, and duration of affiliation.[101]

a) Signatories to the List of Related Parties

The General Director must attest to the reliability and completeness of the information included in the list of related parties by signing this list.[102]

b) Disclosure of the List of Related Parties

Companies must submit the list of related parties to the FCSM or its regional agencies no later than 45 days after the last day of the reporting quarter. The FCSM is, in turn, required to disclose these lists by posting them on its website.[103]

c) The List of Related Companies

Companies which have securities listed on either RTS or MICEX are additionally obliged to disclose the list of related parties (as well as any changes to the list for at least the last three years) on their corporate website with subsequent notification to the FCSM.[104]

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[100] FCSM Regulation No. 17/ps, Section 3.7.

[101] LJSC, Article 93, Clause 4; FCSM Regulation No. 03-19/ps, Section 4.

[102] FCSM Regulation No. 03-19/ps, Section 7.

[103] See www.fcsm.ru. FCSM Regulation No. 03-19/ps, Section 5.

[104] FCSM Regulation No. 03-19/ps, Sections 3 and 8.

➜ *For more detailed discussion on the importance of disclosing related party transaction, see Section B.3 in this Chapter, as well as Part III, Chapter 12, Section C.*

6. Notification to Regulators

Companies must notify regulatory bodies such as the FCSM and the Ministry of Antimonopoly Policy and Support of Entrepreneurial Activities (MAP).[105]

a) Notification to the FCSM

The owner of securities must notify the FCSM about changes in his shareholdings beyond 20% of voting shares within five days from the date of the change. The notification should include general information about the owner and securities under consideration.[106]

b) Notification to the MAP

Notification is required if the total book value of the assets of the acquirer and acquired company exceeds 100 thousand times the minimum monthly wage. The MAP must be notified within 45 days from the date of purchasing 20% and more of voting shares.

The company is also required to notify the MAP within 45 days of the election of an individual to the executive bodies or Supervisory Board of two or more companies with a total book value of assets exceeding 100 thousand times the minimum monthly wage. The same holds true for companies included in the register of companies having more than 35% of the market share of certain goods.[107]

In practice, the book value thresholds are so low that virtually any combination of publicly traded companies, or election to the Supervisory Board, triggers notification requirements.

Notification must include the formal application of the interested person. The notification must also include information about the company's main activities, its production volumes and the distribution of its products in corresponding goods markets, as well as other information required by the MAP.[108]

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[105] Law on the Securities Market, Article 30; Law on Competition, Article 18.

[106] Law on the Securities Market, Article 30, Paragraph 15.

[107] Law on Competition, Article 18, Clause 6.

[108] Order of MAP No. 276 on the Adoption of the Regulation about the Procedure of Submitting Notifications and Petitions to Antimonopoly Bodies in accordance with Articles 17 and 18.

7. Notification to Creditors

Creditors are notified through personal notification and publication of announcements in the press. Figure 3 summarizes the requirements for the notification of creditors when the company decreases its charter capital,[109] reorganizes,[110] liquidates,[111] or enters into bankruptcy proceedings.[112]

Figure 3: Notification to Creditors

		Decrease in Charter Capital	Reorganization	Liquidation	Bankruptcy
Form of Notification	Individually	✓	✓	✓	✓
	Via Press	✓	✓	✓	✓
Deadlines		30 days	30 days	not defined	Three days
Responsible Body		General Director	General Director	Liquidation Commission	Bankruptcy Administrator

Source: IFC, March 2004

8. Providing Information to Company Employees

Employees represent a specific class of information users. One of their rights is to receive information affecting their interests. The representatives of the company's employees, usually members of the local trade union (but other representatives may be elected by employees) have the right to receive information from their employer regarding the following issues:[113]

- Reorganization and liquidation of the company;
- Introduction of technological changes leading to changes in labor conditions;
- Continuous professional education (CPE) to advance professional skills; and

[109] LJSC, Article 30, Clause 1.

[110] LJSC, Article 15, Clause 6, Paragraph 1.

[111] LJSC, Article 22, Clauses 1 and 3.

[112] Law on Insolvency, Article 54.

[113] Labor Code, Article 53, Clause 2.

- Other issues stipulated by Russian legislation, internal corporate documents, and collective bargaining agreements.

Employee representatives are entitled to make suggestions on these issues to the governing bodies and participate in their meetings when these issues are considered.[114] Finally, the company is required to provide employee representatives with full and reliable information needed for the conclusion of collective bargaining agreements and the supervision of their fulfillment.[115]

D. Voluntary Disclosure

It is good practice for companies to voluntarily disclose material information beyond formal legal requirements. This holds particularly true for companies operating in emerging markets that are often marred by weak legal and regulatory environments, and, moreover, poor enforcement mechanisms. To the extent possible, companies are encouraged to use existing forms of disclosure (e.g., prospectuses, and quarterly, annual, and material events reports) and adhere to the same quality standards that are demanded for these forms of reporting. They are also encouraged to use existing channels of communication, such as the internet and the print media. This section describes disclosure practices of Russian companies in the mass media and the internet.

1. Corporate Websites

Corporate websites are easily accessible to the public at low cost, and can be an exceptionally powerful means of communication. At present, the internet is beginning to be accepted as an official disclosure channel. Web-based disclosure is being studied closely by securities commissions worldwide.

Best Practices: The following information should be placed on the company's website:[116]

- The company's charter and amendments thereto;
- Information on the company's development strategy;
- Quarterly reports;

[114] Labor Code, Article 53, Clause 3.

[115] Labor Code, Article 22, Clause 2.

[116] FCSM Code, Chapter 7, Article 1.1.2.

- Prospectuses;
- External Auditor's reports;
- Information on material events;
- Information regarding the GMS; and
- Important Supervisory Board decisions.

