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R95 **RUSSIAN ECONOMY IN 2017. TRENDS AND OUTLOOKS** / [Alexander Abramov etc.; Doctor of sciences (economics) Sergey Sinelnikov-Murylev (editor-in-chief), Doctor of sciences (economics) Alexander Radygin]; Gaidar Institute for Economic Policy. – Moscow: Gaidar Institute Publishers, 2018. – 544 p. – ISBN 978-5-93255-530-9.

The review "Russian economy in 2017. Trends and outlooks" has been published by the Gaidar Institute since 1991. This publication provides a detailed analysis of main trends in Russian economy, global trends in social and economic development. The paper contains 6 big sections that highlight different aspects of Russia's economic development, which allow to monitor all angles of ongoing events over a prolonged period: the socio-political issues and challenges; the monetary and budget spheres; financial markets and institutions; the real sector; social services; institutional changes. The paper employs a huge mass of statistical data that forms the basis of original computation and numerous charts confirming the conclusions.

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6.2. Compliance with the Corporate Governance Code: are there any improvements?[1]

6.2.1. The outspread of Corporate Governance Codes in the world

The first corporate governance code in its present-day meaning – the Cadbury Code – was adopted in the UK in 1992 when the Cadbury Committee on Corporate Governance Issues developed the guidelines for the best corporate governance practices. The Cadbury Code laid the foundation not only for British corporate governance codes, but also paved the way for development of such codes in Europe. Late in the 1990s and early in the 2000s, corporate governance codes were approved in Austria, Belgium, Germany, France, Switzerland and Sweden.[2] At the same period, similar documents were developed in Australia, Canada, the USA and Japan. In Russia, the first corporate governance code was adopted in 2002. At present, a majority of developing and developed countries have introduced such codes, too.

The Cadbury Code emerged on the back of notorious corporate scandals of the late 1980s and the early 1990s (the Barlow Clowes, the Polly Peck and the BCCI). Corporate scandals became an additional motivation for development of corporate governance codes in Australia (the HIH and One. Tel), the Netherlands (the Royal Ahold), the US (the Enron, and the World Com) and Sweden (the ABB and the Skandia). In some countries, adoption of corporate governance codes was of a preventive nature (Austria, Germany and Switzerland).

Adoption of a corporate governance code is normally aimed both at making a country's corporate governance system more transparent and promoting investors', customers', employees' and the general public's confidence in joint-stock companies' governance and supervision practices. But to achieve this goal, a corporate governance code must be complied with. If not, even the very best document, in terms of its content, as an instrument of upgrading the corporate governance performance may become inefficient. So, the issue of introduction of the corporate governance code as well as utilization of some or other mechanisms of implementation thereof is very important. Lots of countries use specific methods of ensuring companies' compliance with their national codes whose standards may differ from one another in terms of toughness of corporate governance norms and do it with varying degrees of success.

The Cadbury Code can be viewed as a turning point of the "comply or explain" approach, the most popular method of ensuring compliance with corporate governance norms. Further promotion of that approach has been facilitated by the legislation of the European Union under which listed companies of the member-states of the European Union are required to disclose information on their compliance with the corporate governance code in terms of the "comply

[1] This section is written by Natalia Polezhaeva, RANEPA.

[2] See: *Haar B.* Shareholder Wealth vs. Stakeholder Interests? Evidence from Code Compliance Under the German Corporate Governance Code (November 24, 2016). SAFE Working Paper No. 154. URL: https://ssrn.com/abstract=2875275.

or explain" approach.[1] Other corporate governance systems adopted that approach, too (Hong Kong, Egypt, Morocco, Singapore and other).

The Russian corporate governance code was adopted not long ago[2], and it is complied with by companies on a voluntary basis, however, it does not mean that this matter is left unattended: compliance is actively controlled by various institutions which engage among other things in "smooth" introduction of the code's principles and recommendations into companies' practices. The outputs of these activities and a number of other relevant issues are presently under consideration.

6.2.2. The novelties of the Russian Corporate Governance Code

The 2008 global financial and economic crisis gave a new impulse to revision and development of corporate governance norms. In its reports of 2009–2010 on corporate governance and financial crisis[3], the OECD specifies that faults in corporate governance were conductive to the financial crisis. In 2011, the Financial Crisis Inquiry Commission established by the US Government released the Financial Crisis Inquiry Report[4], in which it was stated that substantial faults in corporate governance and risk management in numerous systematically important financial institutions were the main cause of the crisis.

As is known, the OECD Corporate Governance Principles (hereinafter the OECD CGP) approved for the first time in 1999 on the back of a series of huge corporate scandals which swept over the world late in the 1990s and early in the 2000s (for example, the Enron and the World Com in the US and the HIH and One. Tel in Australia) were revised as early as 2004. Ten years later, in 2014, the crisis of the late 2000s laid the foundation for the start of a new revising of the OECD CGP and in 2015 the updated document was approved.[5]

It is quite obvious that the global financial and economic crisis was a driver of revision of the 2002 Corporate Behavior Code[6] (hereinafter, CBC). Speculative investors which dominated the Russian market during the period of catch-up growth lost interest in Russian companies, while long-term investors needed precise understanding of a company's strategic goals and prospects and wanted to be sure that their rights would never be violated. This is infeasible to achieve without permanent upgrading of the regulatory norms and corporate governance practices.

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[1] See: Directive 2006/46/EC of the European Parliament and of the Council of 14 June 2006; Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings; Commission Recommendation of 9 April 2014 on the quality of corporate governance reporting ('comply or explain') 2014/208/EU. URL: http://eur-lex.europa.eu.

[2] See hereinafter: *E.Apevalova, N. Polezhayeva*. The Novelties of Corporate Legislation and Regulation: Changes in the Civil Code and the New Corporate Governance Code // The Russian Economy in 2014. Trends and Prospects. Issue 36. Moscow: Gaidar Institute Publishing House, 2015. pp. 460–465.

[3] See: OECD. Corporate governance and the financial crisis. URL: http://www.oecd.org/daf/ca/corporategovernancea-ndthefinancialcrisis.htm.

[4] Financial Crisis Inquiry Commission. The Financial Crisis Inquiry Report: Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States / Official Government Edition, 2011. P. XVIII. URL: http ://fcic.law.stanford.edu/report.

[5] URL: http://www.oecd.org/corporate/principles-corporate-governance.htm.

[6] Instruction No. 421/r of April 04, 2002 of the Federal Commission for Securities Markets (FCSM) "On Guidelines for Application of the Corporate Behavior Code // FCSM Bulletin No.4, April 30, 2002 (Instructions). It actually became null and void after publication of Letter No. 06-52/2463 of April 10, 2014 of the Central Bank of the Russian Federation in which the Corporate Behavior Code was endorsed.

Early in the 2000s, the Russian legislation on joint-stock companies was not yet developed enough and there were plenty of issues which the 2002 CBC was meant to make up for. Due to that, the CBC pattern became rather complicated and overloaded. The Corporate Behavior Principles set out in Chapter 1 of the CBC constituted the basis for the guidelines outlined in the next nine chapters which were formulated too much in detail for the frameworks of such a document.

From the day of adoption of the CBC, a large number of corporate governance issues were resolved at the level of the legislation and regulatory acts. There was no longer any need in numerous CBC regulatory guidelines: individual chapters on the general meeting of shareholders (Chapter 2), governing bodies of the joint-stock company (Chapter 4), dividends (Chapter 9) and settlement of corporate conflicts (Chapter 10) were no longer required.

The new 2014 Corporate Governance Code[1] (hereinafter the CGC) was modeled after the OECD CGP. The CGC is made up of two parts: Part I (A) includes corporate governance principles, while Part II (B), the guidelines for implementing thereof.

Part I of the CGC is of a more practical nature as compared to the annotations of Part II of the OECD CGP which is made up of comments on corporate governance principles meant to explain what such principles are based on.

