OECD PRINCIPLES OF CORPORATE GOVERNANCE ON SHAREHOLDER RIGHTS AND EQUITABLE TREATMENT: THEIR RELEVANCE TO THE RUSSIAN FEDERATION

Paper by

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1. The context[1]

The 1998 financial crisis in Russia has been a catalyst in bringing corporate governance issues to the forefront of the economic policy debate in the country. As liquidity started to dry out, enterprises became confronted with the realities of market forces and the importance of building a strong corporate governance framework. Well-publicised corporate governance abuses, which did not seem to matter in the buoyant equity boom of 1997, were perceived as a major impediment to investment. Insiders stripped enterprises of their assets by various means. Investors have often seen their shares diluted by controlling shareholders. De-capitalising companies have trampled upon the interests of creditors, using insolvency proceedings as a strategic tool to avoid payment discipline. These weaknesses have been compounded by serious deficiencies in the tax and accounting systems as well as institutional structures.

As the result of the first meeting of the OECD/World Bank Corporate Governance Roundtable in June 1999, it was agreed that the protection of shareholders is a key and urgent issue to be dealt with by Russian policy makers. But why is the protection of shareholders a fundamental aspect of corporate governance in Russia today? That is because attracting external equity finance is crucial. In other transition and emerging economies, external equity finance is just another option among many for corporate financing. But Russia does not have the luxury of these options. The option to use the banking system as the corporate governance and finance locomotive was retained in 1994 and it proved to be detrimental. Contrary to what the designers of the loans-for-shares scheme and its successors professed, banks did not lead an investment boom in Russian enterprises. Rather they appear to have used enterprise assets to leverage and enrich themselves and their owners, giving new meaning to the word "conflict of interest" in the process. Following the 1998 collapse of the financial sector, most of the Russian banking sector is in terrible shape-- and the Russian enterprises are left to their own devices.

Some transition economies have capitalised on foreign direct investment (FDI) as a driver of corporate investment and restructuring. At the same time, a corporate governance model based on the widespread presence of foreign strategic investors in key sectors of the economy needs a strong and carefully cultivated political climate. In the case of Russia, this does not seem to be politically feasible. Hence, FDI in Russia in 1998 was a meagre USD 1.5 billion, less than FDI in Hungary, and a tiny fraction (i.e. a little more than 2%) of the inflows that occur yearly in China. While promoting FDI should be on the top of the agenda in some areas (indeed, the banking sector) it is unlikely that a huge FDI inflow will occur in the medium- term. This leaves external equity financing as the only credible solution for the investment-starved large Russian enterprises.

Equity based finance also corresponds to other key characteristics of the Russian corporate landscape. To begin with, for better or for worse, the Russian corporate sector is dominated by large enterprises, more than any other transition economy. As a result of mass privatisation most large enterprises have quite dispersed, public ownership, even though they are not "listed" in the strict sense of this word. That is why

[1] The opinions expressed in this paper are the authors' own and do not necessarily reflect those of the OECD.

the Federal Commission on Securities Markets (FCSM) has been responsible for any issue of securities by these companies; there were approximately 25.000 share issues last year alone. While controlling shareholders have emerged in most of these, a large number of these shares are still held by workers, small domestic investors and foreign investors. The predominance of this enterprise profile suggests both that protection of outside investors is important and that, if such protection is ensured, the market could become more liquid with less of an effort as in, say, developing or emerging markets with entrenched family ownership.

While transparency, disclosure and strong independent boards are also crucial for corporate governance, their function is broader. They are of relevance in the effort to improve all types of governance, whether state, bank or strategic partner- driven. The development of disclosure rules and board practices is, in most countries strongly linked to the actual development of the market. On the other hand, the protection of minority shareholders is much more a rule- based fundamental, the ground upon which the other prerequisites for external finance will grow. At this stage, low liquidity, shallow markets and the limited possibility of exit is another reason for focusing on shareholder rights improvement; shareholders cannot really sell so they need to exercise voice. Finally, improving shareholder protection also has a powerful signalling role to play; as most of the Russian market's poor reputation stems from shareholder abuses, it is progress in this area that will be most effective in "turning the tide".

There are two important aspects to the corporate governance debate. One concerns the legal framework and its implementation and the other the business environment, corporate and investor attitudes, in short the behaviour of private sector institutions.