The company should also place the annual report on its website.

The internet is an effective tool for rapid and cost-effective communications and is increasingly used by Russian companies for voluntary disclosure.

Company Practices in Russia: Some Russian companies place their annual and financial reports, and governance information (such as information on Supervisory Board members and key executives) on their websites. The better websites have special sections devoted to corporate governance and include contact addresses and telephone numbers for inquiries.

Some Russian companies are already following best practices and disclose additional information on their websites, including:[117]

- Financial statements for the last three years;
- Financial ratios for the last three years;
- Internal corporate documents;
- Structure, authorities, and composition of the governing bodies;
- List of affiliated persons for the last year;
- Annual and quarterly reports for the last three years;
- Materials and results of the GMS for the last three years;
- Information on corporate securities; and
- Corporate news ticker.

2. SKRIN "Emitent"

Company Practices in Russia: Russian companies are increasingly disclosing information through the Internet using SKRIN ("System of Complex Disclosure of News Information"). SKRIN was founded by the National Association of Stock Market Participants (NAUFOR), which is now part of the RTS Group.

[117] Based on the results of the 6th all-Russia competition on annual reports and corporate websites. See also: www.rts.ru/?tid=394&mtid=10000.

The heart of SKRIN is a database called SKRIN "Emitent" ("Issuer").[118] Companies contract for SKRIN's services and furnish it with corporate information. SKRIN subscribers are then granted access to the following company-specific information:

- Company charters;
- Quarterly reports;
- Accounting reports, drawn up in accordance with RAS and IFRS; and
- Material events reports.

Some companies pay SKRIN for the expenses related to the dissemination of information and in this way allow users to access their information free of charge.

3. Mass Media

The print media are an additional channel for disclosure. Although publication may entail additional costs, it is a recognized legal channel for disclosure and (unlike the internet, which is passive) ensures the active dissemination of information among the public.

Most companies disclose information about new products, major contracts, acquisitions, financial results, production plans, and securities issues in the print media.

Best Practices: The FCSM Code considers financial statements to be the most important document for shareholders and potential investors to understand the financial position of the company. In this respect, companies with 10,000 or more shareholders should publish their financial statements in at least two newspapers with a circulation of not less than 50,000 each. In principle, these newspapers should be accessible to the majority of the company's shareholders.[119]

E. Summary of Mandatory Disclosures

Table 4 summarizes mandatory disclosure requirements for Russian companies.

[118] See also: www.skrin.ru.

[119] FCSM Code, Chapter 7, Clause 1.1.2.

Table 4: Mandatory Disclosure

Details/ Forms	Disclosure during placement	Quarterly report	Material events reports	List of related parties	Annual report	Notification to regulators	Notification to creditors	Info to employees
Responsible person	General Director (GD)	GD after signing by Chief Accountant	GD, and Chief Accountant in particular cases	GD	GD, Corporate Secretary, or specially appointed executives	GD	GD/ Liquidation Commission/ Bankruptcy Administrator	GD or specially appointed executives
Recipients	Any interested person	Any interested person	Any interested person	Any interested person through the FCSM	Shareholders	Interested persons through the FCSM, MAP	Stakeholders/ creditors	Employees
Deadline/ frequency	Next day/within three and five days depending where disclosed	Not later than 45 days after the last day of the reporting quarter	Next day/ within three and five days depending where disclosed	Every quarter	Within seven days upon request/ 20 days prior to GSM	Five days — the FCSM; and 45 days — MAP	30 days, liquidation — not defined	Not applicable (n/a)
Place of disclosure	Website ticker, corporate Website, mass-media	Submission to the FCSM, company's office, corporate website	Submission to the FCSM website ticker, corporate website, mass-media	Submission to the FCSM	Office of the company executive body	Notification of the FCSM and/ or MAP	Publication in mass media and personal notification	Place of employment
Financial and operating results	n/a	Financial statements, ratios, composition of assets/capital	10% and more increase/ decrease of the assets value, large-scale transactions	n/a	Not defined: results of the development	n/a	n/a	n/a

Table 4: Mandatory Disclosure								
Details/ Forms	**Disclosure during Placement**	**Quarterly report**	**Material events reports**	**List of related parties**	**Annual report**	**Notification to regulators**	**Notification to creditors**	**Info to employees**
Company objectives	n/a	Commercial objectives only	n/a	n/a	Commercial objectives and priority activities	n/a	n/a	n/a
Major share ownership and voting rights	n/a	Owners of over 5%, chain shareholding, related party transactions	Owners of more than 25% of the company's securities	List of related parties	Related party transactions	Owners/ acquirers of 20% and more of any type of securities (FCSM+MAP)	n/a	n/a
Supervisory Board and key executives, remunera-tion	n/a	Info about each member, remuneration in aggregate, size of interest	n/a	Included in the list	Biographical data, share ownership, amount of remuneration in aggregate	Directors and executives holding more than one appointment (MAP)	n/a	n/a
Risk factors	n/a	Risks of industry, region, currency rate fluctuation, other potential risks	n/a	n/a	Major risks affecting activity of the company	n/a	n/a	n/a

Table 4: Mandatory Disclosure								
Details/ Forms	**Disclosure during Placement**	**Quarterly report**	**Material events reports**	**List of related parties**	**Annual report**	**Notification to regulators**	**Notification to creditors**	**Info to employees**
Issues regarding employees and other stakeholders	n/a	General information regarding employees, suppliers, debtors, and creditors	n/a	n/a	n/a	n/a	Decrease in the charter capital, reorganization, liquidation	Reorganization, liquidation, technological changes, CPE, foundation documents, collective bargaining agreements
Governance structures and policies	n/a	Authority of each governing body	n/a	n/a	Compliance with recommendations of the FCSM Code	n/a	n/a	n/a