What is the difference between the 2014 corporate governance principles and the 2002 corporate behavior principles and what do they have in common with the OECD corporate governance principles?

Firstly, the new name of the code – the Corporate Governance Code – reflects changes in the approach and role of the Code. It is not only a document formulating the principles of proper behavior of Russian joint-stock companies in respect of shareholders and investors, but "an effective instrument" of upgrading the efficiency of corporate governance and facilitating the long-term and sustainable development thereof.

The CGC borrowed from the OECD CGP the definition of the corporate governance which was absent in the CBC.

The definition of "corporate governance" covers the system of networking between the executive bodies of a joint-stock company and its board of directors, shareholders and other interested parties. Corporate governance is an instrument of defining the company's goals and methods of achievement thereof, as well as facilitating effective control over the company's activities on the part of shareholders and other interested parties.

Secondly, the CGC borrows the CBC's principles based on the OECD CGP as regards the rights of shareholders and equality of conditions for shareholders in carrying out by them of their rights and elaborates on them further in the guidelines (Chapter 1).

Thirdly, the principles related to a company's board of directors were modified the most (Chapter II).

The CGC specified the responsibilities of the board of directors by including a few OECD corporate governance principles. The board of directors is obligated to do the following:

– define the principles and approaches to organization of the company's risk management system and in-house control (2.1.3);

– play a key role in facilitating the company's transparency and complete disclosure of the information on a timely basis, as well as ensuring an easy access for shareholders to the company's documents (2.1.6);

[1] Letter No. 06-52/2463 of April 10, 2014 of the Central Bank of Russia "On Corporate Governance Code" // Bulletin No.40 of the Central Bank of the Russian Federation, April 18, 2014.

– carry out control over the company's corporate governance practice and play a key role in the company's corporate affairs (2.1.7).

The CGC attached a form of the principle to the CBC recommendations dealing with the requirements set to a member of the board of directors. A member of the board of directors is recommended to have an impeccable business and personal repute; relevant knowledge, skills and experience required for effective fulfillment of his/her duties (2.3.1).

The CGC has upgraded the principles as regards independent directors (2.4.1–2.4.4) as compared to OECD CGP by defining among other things the independent director as a person who has sufficient qualification, experience and independence to form a position of his /her own and make independent, objective and scrupulous judgments.

According to the CBC's recommendations, independent directors should make up minimum a quarter of the board of directors (in any case, at least three independent directors). As in case of the definition of an independent director, the requirement set to the number of independent directors became a CBC recommendation. The CGC made a principle out of that recommendation and increased the number of independent directors at least to one-third.

The CBC recommends toestablish committees made up of members of the board of directors for preliminary consideration of the most important issues facing the company. The CGC principles set new requirements to the composition of the committees (2.8).

The committees on the audit and remuneration should consist of independent directors. A committee on remuneration is to be chaired by an independent director who is not the chairman of the board of directors. Most members of the committee should be independent directors by nomination.

The latest recommendations transformed into the principle were the statutes on the chairman of the board of directors (2.5) (such a principle is absent in the OECD CGP), rights and obligations of members of the board of directors (2.6) and the obligation of the board of directors to facilitate evaluation of the quality of activities of the board of directors, its committees and members of the board of directors (2.9).

Fourthly, unlike the OECD corporate governance principles the Russian principles include those which deal with a company's corporate secretary. At present, such principles make up a separate small chapter (Chapter III of the CGC) and they are partially based on the CBC recommendations (Chapter 5 of the CBC Recommendations) which specify the objectives of the company's corporate secretary (that is, effective routine networking with shareholders, coordination of the company's activities as regards protection of rights and interests of shareholders and facilitation of efficient work of the board of directors) and set requirements to his/her job (for example, fair independence from the company's executive bodies).

Fifthly, the CGC develops into separate Chapter IV on the Remuneration System an individual principle of the CBC and the OECD CGP defining the dependence of the remuneration of members of the board of directors, executive bodies and other key managers of the company on their actual contribution to the company's performance, as well as long-term interests of the company and its shareholders.

Sixthly, the CGC updates the principles dealing with in-house control and establishes new principles of risk management (Chapter V). The CBC included risk management in the in-house control procedures, so, risk management principles were absent in it.

Development of the specified principles is justified by the notorious role which corporate governance shortcomings in risk management played in development of the global financial and economic crisis of the late 2000s. Despite the important role of the risk management system, very little is said about it in the OECD CGP.

Seventhly, as regards the principles of disclosure of the information on the company and the company's information policy the CBC and CGC (Chapter VI) do not specify what relevant information the company should disclose about its activities. However, the recommended parts of the CBC and the CGC include a list of information meant for disclosure: from the information on the pattern of the company's capital to that on the company's social and ecological responsibilities.

The OECD corporate governance principles establish straightforward that the relevant information for disclosure should include among other things the information on the rights of major shareholders, voting rights, transactions with related parties and expected risk factors.

According to the guidelines of the CGC, the company's Web-site is the main source of information disclosure.

The principles of the CGC and the CBC dealing with confidentiality and the insider information are absent in the OECD CGP, but the principles of information provision are set out in the annotations to the OECD corporate governance principles.

Eighthly, as was seen, the CGC has transformed some recommendations of the CBC into the principles of corporate governance. The most important transformation is related to the provisions on material corporate operations (they were transformed from recommended Chapter 6 of the CBC into Chapter VII on the CGC Principles).

In Corporate Governance Codes, deemed as material corporate operations are, for example, a restructuring and a takeover of the company and transactions that have led to a substantial increase in or reduction of the company's authorized capital. A novelty of the CGC consists in the fact that listing and delisting of the company's equities are attributed to the above-stated operations. Provisions on material corporate operations are absent in the OECD CGP.

So, the main advantage of the 2014 CGC consists in its pattern which became more compact and convenient. Excessive provisions duplicating the legislation were removed from the CGC which started to meet to a greater extent the international standards of corporate governance and facilitate effective application thereof by companies.

6.2.3. The "comply or explain" approach

Under the Russian CGC, joint-stock companies, state-run corporations and companies, as well as other legal entities comply with the CGC's provisions on a *voluntary* basis. However, joint-stock companies whose securities are traded publicly *should* disclose information on compliance or specify the reasons for noncompliance with the CGC's principles. Consequently, the compliance of listed companies with the Russian CGC is based on the so-called "comply or explain" approach. However, it appears that in this context the meaning of the word "should" is not quite clear: is it a pressing suggestion or an obligation and if it is the latter what consequences does a company face for a failure to comply with the CGC?

The Statutes of the Central Bank of the Russian Federation on Disclosure of the Information by Issuers of Equity Securities[1] are more concrete and establish that the company's annual report *should* include a statement on the company's compliance with the principles and recommendations of the CGC (Clause 70.3). Also, the provision in question sets the requirements to the content of the statement (Clause 70.4). In addition to the above, the Central

[1] Approved by the Central Bank of the Russian Federation on December 30, 2014; No.454-P // Bulletin of the Central Bank of the Russian Federation, Issue No.18–19, March 06, 2015.

Bank of the Russian Federation has developed both the guidelines for preparing the statement and the form of the statement.[1]

In the present-day practice of the corporate governance regulation, mandatory and hybrid regulations have become the most wide-spread. The latter represents a combination of the legislation ("the hard law") and the corporate governance code ("the soft law") which can be either complied with on an unconditionally voluntary basis or based on the "comply or explain" approach.[2] In case of a hybrid regulation, the laws regulate such components of corporate governance as organization of the board of directors, shareholders' rights and the existence of the audit committee and mandatory external audit. The corporate governance codes deal with the issues related to independence of the members of the board of directors, in-house control, risk management and existence of the committees on remuneration and appointments.