In principle, shareholder rights and equitable treatment are primarily (but not by any means exclusively) a prescriptive, framework issue. But, there is a further distinction to be made between issues related to the adequacy of the legal framework and issues related to its implementation. In Russia, there has been quite a lot of progress in the legal framework of shareholder protection. In 1996, Russia adopted a "Joint Stock Company" law (the Company Law) that set out the basic principles of shareholders' rights and corporate governance. This law, albeit far from perfect, is a significant improvement from the confusing legal framework that existed at the time of mass privatisation in 1992. In 1999, the Law on the Protection of Investor Rights (the Investor Protection Law) increased the powers of the FCSM and improved the previously weak framework set by the Federal Securities Law of 1996 (the Securities Law).

In contrast, enforcement is weak. The source of this weakness can be found in the fundamental public governance problems that have been plaguing Russia for the last 10 years. The judiciary, at least at its lower levels, is under-paid, over-worked and often corrupt. Local authorities often have an overbearing influence on judges, but also on company management; while they might have some legitimate stakeholder concerns in a one company-town environment, a lot of their interventions are motivated by their commercial interests, of the crony capitalism variant. But even when fairness prevails, enforcing a judicial decision might be a difficult and long process with uncertain outcomes due to the weak enforcement infrastructure.

At the same time, the behaviour of the private sector towards shareholder rights is also very important. It can be argued that it might even be more important in the short term in the Russian environment, as the basic confidence on the operation of the rules has not been established. On the corporate side, Russian companies are starting to show signs of wanting to turn the page on their sinful past. Realising that outside finance will not materialise unless some evidence of good behaviour emerges; managers are starting to sound increasingly open to investor concerns. Assuming this trend is confirmed it might be viewed partly as a result of recent ownership changes and the demise of the banks as key corporate governance principles.

But there is along way to go. On one hand, Russian enterprises have likely developed the worst reputation in the world for abusing shareholder rights. On the other hand, investors and the financial market intermediaries that serve them are becoming more vocal and organised, not least because of new powers to drive investor protection, conferred to them by the 1999 Investor Protection law. But here there is also work to be done both from a normative and a market development perspective. Market participants need to be perceived as playing by the rules that integrity can be built into the market. Most importantly, Russia lacks domestic institutional investment of a size that corresponds to its corporate sector. The earlier experiment of trying to use mass privatisation funds to create such institutions was a failure but the state might need to support their emergence. It is through these institutions that savings will be mobilised and thus boost both domestic investment and corporate governance progress.

In the following pages we will go through the first two chapters of the OECD Principles of Corporate Governance on shareholder rights and their equitable treatment and look through their prism at the Russian corporate governance condition. The Principles were drafted with listed companies in mind, i.e. companies that have outside small shareholders and institutional shareholders as well as insiders (such as families or other block holders). This means that they are well adapted to serve as a tool in assessing the Russian corporate governance environment for large companies.

The Principles are general in nature and global in view; many of the problems that Russia faces will be only loosely connected to their language. Some of them will be of great relevance to Russia of today while others will be of less. In other words, the Principles are a first global language on corporate governance not a set of one-size fits all prescriptions. As such they are helpful in focusing the debate. Correspondingly, the purpose of the paper is not to offer solutions but to draw a picture of the main issues using the Principles language. In turn, it is hoped that Russian policy makers will consider solutions that will deal with the problems of corporate governance in a comprehensive and coherent way.

I. The Rights of Shareholders

The first chapter of the OECD Principles concerns the protection of shareholders' rights and the ability of shareholders to influence the behaviour of corporations. The Principles list some basic rights including those to: obtain relevant information, share in residual profits, participate in basic decisions, fair and transparent treatment during changes of control, and fair use of voting rights. Shareholders as the legal owners of corporations should expect to be able to enjoy these rights in all jurisdictions.

A. Basic shareholder rights

The Principles explicitly state the most basic rights of shareholders. This includes: ensuring adequate methods of ownership registration, conveying or transferring shares, participating in the company's profits, obtaining information on a timely basis, participating and voting in general shareholder meetings. The Company Law provides the explicit foundation for most of these rights; the duty to provide information to the shareholders was considerably expanded through the Securities Law. But there are still remaining issues in the way these rights are defined, enforced, and implemented.