In *the mandatory regulation,* also known as the "comply or else" approach, the regulator establishes in the form of law the corporate governance norms which are uniform and mandatory for all the companies. In case of a failure to comply with such norms, the company (its officials) will suffer a penalty in the form of a fine or imprisonment. The law does not elaborate on the factors behind noncompliance with the norms.[3]. This approach is not expensive, but effective, so it is recommended by the European Union for the integration process of developing countries, however, it has a lack of flexibility and motivation on the part of companies, entails a disproportionate burden in case of small companies and appeals little to foreign investors.[4]

In case of the "comply or explain" approach which is believed to be more efficient, the principles and codes of corporate governance are of a recommendatory nature and, consequently, are not mandatory to be complied with. However, a company which fails to comply with any norms is obligated to provide sufficient explanations. Both application of the norms and justification of explanations of noncompliance therewith are acceptable methods of compliance with the norms. If the company fails to provide explanations or provides insufficient explanations, the company may be punished. This approach permits companies to adjust corporate governance norms to their own specifics and grants them relative freedom in establishing the most suitable governance patterns to upgrade governance performance. Most developing and developed countries utilize the "comply or explain" approach.

Despite the fact that corporate governance codes involving the "comply or explain" approach are regarded as voluntary, too, implementation of the approach proper must be mandatory and underpinned by relevant institutions, as well as judicial and market enforcement measures. If not, corporate governance codes which officially declare such an approach do not differ at all from ordinary voluntary corporate governance codes and may happen to be even less efficient.

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[1] See Letter No. IN-06-52/8 of February 17, 2016 of the Central Bank of the Russian Federation "On Disclosure in the Annual Report of a Public Joint-Stock Company of the Information on Compliance with the Principles and Recommendations of the Corporate Governance Code // URL: http://www.cbr.ru/.

[2] There is another approach – "apply or explain" – which represents a more accurately formulated version of the "comply or explain" approach. This approach is used in the Republic of South Africa.

[3] See here and after: *Sarkar S.* The Comply-or-Explain Approach for Enforcing Governance Norms (July 15, 2015). URL: https://ssrn.com/abstract=2638252.

[4] See.: *Nedelchev M.* Good Practices in Corporate Governance: One-Size-Fits-All vs. Comply-or-Explain (September 30, 2013) // International Journal of Business Administration. Vol. 4. No. 6. P. 77, 78.

Unfortunately, in practice the latter option prevails.[1] Another disadvantage of this approach consists in the fact that it is mainly applied to listed companies.

At the relatively early stages of the corporate sector development when corporate governance standards are only being introduced by the regulator and companies, the "comply or explain" approach is less appropriate. With standards being defined, the benefit from flexibility of the approach starts to outweigh its cost; the company gets higher motivation to adopt good governance practices and the regulator becomes more effective in evaluating alternative patterns of governance. With most standards established, the regulator becoming completely efficient and complexity of regulation reduced to enforcement of compliance with corporate governance norms, a switch-over to the "comply or else" approach which has a certain extent of flexibility[2] may become expedient.

It is to be noted that in developing countries where optimal governance mechanisms maximizing the company value are just evolving, such factors as non-transparency of the company's activities, inefficiency of stock markets and a lack of financial experience with an average shareholder coupled with complex and multiple organizational, ownership and supervising structures may on one side make the "comply or explain" approach quite effective, while on the other side complicate application thereof by burdening the regulator with identification and promotion of the best governance structures.

Lots of European countries are at the advanced stage of the "comply or explain" approach with a detailed description of principles and codes of corporate governance and an active regulator in place. India and the US apply the "comply or else" approach.[3] India is a fast-growing and developing economy with evolving standards of corporate governance.[4] On the contrary, the US is a very mature economy with a corporate governance system being well adjusted for many years. However, both India and the US consider a possibility of introducing the "comply or explain" approach in respect of individual corporate governance norms related to independent directors, non-financial reporting and corporate social responsibility.[5]

The efficiency of the "comply or explain" approach largely depends on a drive to good corporate governance, transparency of the company's activities and identification of governance standards. The efficiency of this approach is influenced by the quality of *evaluation of the adequacy of explanations* provided by companies in respect of departures from the norms. There are three "appraisers": a shareholder, the financial market and the regulator.

The first two "appraisers" have disadvantages which make them unpopular.

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[1] См.: *Hadjikyprianou G.C.* The Principle of 'Comply or Explain' Underpinning the UK Corporate Governance Regulation: Is There a Need for a Change? (May 20, 2015). Corporate Law: Corporate Governance Law Journal, Vol 7, Issue 81, November 27, 2015. URL: https://ssrn.com/abstract=2690687.

[2] For example, requirements to the composition of the board of directors and companies' committees are determined as a percentage of the size of the boards and committees and not by concrete figures.

[3] See Clause 49 of the 2000 Listing Agreement and the Sarbanes-OxleyAct of 2002.

[4] At the same time, Brazil and the Republic of South Africa whose governance structures are undergoing the initial stages of development have adopted the "comply or explain" approach.

[5]See: *Lai B.Y.* Are Independent Directors Effective Corporate Monitors? // An Analysis of the Empirical Evidence in the USA and Canada (May 2, 2014). URL: https://ssrn.com/abstract=2781671; *Harper H., Virginia E.* 'Comply or Explain' and the Future of Nonfinancial Reporting // 21 Lewis & Clark Law Review 317 (2017); *Singh P.D., Poonawala S.H.* Whether and Where to Spend Mandatory CSR? (June 30, 2016). URL: https://ssrn.com/abstract=2802866; *Dharmapala D., Khanna V.S.* The Impact of Mandated Corporate Social Responsibility: Evidence from India's Companies Act of 2013 (November 28, 2016). CES ifo Working Paper Series No. 6200. URL: https://ssrn.com/abstract=2895986.

Shareholders as "appraisers" may lack financial experience and economic motivation and a free-rider problem is common to them. For an average shareholder who is less informed than a company's manager it is difficult to assess a departure from the corporate governance norm, particularly, the principle.[1] Even in case of identification by an individual shareholder of an unjustified departure from the norm, a retrieval of the optimal governance structure may have no sense in economic terms because the organization of networking with other shareholders on this issue requires substantial costs. Also, a substandard quality of assessment by shareholders can be explained by the existence of the so-called free-rider problem when each shareholder seeking to save funds expects other shareholders to make a good assessment without his/her participation.

The financial market involves multiple investors, so as an "appraiser" it does not experience a shortage in economic motivation. However, as an association of individual shareholders, the financial market faces the free-rider problem and the problem related to a lack of experience, too. In addition, the financial market is an expensive instrument of ensuring compliance with the corporate governance norms. The financial market as an "appraiser" does not suit well developing economies because they lack the required conditions (disapproval of the overlapping of the roles of the top manager and a dominating shareholder, existence of a highly liquid financial market with low operating costs and other). In the financial market, if a company departs from the "comply or explain" approach, market-based measures of enforcement are available.

Shareholders and financial markets are "appraisers" in Brazil, Spain, the Republic of South Africa and South Korea. In the UK, shareholders assess the quality of explanations of departures from the norms of the corporate governance code and inform the regulator of any discrepancies. However, due to insufficient efficiency of the existing method of ensuring a company's compliance with the code, the UK is looking for other options with an expanded role of the regulator.[2]

The regulator can be an effective "appraiser" and have proper competence, motivation and authorities to seek enforcement of its requirements. However, as in case of shareholders, the regulator has disadvantages of its own (a lack of skilled personnel, excessive toughness and other) which may turn out to be very serious in such a specific institutional environment as Russian. An immature regulative interference may pose a threat to the entire concept of the "comply or explain" approach by undermining the principles of voluntary participation and flexibility initially envisaged in it. The regulator's interference should not unreasonably overburden companies.

In lots of West European countries, including Belgium, Germany, France and Sweden, the regulator acts as an "appraiser". It is worth paying attention to Belgium's experience in developing practical guidelines for high quality explanations[3], for example: in explaining its departure from the norms of the corporate governance code a company cannot simply refer to the fact that it considers such norms as inappropriate; for ensuring better transparency the

[1] For example, the Chinese Corporate Governance Code is made up of 95 principles of corporate governance, but includes no explanations of them, nor does it specify the status and number of independent directors in the board of directors. For an average Chinese shareholder, it is difficult to estimate compliance of the governance structure proposed by managers with the company's interests.

[2] For more details, see: *Hadjikyprianou G.C.*

[3] Belgian Corporate Governance Committee. Practical rules for high-quality explanations (2016). URL: http://www.corporategovernancecommittee.be/en/explanatory-notes/practical-rules-high-quality-explanations-2016-version.

reasons for departure from the norms should be specified in the corporate governance statement; the board of directors should approve the reasons for such departures, their contents and other.[1]

It is believed that in many developing countries in the "comply or explain" approach the regulator together with shareholders can be the main "appraisers"; this practice may minimize disadvantages proper to either of them as an individual "appraiser". Taking into account its weakness in the above stated category of countries, the financial market plays an auxiliary role.

6.2.4. Compliance of companies' practices with Corporate Governance Codes abroad

The levels of compliance of companies with corporate governance codes may greatly differ in various countries. For example, in Belgium, Spain, Italy, the Netherlands and Germany they exceed 90 percent.[2] As shown below, they are much lower in countries of Central and Eastern Europe.

A particular attention is to be paid to the German Corporate Governance Code (Deutscher Corporate Governance Kodex, DCGK[3]) as revised in 2015 which was developed by the German Government Commission on DCGK.

The DCGK includes the norms of governance and supervision for listed companies, as well as generally recognized standards of good and responsible governance. The Code is meant to make the corporate governance system more transparent and clear. It is aimed at promoting international and national investors', customers', employees' and general public's confidence in supervision and governance of listed companies in Germany.

The Code includes the guidelines noncompliance with which the company has to explain (that is, "shall" guidelines) and those noncompliance with which it may not explain (the "should" guidelines"). The DCGK is mainly made up of the "shall" guidelines and, consequently, is based on the "comply or explain" approach which is mandatory as envisaged by Clause 161 of the German Law on Joint-Stock Companies (Aktiengesetz, ActG).

The main three novelties of the 2015 DCGK emphasize the growing role of the supervisory council:[4]

– the supervisory council of a listed company is advised to establish the maximum term of office of a member of the supervisory council, taking into account the company's specifics (the "should" guidelines);

– the supervisory council is recommended to make sure that a nominee to the supervisory council is fit to fulfill his/her responsibilities during the entire period of the established term of office (the "should" guidelines);

– the supervisory council is advised to specify in its statement that during the financial year its member took part in less than a half of meetings of the council or committee which he/she

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[1] In Russia, similar recommendations can be found in Letter No. IN-06-52/8 of February 17, 2016 of the Central Bank of the Russian Federation "On Disclosure in the Annual Report of a Public Joint-Stock Company of the Statement on Compliance with the Principles and Guidelines of the Corporate Governance Code".

[2] See: *Harper Ho, Virginia E.*, 'Comply or Explain' and the Future of Nonfinancial Reporting (July 15, 2017). 21 Lewis & Clark Law Review (2017). P. 320.

[3] URL: http://www.ecgi.org/codes/documents/cg_code_germany_5may2015_en.pdf.

[4] The board of directors in the German model of corporate governance is a two-tier body made up of a unit which is entrusted with day-to-day management – the board of governors – and the body which forms the composition of the board of governors, controls its operations and formulates the general development strategy of the company, that is, the supervisory council. Also, the Supervisory Council appoints the company's general director. See: *Yu.I. Pugach*. Comparing Corporate Governance Models in US and German Companies // Law and Modern State. 2015. Issue No.1. p. 84.

is a member of; participation in meetings by phone or videoconferencing is regarded as proper participation, however, it should not be a prevailing one (the "should" guidelines)[1].

Late in March 2017, all the companies listed on the DAX and the MDAX – the stock exchange indices -- had their statements on compliance with DCGK published, so, one can make the following conclusions based on them.[2]

On average, 96.4 percent of large listed companies have the "shall" guidelines. Plenty of companies demonstrate a 100-percent compliance with the guidelines; 8 percent of companies fail to comply at least with one out ten recommendations of GCGC. As compared to the previous year, in 2017 the level of compliance of DAX-listed companies did not change, while that of MDAX-listed companies grew by 0.4 percent.

It is to be noted that only 7 percent of all the companies explain the noncompliance with the "should" guidelines.

The GCGC norms which fail to be complied with more often include those on the board of governors, the supervisory council and transparency. In particular, companies do not comply with recommendations in respect of the upper limit of the remuneration of members of the board of governors; upper limits of termination benefits; disclosure of the size of remuneration of members of the supervisory council by means of tables proposed by GCGC; the composition of the supervisory councils and objective set to it; remuneration of the directors.

The clause on the composition of the supervisory council has the lowest level of compliance (56 percent). A similar situation is observed with setting of objectives to the board of directors. The clause dealing with the pattern of remuneration to members of the board of governors is rated the second as regards noncompliance (only 60 percent). Recommendations as regards disclosure of the size of remuneration to members of the board of governors by means of tables proposed by GCGC are complied with in less than 90 percent of cases.

Large companies demonstrate a higher level of GCGC compliance.

It is to be noted that about three-fourth of DAX-listed companies achieve the indicator's best values as regards "monitoring and control", "transparency" and "dilution of equity" and lower values as regards "motivation schemes". Only a half of MDAX-listed companies achieved maximum results as regards all the four indicators. More substantial changes are observed in the "dilution of capital" indicator: in 2017 this indicator's minimum value fell from 67 percent to 50 percent as compared to the previous year. Nearly 30 percent of DAX-listed companies have the level of compliance as regards "motivation schemes" below 85 percent. Companies expect relevant changes to permit them to reduce by 4 percent the level of noncompliance.

The German practice of dividing the guidelines of the corporate governance code into those which require explanations of noncompliance and those which do not is believed to be quite effective, trend-setting and at the same time not burdensome for companies which are not yet prepared for corporate governance structures. The practice of making the "comply or explain" approach legally mandatory both for the companies and the controller, particularly, in countries where the culture of compliance with corporate governance norms has not been completely formed yet – this was proved by findings of the research carried out by the European Bank for Reconstruction and Development (EBRD) – is worth studying.

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[1] See: Regierungs kommission. Deutscher Corporate Governance Kodex. Press Release. Frankfurt am Main, 11 May 2015. P. 1, 2.

[2] See: *Beyenbach J.*, *Rapp M.S.*, *Strenger C.*, *Wolff M.* Code Compliance Study 2017 - Analysis of the Declarations of Conformity with the German Corporate Governance Code (Version May 2015) (June 27, 2017). URL: https://ssrn.com/abstract=2993262.

In the 2016–2017 EBRD reports[1], they assessed the state of corporate governance systems and individual components thereof, strengths and weaknesses of corporate governance systems and the need of further corporate governance reforming in 34 countries (*Table 17*). According to their estimates, moderate strong ("4") corporate governance codes envisaging the "comply or explain" approach are in effect in Poland, Slovenia, Croatia, Estonia, Lithuania and Latvia ("3–4").