Russian Company law provides for only registered shares in joint stock companies. In this, it is quite advanced even compared to a number of OECD countries. This implies that property rights protection begins with ensuring investors that their share ownership is registered in the company's books. The Securities Law spells out the rules for registrar's operation and shareholder's rights to obtain proof of ownership from the registrar, while the Company Law requires all joint stock companies to maintain a register of its shareholders. Companies with more than 500 shareholders must appoint an independent company licensed by the FCSM as a registrar. Securities' trading in Russia requires that any transfer of securities be recorded in the issuing company's share register and/or depository.

Companies and their managers have directly or indirectly controlled many registrars; this was a source of abuse early on. There have been several cases of refusal to re-register share transactions or of illegally changing share registration from common to preferred, in order to prevent shareholders from exercising their voting rights. Recent efforts have been aimed at increasingly replacing company- controlled registration with independent professional registrars. An indication of progress is that the number of registrars has fallen significantly from 500 in 1996 to 125 in early 1999.

B. The right to participate in and be sufficiently informed on decisions concerning fundamental corporate changes.

Key shareholder rights are the participation in any decision concerning fundamental corporate changes and the right to be informed of options to address these changes. These fundamental changes can be amendments in the corporate chapter; authorisation of additional shares; and extraordinary transactions that result in a fundamental change of the asset structure.

In Russia, these rights are quite ill defined and smaller investors are often prone to abuse by managers or controlling shareholders. The company law's provisions on share issuance are sufficiently broad to allow a systematic share dilution and the disregard of pre-emption rights by existing shareholders. The YUKOS case pretty telling in this respect; a substantial minority shareholder was excluded from the Annual General Meeting (AGM) and subsequently not allowed to participate in the increase of capital that the AGM decided. In addition, many companies have disregarded the law by issuing shares without AGM authorisation. Another typical example is the failure to notify shareholders allowing them to exercise their pre-emptive rights; and the fact that there is practically no sanction in the law for failing to notify. Finally, some companies (e.g. Sidanko) have tried to use the issuance of convertible bonds as a means of share dilution, as there is a regulatory loophole on filing requirements (and subsequent control) of these issues. The FCSM responded successfully to this regulatory challenge. It has not been as successful in the YUKOS case.

The Company law provides for shareholder approval of major transactions (or unanimous BoD approval when the value is less than 50% of the book value). But the provisions are vague and do not provide for any sanction related to the breach of the approval procedure. The Company law does provide for the possibility of an appraisal and buy- back of existing shareholders, when some fundamental changes (mainly control-related and exhaustively enumerated in the law) occur without their consent. However in practice this right is hard to enforce without an independent appraisal mechanism. Appraisals up to now have been below investor expectations--the case of RAO United Energy Systems buying back foreign investor shares due to a breach of foreign ownership limits might be a case in point.
A number of the early disputes on issues related to major transactions originated in the pre-company law era, in which many companies chose their own privatisation charter which still remained in force irrespective of it being contrary to the Company law. In order to ensure compliance with the joint stock company law, the FCSM required all Russian companies to amend their corporate charters in July 1996. Charters not properly amended were to be deemed invalid. However, to date only a few charters have been corrected, thereby undermining the effectiveness of the law. The FCSM does not have an instrument to penalise companies who continue to violate this law.

C. The right to participate effectively and vote in general shareholder meetings and to be informed of the rules; including voting procedures, that govern these meetings

One way for shareholders to influence the company is through the exercise of their voting rights at the AGM. This presupposes a system, which allows the effective participation of shareholders and the accurate representation of their views through the proxy mechanism. The Principles stress the importance of supplying shareholders with sufficient and timely information concerning the date, location and agenda of general meetings. In order to enable more full participation in meetings by investors, some OECD countries have increased the ability of shareholders to submit items on the agenda by simplifying the process of filing amendments and resolutions.

The Principles encourage efforts by companies to remove artificial barriers to participation in AGMs. In some OECD countries, management and controlling shareholders have sometimes sought to discourage other shareholders from trying to influence the direction of the company by charging voting fees, prohibiting proxy voting and requiring personal attendance at meetings to vote. Many companies in OECD countries are seeking to develop better channels of communication and decision-making with shareholders.

The Russian Company Law provides detailed rules on the procedures for calling and conducting an AGM, which seem to meet the norms corresponding to the OECD Principles. However, in practice, a number of systematic violations have been reported. The most prevalent has been the failure to give a shareholder adequate notice (if at all) of the time and location of the AGM and notification of the agenda. It is hoped that recent case law by the courts, declaring AGMs null and void for this type of violation, will discourage abuse.

A key factor in the accountability of companies to owners is the process by which shareholders vote. There have been numerous cases in Russia where procedural requirements for voting during the general meetings are not observed and shareholders are prevented from voting on various grounds. The Principles recommend that voting by proxy be generally accepted. Companies increasingly favour the use of technology in voting, including telephone and electronic voting, in order to broaden shareholder participation. In Russia proxy voting is still quite rudimentary and casting votes in absentia is in practice impossible.

D. Capital structures and arrangements that enable certain shareholders to obtain a degree of control disproportionate to their equity ownership should be disclosed.

In some OECD countries, management and controlling shareholders use corporate structures, such as groups of companies, pyramids and shareholder agreements to redistribute control over the company in ways that deviate from proportionality. As a result, some shareholders bear more risk than others do, even though they are holding identical instruments. Effective control and strategic direction of an enterprise by a major shareholder is not in itself undesirable and the Principles show no preference regarding what ownership structures might best achieve this goal. Ownership and control structures should, however, under all circumstances be transparent. That is because outside shareholders need to properly assess how control is exercised to evaluate their own position and interesting in providing equity finance. It should also be noted that in situations where the market is narrow and the block-holders are a prevalent form of control, it might be wise to introduce tighter regimes that, in addition to disclosure, mandate for the active protection of minority shareholders and an increased responsibility of controlling entities.

A frequent complaint about the Russian market has been the lack of transparency in corporate capital arrangements. Corporations have often adopted intricate patterns of cross-ownership with financial institutions, in the form of financial-industrial groups (FIGS). Many of these groups are now disintegrating as a result of the banking crisis and, in the process, major shareholders are trying to expropriate minority ones of their wealth. Current FCSM regulations ask for some detailed disclosure of major shareholding by issuers--of any stake in another company that is more than 5%. The company law requires such disclosure when a threshold of 25% of ownership is passed. However, shareholders often disguise their ownership by buying shares through one or more offshore shell-companies not traceably connected to the beneficial owner.

Regulators have no tools in getting to these owners, even though off shore corporate vehicles are also widely suspected as centres of corruption. Shareholder agreements are another way to redistribute control and risk in the equity ownership and formal rights. Under current rules, there is no obligation to disclose such agreements, even though they might damage minority shareholder interests. Moreover, disclosure of off-balance sheet, control-related transactions such as cross- guarantees of debts between affiliates is not required. This undermines the effectiveness of rules on interested- party transactions, insider dealing, conflicts of interest and anti-monopoly policies.

A particularly Russian problem in this respect is the role of the state as a major shareholder in many large corporations. At present, there is little predictability as to how the state will manage its holdings. Privatisation strategies are also quite vague, even though some sales are occurring. In OECD countries the trend has clearly been to use the state holdings as a tool for introducing further transparency in corporate governance arrangements. Hence, the state as a commercial asset manager should become the most transparent of owners (and sellers) of assets. In Russia, this is even more important in order to restore the image of the insider deals that prevailed (at least after 1994) as a method of state asset disposal and other opaque corporate governance arrangements in SOEs. The case of relinquishing governance over RAO Gazprom to its management is a case in point.

The proposed Law on Affiliated entities might be an important step in addressing issues related to corporate groups and similar control arrangements through a series of assumptions on corporate control and responsibility, not unlike the German law on corporate groups. This could probably allow the piercing of the corporate veil, i.e. holding a parent responsible for the debts of an affiliate. As it is, Russian Company law (read in combination with the Civil Code) limits severely the possibility of piercing the corporate veil. It thus hinders the effort of pursuing a controlling entity for behaviour it has imposed in its "subsidiary" and the damage it caused to the latter's minority shareholders.

E. Markets for corporate control should be allowed to function in an efficient and transparent manner.

The Principles recommend that markets for corporate control should be allowed to function in an efficient and transparent manner. Regulations for take-overs generally aim at ensuring equal treatment of shareholders in the process of a change of control. Their other aim is to ensure that, in companies that are broadly held, management does not pursue an unbridled, opportunistic behaviour shielded by the take-over market through anti-take-over devices

Changes in corporate control do occur quite often in Russia. Usually they take the form of major sales, asset swaps or additional share issuance, discussed above. However, take-overs via the stock market are not common and contested take-overs are even less prevalent (although there has been at least one attempt). This is because of the dominance of major shareholders in large, "listed", corporations and the very low liquidity in the stock market. Russian Company law stipulates a mandatory take-over bid for all outstanding stock in an acquisition that aims at more than 30% of common stock. However, no details as to the process have been adopted. Moreover, this obligation can be waived in the charter and its infringement does not carry any type of sanction. These regulations have not really been tested, but they might prove to be quite ineffective as the Russian take-over market develops.