Table 17

The state of corporate governance codes and the need of their reforming in 34 states, EBRD

Country	CGC	Country	CGC	
Azerbaijan	2	Macedonia	2	
Albania	2–3	Morocco	2	**"5"** – ***strong or very strong***: corporate governance code (CGC) corresponds to its purpose and best practice.
Armenia	3	Moldova	2	
Belarus	2	Mongolia	2	
Bulgaria	2	Poland	4	**"4"** – ***moderately strong***: larger part of code complies with its purpose, but further reforms on some aspects are required.
Bosnia and Herzegovina	2	Russia	4	
Hungary	3	Romania	3	
Greece	3	Serbia	2–3	"**3"** – ***good:*** code represents some components of good practice, but there are a few key issues pointing to need to reassess code as a whole for reforming purposes.
Georgia	2	Slovakia	3	
Egypt	2–3	Slovenia	4	
Jordan	2	Tajikistan	2	
Kazakhstan	2	Tunisia	2	**"2"** – ***weak***: code may represent some components of good practice, but needs reforming in general.
Cyprus	3	Turkey	3	
Kosovo	3–4	Ukraine	2	"**1"** – ***very weak***: code represents substantial risks and needs serious reforming
Kirgizia	2	Croatia	4	
Latvia	3–4	Montenegro	2	
Lithuania	3–4	Estonia	4–5	

Source: The table is based on the EBRD reports.

The 2005 Estonian guidelines for corporate governance (currently under revision) developed by the Financial Supervision Authority, (FSA) and the Tallinn Stock Exchange, (TSE) are approaching the very strong level ("5") and correspond to their purpose and good practice. The document is fairly complete and well implemented.

Ten large national listed companies publish statements on corporate governance on their Web-sites and in their annual reports. Many explanations of departures from provisions of the code are adequately justified, informative and refer to companies' practices. A majority of listed companies do not comply with recommendations on electronic voting and disclosure of remunerations to members of the board of directors.

It is to be noted that the Estonian code does not cover key issues as regards formation and composition of committees of the board of directors, assessment of activities thereof, the Ethics Code, qualification of the directors, in-house control and other. This partially explains a high level of companies' compliance with the Code's provisions.

Generally, the FSA effectively facilitates compliance with the corporate governance guidelines and publishes on a regular basis detailed reports on assessment and promotion of listed companies' practices and progress in the disclosure of information. The latest reports were provided in 2010 and 2011.[2] On its part, the TSE facilitates compliance with the Code, publishing annual ratings of the top 20 listed companies of the Baltic Region. One of the criteria

[1] See: The EBRD. Corporate Governance Sector Assessment. URL: http://www.ebrd.com/what-we-do/sectors/legal-reform/corporate-governance/sector-assessment.html.

[2] See: FSA. Corporate Governance Overviews. URL: https://www.fi.ee/index.php?id=12510.

of the rating is the quality of a company's annual report. Companies which seek to occupy the top rating positions are expected to provide a complete review of their practices.

The Polish, Slovenian and Croatian Corporate Governance Codes are comprehensive and well-implemented.

Poland's ten largest listed companies provide reporting on their compliance with the national corporate governance code, with nine of them offering explanations in case of noncompliance with individual provisions of the Code. On average, companies fail to comply with 1–3 provisions of the CGC. Most explanations are of an informative nature, but the quality is getting down as the size of companies diminishes. The Warsaw Stock Exchange is entrusted with the responsibility of facilitating companies' compliance with the Polish Corporate Governance Code, however, the EBRD did not find relevant reports of the stock exchange or another entity which is in charge of control over compliance with the code.

Slovenia's nine largest listed companies out of ten included statements on compliance – based on the "comply or explain" approach – with the corporate governance code in their annual reports. Only two companies appointed an official to supervise the company's compliance with the Code. The Ljubljana Stock Exchange which actively promotes good corporate governance practices published in 2012 the statistical analysis of companies' compliance with the Slovenian Code.[1] According to the analysis in question, upgrade in the compliance level was observed in the past few years. However, the level of compliance presented in annual reports can be artificially overstated on the back of incorrect interpretation by companies of the CGC's provisions. Also, companies' explanations of departures from the Code's provisions seem too formal and rarely include concrete arguments or alternative practices.

Croatia's ten largest listed companies published statements on their compliance with the national corporate governance code, however, not all the explanations of departures from the norms were justified. Despite good statistical reports on corporate governance in general, the Croatian Financial Supervision Authority and the Zagreb Stock Exchange do not exercise proper control over explanations provided by companies.

The courts of law in the above countries rarely or never refer to corporate governance codes as a source of companies' rights and obligations.

In Latvia and Lithuania, companies' explanations in case of noncompliance with provisions of the corporate governance code look often uninformative. Also, a big problem is a lack of active controllers monitoring compliance with the Codes and, consequently, this makes relevant reporting unavailable.

The countries with a good ("3") level of corporate governance codes based on the "comply or explain" approach include Hungary, Greece, Cyprus, Romania, Slovakia, Serbia and Turkey. All these countries are member-states or associate members of the EU.

According to the Hungarian legislation and the listing rules of the Budapest Stock Exchange, the country's listed companies are obligated to provide reporting on compliance with the corporate governance code and explain the reasons for departure from the code's provisions. Hungary's ten largest companies publish compliance statements on their Web-sites. Most statements demonstrate a fairly high level of compliance, but explanations of departures from the norms are often formal and uninformative. Also, the corporate governance code has a rather complicated pattern: provisions are divided into recommendations, proposals and explanations. It is to be noted that not all the provisions are in line with the latest legislative changes and the

[1] See**:** Ljubljanska borza. Analiza razkritij odstopanj v izjavah o skladnosti s Kodeksom (September 2014) http://www.ljse.si/media/Attachments/Izdajatelji/Analiza_razkritij_odstopanj_izjav_CG_2012_internet.pdf

best practices. It is not clear again which entity is responsible for ensuring companies' compliance with the Hungarian Code.

In other countries of this group, a generally similar situation with some deviations is observed. For example, Creek companies interpret differently the "comply or explain" approach: at least 1/3 of the listed companies developed corporate governance codes of their own and provided statements on compliance with them, which situation cannot be regarded as a very good practice. In the Turkish Code, provisions related to independent directors, committees and separation of duties between the chairman of the board of directors and the chief executive director are mandatory for listed companies. Fulfillment of other provisions is based on the "comply or explain" approach. However, penalties may not necessarily be imposed either in case of violation of a mandatory provision or supply of insufficient explanations of departures from a non-mandatory norm; this is evidence of insufficient control over companies' compliance with corporate governance norms.

The weak ("2") level of corporate governance codes based on the "comply or explain" approach can be observed in Bulgaria, Macedonia, Montenegro, Bosnia and Herzegovina, as well Moldova. The CGCs of the above countries are characterized by a weak content; only a few companies comply with the CGC; application of the "comply or explain" approach is ineffective (for example, scoring tables with numerical values in Bulgaria and Montenegro); explanations of departures from the CGC's provisions are few and uninformative; there is a lack of proper control over compliance with the corporate governance code.

In the rest of the countries with weak corporate governance, compliance with the CGC is voluntary (Belarus, Kazakhstan, Mongolia, Tunisia, Ukraine and other) or this can be stated as such judging by a rather low level of companies' compliance with the Codes (Azerbaijan, Georgia, Egypt, Jordan, Morocco and other).

So, the "comply or explain" approach is the most effective for a majority of developed countries and numerous developing countries not only as a method of ensuring companies' compliance with corporate governance norms, but also in terms of upgrading the norms as a result of promotion of corporate governance performance.

Being a kind of co-regulation, this approach based on a dialogue between the regulator and regulated entities facilitates the regulator's better understanding of regulated entities' essential needs and alternatives in corporate governance, thus making the regulator's policy more efficient.

Flexibility of the "comply or explain" approach permits companies to adapt corporate governance norms to their own specifics and have some freedom in establishing governance patterns which suit them the best.

However, it is not enough to declare the "comply or explain" approach to upgrade corporate governance performance. The efficiency of the approach depends on a number of factors, including the level of a country's economic development, as well as the method of handling some procedural issues, the main of which is assessment of the quality of the actual corporate governance practice.