F. Institutional investors should consider the cost and benefits of exercising their voting rights.

The Principles do not take a position on whether institutional investors should be obliged to vote or to have an active policy. But the fact that the issue is raised in the Principles is in itself an indication of the increasing importance of these investors in the corporate governance context. In Russia, an active policy by these institutions is even more needed, due to the low liquidity of the market. However, for this to occur, it is important that institutional investors themselves improve their behaviour in terms of conflict of interest and become protagonists in improving the integrity of the market. At present there are still important problems in these respects, especially as regards distinctions between proprietary trading and trading on account, as well as trading on inside information. The 1999 Investor Protection Law gives more power to the FCSM and to self-regulatory bodies in this respect, but it remains to be seen whether these provisions will be used in an effective way.

II. The Equitable Treatment of Shareholders

The second chapter of the Principles emphasises that all shareholders, including minority and foreign shareholders, should be treated equitably by controlling shareholders, boards and management. Insider trading and abusive self-dealing should be prohibited. The Principles call for transparency with respect to distribution of voting rights and the ways voting rights are exercised. They also call for disclosure of any material interests that managers and directors have in transactions or matters affecting the corporation.

While regulation should protect investors from expropriation, such transactions will inevitably occur. For this reason, the Principles call for providing shareholders with the opportunity to obtain effective redress for violation of their rights. A legal system that provides for legal remedies at a reasonable cost and without excessive delay for violations of the rights of non-controlling shareholders is key in enhancing overall investor confidence. Its perceived effectiveness is much more important than the actual amount of litigation that is process through it, as it builds confidence into the corporate governance system. Many countries with weaker judicial systems have found that alternative settlement procedures, such as administrative hearings or arbitration procedures organised by the securities regulators or other regulatory bodies are an efficient method for dispute settlement, at least at the first instance.

The Russian Company Law offers a number of legal remedies to minority shareholders. These include an appeal against a resolution adopted by the AGM, the possibility to seek the annulment of a large transaction, and a suit seeking the invalidation of a transaction involving a conflict of interest. The possibility to file a derivative suit (i.e. on behalf of the company against the company directors) is also available in the Company law, to shareholders holding at least 1% of common stock. However, courts in some recent cases have made a worrying interpretation of the law's key minority protection positions. It was decided that decisions or actions that did not meet the disclosure or procedural decision- making requirements of the law are valid, if the plaintiff (the minority shareholder) could not do much to stop them from happening anyway. This sets a dangerous precedent for upholding legal requirements and might give a very wrong signal to both the abusers and the abused as regards the rule of law.

As mentioned earlier, there are severe problems with adjudication and enforcement. The courts admit only documentary evidence, which is rarely available, given limited discovery and unwillingness to disclose by management. Moreover, there are allegations that a shareholder that sues a major company often loses at the trial court level, because of a combination of local court bias and judicial corruption. A persistent shareholder with a strong case has an opportunity to receive a favourable judgement on appeal. But pursuing a case through three levels of appeal could take years. At the final stage enforcing a judgement has been known to be problematic, because enforcement is by the same biased or corrupt lower court that the shareholder began with. While a number of lawsuits have been initiated, there is no evidence yet as to whether the awards for damages to shareholders have been effectuated

On the positive side, changes in the legal framework last year have considerably improved the possibility of redress. The 1999 Investor Protection law stipulates that the FCSM can file lawsuits and initiate court proceedings on behalf of individual shareholders or the state when their rights have been violated. The FCSM has brought approximately 130 cases related to shareholder abuse and has won more than 80% of these cases. Furthermore, self-regulatory organisations such as PARTAD and NAUFOR can investigate the violation of shareholder rights by registrars, depositories or custodian and brokers, respectively. Further widening of the enforcement net needs to be pursued so that the bottlenecks of the court system can be less severe in the future. This will benefit both the aggrieved shareholders and the court system, which will be less burdened and thus be able to be more attentive and transparent to the cases at hand.