6.2.5. The analysis of companies' compliance with the Corporate Governance Code in Russia

Analyzing Russian companies' compliance with the corporate governance code (CGC), both the Central Bank of the Russian Federation and other entities utilized in their research mainly public information which is available in companies' open documents (quarterly and annual reports, statements on compliance with the CGC principles, lists of affiliated persons, reports

on material facts and other) and *did not carry out verification of authenticity of such information.* Joint-stock companies determined on their own the extent of compliance with one or another principle of the CGC and the entities which carried out the analysis specified *a high level of formal approach and a low information content* of statements provided by companies, particularly, as regards explanations of departures from corporate governance norms. With such an approach prevailing, the research discussed below does not completely reflect the authenticity of companies' compliance with the CGC in Russia.

In Russia, companies' compliance with the CGC by means of the "comply or explain" approach is controlled by the Central Bank of the Russian Federation. The first review of the corporate governance practice at Russian public companies in 2015 was published by the Central Bank of the Russian Federation in April 2017.[1] The second and currently latest review based on the results of 2016 was released in December 2017[2]; it presents a comparative analysis of practices of the CGC application in 2015 and 2016.

For the second review, the Central Bank of the Russian Federation examined statements on compliance with the CGC principles and recommendations provided by 49 companies and 29 companies whose equities were included in the quotation list of the first level (QL1) and the quotation list of the second level (QL2), respectively. The remaining six companies did not provide any statements.

The analysis identified positive dynamics of introduction of the CGC principles and recommendations in the practice of Russian companies. For example, six companies from QL1 promoted by more than 20 percent the level of compliance with the CGC principles and upgraded the quality of explanations of departures from the CGC norms. Though no such substantial changes were observed in QL2, four companies declared that they started to comply with more than a half of norms within the past year. Plenty of companies expect to promote further their compliance with the CGC. Next year, the Central Bank of the Russian Federation expects growth in the level of introduction of the CGC, too, though a more moderate one.

However, the regulator points to the same quality of companies' explanations of departures from the CGC principles, which fact means that the Central Bank of the Russian Federation has to take more efforts to explain to companies what quality of explanations it expects from them (explanatory letters, seminars, networking with companies on the individual basis, sampling analysis of the authenticity of statements and other). The work of the Central Bank of the Russian Federation both on the reviews and with joint-stock companies is an important factor facilitating upgrading of the corporate governance practice.

The outputs of the research carried out by the Central Bank of the Russian Federation pointed to growth of 11 percent in the average level of compliance with the CGC principles and recommendations as compared to the previous year. In 2016, this level was equal to 69 percent. Three companies reported on compliance with over 90 percent of the principles, however none of them managed to comply completely with the CGC.

The share of the companies which complied with less than a half of the CGC principles decreased from 36 percent to 11.5 percent. In QL1, the specified share fell from 23 percent to 4 percent. In QL2, the share of companies which complied with over 75 percent of the CGC principles doubled (*Fig. 1*).

[1] URL: http://www.cbr.ru/StaticHtml/File/14233/Review_17042017.pdf.
[2] URL: http://www.cbr.ru/Content/Document/File/33001/Review_27122017.pdf.

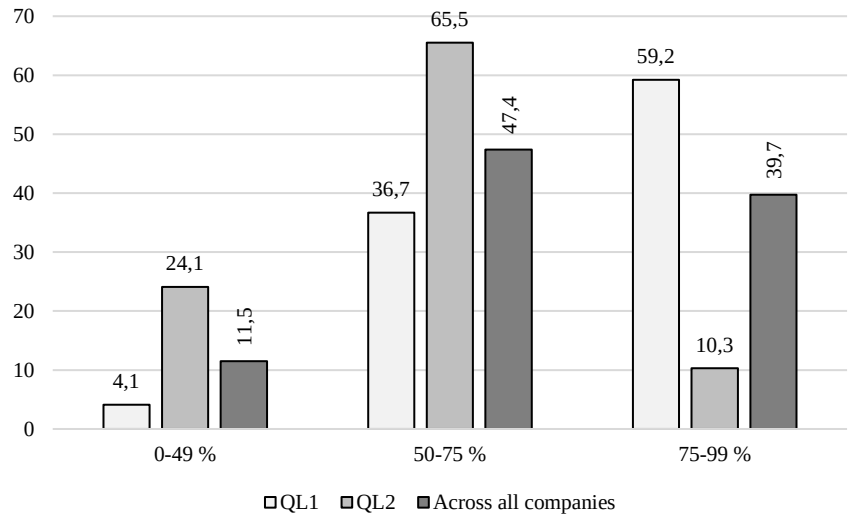

Fig. 1. Distribution of the companies by the level of their compliance with the CGC principles in 2016, *%*

Source: The data of the second Review by the Central Bank of the Russian Federation based on the results of 2016

Over 75 percent of the CGC principles are complied with by 39.7 percent of companies, while 50–75 percent of the principles, by 47.4 percent of the companies. The minimum percent of compliance with the CGC principles is equal to 34 percent.

The average share of companies' noncompliance with the CGC principles fell from 15 percent to 9 percent. In QL1, this share decreased two times over from 12 percent to 6 percent, while in QL2, from 24 percent to 15 percent (*Fig. 2*).

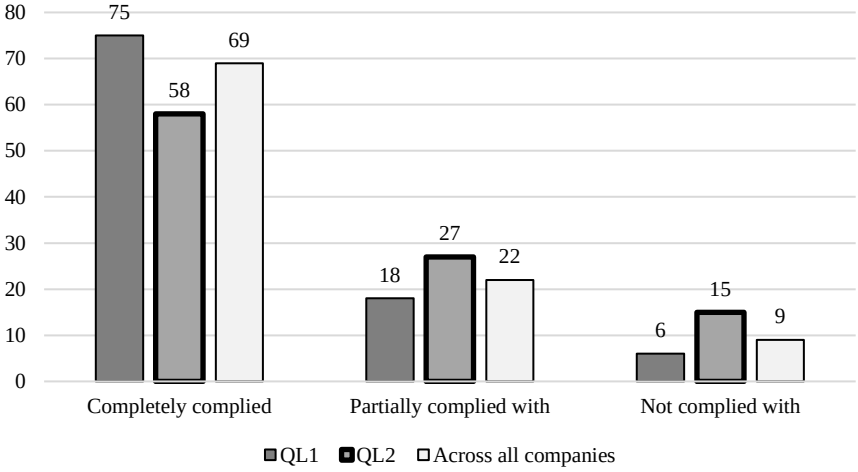

Fig. 2. The average number of CGC principles complied with by companies in 2016, %

Source: The data of the second Review by the Central Bank of the Russian Federation based on the results of 2016

As regards complete compliance with principles and recommendations of individual chapters of the CGC, Chapter III on the Corporate Sector is complied the most with (77 percent of companies). It is followed by Chapter V on the Risk Management System and In-House Control (55 percent of companies). In 2015, the above-mentioned chapters were complied the

most with, but the number of companies which observed them was smaller (45 percent and 42 percent).

The most complicated chapter in terms of implementation is Chapter II on the Company's Board of Directors, which is made up of 36 principles. None of the companies managed to comply with it. Apart from a large number of principles, implementation of that chapter is complicated by lack of actual loyalty on the part of members of the board of directors to relevant corporate governance approaches (*Table 18*).

There are difficulties with implementation of provisions of Chapter I on the Rights of Shareholders and Equality of Conditions for Shareholders; only 8 percent of QL1 companies comply completely with it against 3 percent of QL2 companies, though in 2015 there were no such companies at all.

Generally, the number of companies which reported full compliance with the principles of individual chapters of the CGC has increased. However, the Central Bank of the Russian Federation stated a somewhat decrease in implementation by QL2 companies of the principles of the three chapters – on the Remuneration System, the Disclosure of the Information and Material Corporate Operations – which situation can be justified by instability of the QL2 composition that changed more than 25 percent as compared to 2015.

Table 18

The percentage of the companies which reported 100 percent compliance with the principles of individual chapters of the CGC in 2016

Chapter of CGC	Number of principles	QL1, %	QL2, %
I. Shareholders' Rights and Equality of Conditions for Shareholders in Fulfillment of Their Rights	13	8	3
II. Company's Board of Directors	36	0	0
III. Company's Corporate Secretary	2	78	76
IV. Company's System of Remuneration of Members of Board of Directors, Executive Authorities and Other Key Managers	10	8	0
V. Risk Management System and In-House Control	6	55	55
VI. Disclosure of Information on Company and Company's Information Policy	7	24	3
VII. Material Corporate Operations	5	12	3

Source: The data of the second review by the Central Bank of the Russian Federation based on the results of 2016.

The ten CGC principles which are most commonly complied with by companies did not change, but the level of compliance with those principles greatly increased, If in 2015 all the companies reported full compliance with only one principle under which shareholders should be provided with reliable and effective methods of accounting of their share rights and grated a feasibility to make a free and easy assignment of their shares (1.4.1), in 2016 companies complied completely with seven CGC principles, including those establishing the following:

– extra payments or compensations are not envisaged by companies in case of early termination of the authorities of members of the board of directors due to a change in control over the company or other events (4.2.3);

– the compensation amount ("a gold parachute") paid by the company in case of early termination of the authorities to members of the executive bodies or top managers on the company's initiative and in case of absence of unscrupulous practices on their part should not exceed a double amount of the fixed portion of the annual remuneration (4.3.3).

Three more CGC principles (1.1.1, 1.3.1, 3.1.2) are complied with by 97 – 99 percent of the companies. As compared to the previous year, the number of the principles which are fully complied with by over 80 percent of the companies has increased.

Seven out of nine principles which are not complied with more often than others and observed by less than a half of the companies are related to the board of directors.

The least observed principle (7.2.2) concerns the norms and procedures which are to be specified in the company's internal documents as regards fulfillment of material corporate operations. This principle is complied with by only 19 percent of the companies.

Also, the least observed principles are at present the following ones (complied with by 21 percent and 22 percent of companies, respectively) under which:

– an independent director is elected the chairman of the board of directors or a senior independent director is determined from among the elected independent directors to coordinate the work of independent directors and maintain networking with the chairman of the board of directors (2.5.1);

– the company has implemented the program of long-term motivation of members of the executive bodies and other top managers with utilization of the company's equities (options or other financial derivatives based on the company's equities) (4.3.2).

Despite a low level of compliance with theses CGC principles, some progress in performance is observed as compared to 2015. For example, the share of the companies which fully complied with Principle 7.2.2, Principle 2.5.1 and Principle 4.3.2 increased by 2-3 percent. The number of the companies meeting the remaining seven principles increased on average by 11.4 percent.

The "comply or observe" approach offers companies the following two options of compliance with corporate governance norms: (1) comply with the CGC principles and recommendations (Russian companies are definitely making quite a good progress in it); (2) not comply with individual CGC provisions, but disclose the information on the reasons for such noncompliance. In the latter option, the quality of companies' explanations of departures from the CGC principles remains not very high.

At the year-end 2016, the average level of quality of explanations across all the companies amounted to 39 percent, an increase of only 4 percent compared to 2015. In QL1, the level of quality of explanations increased from 38 percent to 45 percent. In QL2, this level fell from 33% to 30%, probably, on the back of substantial renewal of the composition of QL2. It is to be noted that numerous companies in QL2 lacked experience in providing explanations and the regulator did not have time to carry out explanatory work with them, so, only a few QL2 companies managed to upgrade the quality of their explanations as compared to 2015 (*Fig. 3*).

A high level of quality explanations of the reasons for noncompliance with the CGC principles (over 75 percent) was achieved only by few companies. In QL2, there are no such companies, while in QL1 their share amounts to 10 percent, that is, only five companies all together, including four companies assessing the quality of their explanations to be more than 80 percent and one company estimating it over 90 percent.

The share of the companies whose quality of explanations needs upgrading has largely increased. In QL1, this share grew from 18 percent to 29 percent as compared to 2015, while in QL2, from 7 percent to 17 percent.

A positive thing is a reduction from 80 percent to 69 percent of the share of companies whose quality of explanations requires substantial improvement. It is to be noted that in QL1, the number of companies with the quality of explanations estimated below 10 percent has decreased by 50 percent to three companies.

QL1 **QL2**

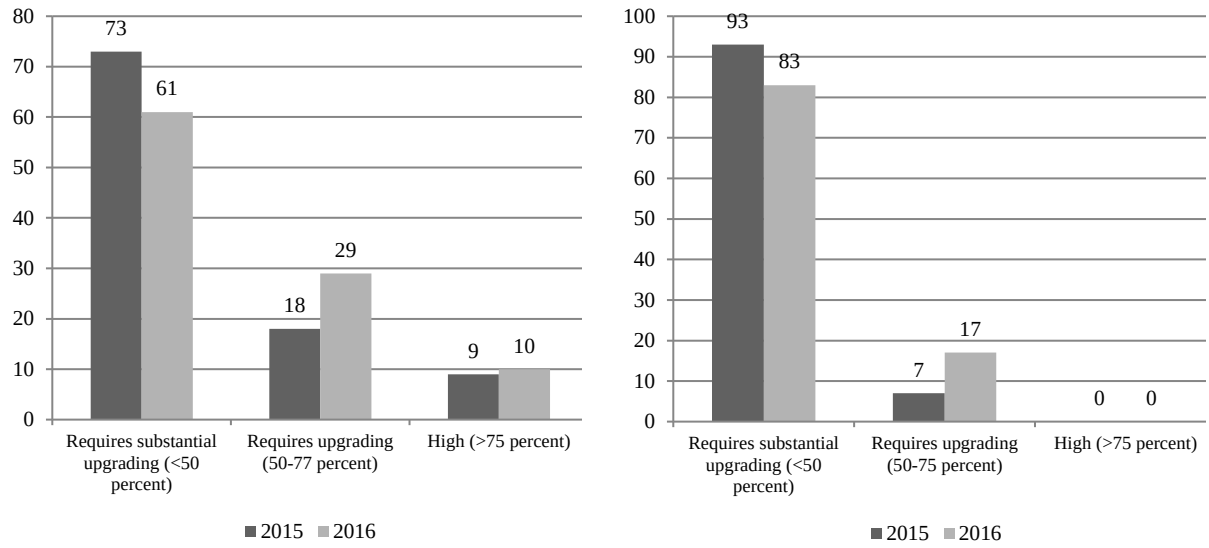

Fig. 3. The shares of different quality levels of explanations of reasons for noncompliance with the CGC principles by QL1 companies and QL2 companies, %

Source: the data of the second Review by the Central Bank of the Russian Federation based on the results of 2016.

The largest number of high-quality explanations (33 percent of the companies) was provided in respect of the reasons for noncompliance with Principle 7.2.1, under which the information on fulfillment of material corporate operations should be disclosed with explanation of reasons for such operations and terms and consequences thereof.

Five out of ten principles in respect of which companies demonstrated the lowest level of quality of explanations deal with regulation of the work of the board of directors (Principle 2.2.1, Principle 2.3.3 and other). On average, 88 percent of the companies failed to provide quality explanations.

So, unlike the level of companies' compliance with the principles and recommendations of the Russian CGC which largely increased in 2016 and is expected to keep on growing, the quality of explanations of reasons for departures from individual principles leaves much to be desired. Instead of reasonable comments, companies reduce their explanations to the sheer fact of noncompliance with a principle or refer to the absence of the relevant requirement either in the legislation or listing rules; this cannot be regarded as a reasonable explanation, either.