A. All shareholders of the same class should be treated equally

The Principles support maximum transparency regarding the distribution of voting rights among different categories of shareholders; they require previous shareholder approval of any changes in these rights. On the other hand, the Principles recognise that many countries with liquid and efficient markets could leave all decisions regarding the capital structure of companies to their discretion and to the assessment (through disclosure) by sophisticated shareholders. Hence, the Principles do not take a position on the rule "one share/ one vote" for common stock, but, tellingly, they note the support of this concept by institutional investors and shareholder associations. It should also be noted here that one share/one vote is often a listing requirement, even when it is not required by law as such.

However, in transition and developing economies full disclosure, even if mandated, is in practice problematic. A straightforward one-share/ one-vote rule for common stock may therefore be important for the attraction of external finance. This is the position taken in the "General Principles for Company Law in Transition Economies", as OECD document that predates the Principles. In Russia, the Company law does have a one share/one vote provision. This is an important legal basis. However, there have been reported cases where company charters provide for differently weighted majority requirements for certain issues that might undermine the thrust of the law. Although these arrangements are of dubious legality, they have not really been challenged.

In OECD countries there is a growing trend to remove provisions that automatically enable custodians to vote the shares of their beneficiaries. Rules are being revised to require them to inform shareholders of all their options in the use of their voting rights either delegate all their votes to custodians or may decide to cast some votes while delegating others to custodians.

In Russia, there seems to be no requirement (in the law or a professional practice) to allow for previous consultation on voting for shares. This might be a serious omission as outside shareholders have little recourse to anything else but to the exercise of shareholder voice. Moreover, prior consultations on the agenda and the positions to be taken are an important bulwark against any accusations of capture of custodians and other intermediaries by company interests.

In Russia, there are no grounds in the law to treat foreign investors differently from domestic ones. In practice however, there have been blatant violations toward foreign investors in locking them out of AGMs and not allowing them to vote. A widely know example is a German construction materials company which found itself unable to take control of a Russian firm it majority- owned because local authorities in Kransodar refused to recognise Federal Court decisions and instead re-nationalised the factory. A similar case surfaced in St. Petersburg with the re-nationalisation of a porcelain factory. In the well know case between YUKOS and a foreign investor holding 14% of its capital, the latter, along with other foreign shareholders, was locked out of the AGM and not allowed to vote on his shares on the basis of court decisions that clearly discriminated against him.

B. Insider trading and abusive self-dealing should be prohibited.

Insider trading rules enhance the functioning of the market by providing equal information rights to all investors. However, not all jurisdictions prohibit such practices and in some cases enforcement is problematic. These practices can be seen as constituting a breach of sound corporate governance inasmuch as they violate the principle of equitable treatment. More importantly, widespread insider trading in a transition environment, like in Russia, exacerbates adverse selection in the market, a problem noted in the first part of this paper. The integrity of the market is thus prejudiced, and the reputational effects of this impairment might last for a long time. Insider trading is prohibited by the Russian Securities Law but the implementation of these provisions has not taken place. This is not surprising given the notorious difficulty of tracking down and producing evidence for such abuses. What is more disappointing is the little success until now of the market participants and their key professional and self-regulatory institutions in providing their own surveillance of the market's integrity and in driving the effort for a more level playing field in market information.

Insider abuse and self- dealing is probably the most pernicious phenomenon in Russian corporate governance. Cases of abusive self-dealing, where resources of the companies are used to benefit the controlling shareholder or the mangers are widespread. Only recently UNEXIM bank transferred all of its good assets to a new corporate structure (with the same majority owners) leaving the minority shareholders -and, in this case, the creditors- with a liability- filled shell. Such direct asset stripping has been there since the early days of transition and unfortunately it is still rampant. An important reason for this is the weak criminal and civil sanctions reserved by the law for this type of behaviour. Current provisions in the Company law that regulate interested party transactions are quite vague, both in defining who is an affiliated-party and in setting the threshold for the transaction to require shareholder approval. Also, judicial action may be hampered by the fact that only the company--not its shareholders, can file suits. In addition, provisions in the labour law may exonerate directors (when they are the insider party) from most of the liability. Most importantly, strong criminal sanctions are needed to counter this type of behaviour.

Transfer pricing is another widely used method to transfer value away from subsidiaries and outside investors to a holding structure. Profits usually end up with an off- shore management-controlled company. The same problems as in asset stripping are present here as regards remedies and enforcement. Once again, the identification of off- shore beneficial ownership should be crucial to fighting these abuses.

C. Members of the board and managers should be required to disclose any material interests in transactions or matters affecting the corporation.

This is obviously a key obligation if any of the self- dealing abuses are to be effectively addressed. In Russia this obligation exists only as regards specific transactions and even in those cases the obligation is vague and bears no sanctions. Directors and managers do not have a responsibility to make periodic disclosures on their business interests, their stakes in the company or their positions in other companies as directors or managers. The key element for making such requirements effective is a clear civil and criminal liability regime for a company's directors and managers. The members of the "observation council" should be assumed to be aware of and held liable for abusive self-dealing. From a criminal law perspective, the situation in Russia might warrant an approach close to the French one; i.e. a broad- based criminal liability of directors for abuse of corporate funds.

2. Concluding remarks

Corporate governance considerations, the vital next step of Russian enterprise reform, are at long last coming to the forefront of economic-decision maker's concerns. After years of corporate governance abuse, there is some evidence that the corporate governance environment is changing in Russia. The presence today of the Supreme Arbitrazh Court and the Federal Commission for the Securities Market underlines the willingness to move forward and the broad support for it. It also highlights another important reason for the urgency of the reforms. Corporate misconduct and abuse at such a wide scale have a devastating effect on judicial and public institutions and the integrity of public life. Better corporate governance is not only about increased financing for corporations, more investment and deeper markets. It is a force for improving the rule of law and creating a more transparent society. Conversely, improvements in corporate governance will not happen unless there is some parallel progress in the way laws are implemented. Initial steps could include more transparency and publicity of court decisions, the requirement to reason opinions of lower courts, more robust action on judicial corruption but also better pay and training for judges. The possibility to drive enforcement by multiple means including self-regulatory bodies and winning plaintiffs might be another way to avoid non compliance due to capture and corruption at the local level.

Corporate governance will not improve unless Russian corporations are convinced that this improvement is actually to their benefit. The regulatory "sticks" will be only effective if the carrots in this process become apparent. The experience of some Russian companies like Vimplecom that managed to raise external funds in the middle of the Russian financial melt- down is telling as to the premium for good corporate governance, especially when the market and country risk are low. Some foreign investors might be fickle enough to return back to the equity markets in which they got burned, without any visible change: they represent the so- called "hot money". The more patient-- and much, much richer-- western institutions, led by pension funds and insurance companies, need a clear reassurance that their money will not be appropriated by some clever manager or majority shareholders. In order to support their entry (or return) to some emerging markets, a number of rating agencies are currently debating corporate governance related rating systems. These large institutions are largely responsible for changing the face and investment prospects of European corporations. In France they own more than 50% of the 100 largest companies and it Italy somewhere near 30% of the Milan index. Japan, one of the shyest of the OECD countries in terms of foreign involvement in its market has some 15% of foreign institutional ownership in the NIKKEI index companies.

Some Russian companies might (and have) raised money in the international capital markets through ADRs and GDRs. This may improve corporate governance as these tools will slowly but surely bring corporate behaviour closer to international norms of corporate governance. International issuance has been recognised as a driving force of convergence in this respect. But what is beneficial for some large companies might not be for the Russian market: if the good players are forced to leave, the adverse selection process will accelerate and the market's role as a corporate finance tool will remain negligible. As noted in our introduction, this might be detrimental to the rest of Russian corporations in the medium term. The situation will be even worst for Russian market players and intermediaries. They are the ones whose survival and prosperity depends on better corporate governance even in the short run. In addition to turning the screws on issuers, they also need to be perceived as putting their own house in order. Recent changes in the legislation give them the opportunity to play a leading role in this respect and they should make full use of it.

To sum up, the agenda for reform and action is full, from the Duma level to individual brokers and corporations. The results of corporate governance reforms should not be expected to emerge overnight as, in the end, they involve a cultural shift. We, at the OECD are here to lend our support at every step, in close-co-operation with our colleagues from the World Bank and the EBRD. Hopefully, the work of the

OECD/World Bank Corporate Governance Roundtable will be useful in keeping the issue at the heart of reforms for as long as it takes to achieve this cultural shift. In the process, we hope to make visible to the world the progress made by Russian institutions, public and private.