The Central Bank of the Russian Federation specifies that it is necessary to formulate clearly in explanations the reasons for which this or that situation prevails in the company; what factors it can be justified by; whether such a situation is accepted as suitable to the company in terms of specific conditions of the company's operation and development; what measures the company has taken or is going to take to reduce risks related to a failure to apply the best corporate governance practice; whether the company plans and within what time-limits to introduce the relevant CGC recommendations and other.[1]

It is to be reminded that without quality explanations the "comply or explain" approach is not going to be effective enough.

[1] See: The Central Bank of the Russian Federation. The Review Based on the 2016 Results of Corporate Governance Practices in Russian Publicly Traded Companies. Issue No. 2 (December 2017). p. 34.

Apart from the Central Bank of the Russian Federation, the issues of introduction of the CGC are dealt with at twelve state-controlled joint-stock companies by the Rosimuschestvo, the Open Government, the Expert Council under the Government of the Russian Federation and the Working Group on Establishment of the International Financial Center. The list includes the following: the PAO (a publicly traded company) AK "ALROSA", the PAO "AK Transneft, the PAO Aeroflot, the PAO Gazprom, the PAO NK Rosneft, the OAO (open-end joint-stock company) "RZHD", the PAO "Rosseti", the PAO "RusGidro", the PAO "Rostelekom", the PAO "FSK UES", the PAO Sovkomflot and the PAO VTB Bank.

The need of introducing an individual monitoring for joint-stock companies with state participation is substantiated by the specifics of such companies.

The Rosimuschestvo has been carrying out implementation of the CGC at state-controlled joint-stock companies since 2014. The Agency analyzed the 2016 annual reports of 20 joint-stock companies with state participation as regards their compliance with the CGC principles and recommendations.[1]

On average, the level of compliance by companies with a sample of *key* CGC provisions amounts to 90 percent, an increase of 13 percent as compared to 2015.

The chapters which are the most complied with include Chapter III on the Corporate Sector (100 percent), Chapter I on the Rights of Shareholders (93 percent) and Chapter IV on the System of Remuneration of Members of the Board of Directors (92 percent). The levels of compliance with the remaining chapters exceed 70 percent.

The highest positions as regards introduction of key sections of the CGC are occupied by the PAO Gazprom (100 percent), the PAO Aeroflot (100 percent), the PAO Sovkomflot (97 percent) and the PAO NK Rosneft (95 percent).

The highest progress as regards introduction of the CGC in 2016 as compared to 2015 was achieved by the PAO Aeroflot (from 81 percent to 100 percent), the PAO Transneft (from 58 percent to 74 percent) and the PAO Rusgidro (from 38 percent to 63 percent).

The Roskomimuschestvo does not analyze the provided explanations of the reasons for noncompliance with individual CGC principles.

The Open Government, the Expert Council under the Government of the Russian Federation and the Working Group on Establishment of the International Financial Center carry out on a regular basis – several times a year – a monitoring of introduction at the above 12 joint-stock companies with state participation of 13 main CGC recommendations as regards upgrading the efficiency of the board of directors and its role in corporate governance:[2]

– a ban on voting by quasi-treasury stocks;

– taking of decisions by a simple majority of all the members of the board of directors;

– issues addressed "in praesentia" by the board of directors;

– issues related to the conflict of interests of members of the board of directors;

– the right of access of the members of the board of directors to the company's and controlled legal entities' documents and information;

– authorities of the board of directors in respect of controlled legal entities' boards of directors and sole executive bodies;

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[1] See: The minutes No.4 of September 21, 2017 of the meeting of the Public Council under the Ministry for Economic Development of the Russian Federation URL: http://economy.gov.ru/wps/wcm/connect/c6b9eee6-365e-4022-ac85-eeca22d7e12a/4.pdf?MOD=AJPERES&CACHEID=c6b9eee6-365e-4022-ac85-eeca22d7e12a.

[2] See: The Open Government. The corporate governance level at companies with state participation started to meet higher standards, but some system-based problems still exist (14.11.17). URL: http://open.gov.ru/events/5516467/?sphrase_id=236270.

– authorities of the board of directors in respect of controlled legal entities' operations;
– authorities of the board of directors in respect of control over the company's management;
– the board of directors' audit committee made up of independent directors;
– anti-corruption policy, "hot-line";
–in-house audit;
– risk management department;
– formalized risk management system.

Table 19

The ratings of complete introduction of the CGC's priority recommendations

Company	Rostelekom	ALROSA	VTB	Aeroflot	Rosseti	Transneft	Rosneft	RusGidro	FSK UES	Gazprom	RZhD	Sovkomflot
Number of implemented recommendations	11/13	9/13	9/13	8/13	8/13	8/12	6/13	6/12	5/13	3/13	2/12	2/12

Source: The data of the outputs of the monitoring by the Open Government, the Expert Council under the Government of the Russian Federation and the Working Group on Establishment of the International Financial Center for November 2017

In the past three years, the level of corporate governance in companies with state participation has started to meet in general higher standards, but in most companies the specified recommendations were not implemented in full. Also, a number of cases of noncompliance with recommendations which companies used to comply with before was identified.

In accordance with the criteria under review, the PAO Rostelekom is more effective than others in implementing recommendations (*Table. 19*). The company initially had at its disposal a risk management system which met the requirements of the CGC and introduced the in-house audit and a number of measures enhancing the role of the board of directors in compliance with the CGC. However, the company systematically violates the recommendation as regards a ban on voting by quasi-treasury stocks.

The PAO Gazprom fails to comply with recommendations on promotion of the role and efficiency of the board of directors as well as those dealing with a ban on voting by quasi-treasury stocks, the in-house audit and the risk management system despite the fact that the company established a special risk management department. According to experts, the PAO Cazprom's unwillingness to introduce recommendations is evident. It is to be reminded that as per the Rosimuschestvo's data the PAO Cazprom has introduced completely (100 percent) the key sections of the CGC, so it remains unclear what factors are behind this contradiction.

Unlike the PAO Gazprom, the RZhD – despite its second to last place in the rating – prepared a draft of amendments to its charter with experts' recommendations taken into account and the statutes on the board of directors to upgrade considerably the company's position.

The Open Government and other participants in the monitoring pay attention to companies' explanations of non-implementation of the CGC's priority recommendations, as well as

companies' reasons for which they consider recommendations introduced, but do not offer their assessments thereof.[1]

Thus, despite somewhat different approaches to analyzing and discrepancies in the outputs, both the Central Bank of the Russian Federation and other institutions rated fairly highly the level of Russian companies' compliance with the CGC's recommendations and principles and made positive forecasts as regards further implementation thereof. Unlike the extent of compliance with the CGC's provision, the quality of companies' explanations of noncompliance with some principles leaves much to be desired. Being the main "appraiser" of such explanations, the Central Bank of the Russian Federation refrains from taking tough enforcement measures in respect of companies whose explanations are insufficient and makes a greater emphasis on the explanatory work.

However, not all the institutions analyzing companies' compliance with the CGC in Russia arrived at the same results in their research.

For example, despite a switchover of the Russian CGC from the category of good ("3") Codes to that of moderately strong ones ("4") in December 2017[2], the European Bank for Reconstruction and Development stressed that as before only Russia's five large listed companies out of ten had disclosed the information on compliance with the CGC. In addition to that, a majority of explanations did not include any references to the current state of corporate governance practices at companies. Also, the EBRD specified that there were no references to the CGC as the source of companies' rights and obligations in the judicial practice.

Having compared the results of its research into corporate governance structures of Russian publicly traded companies in 2012 and 2015, the Deloitte CIS Corporate Governance Center came to the conclusion that corporate governance had seen no change for the better since 2012.[3]

The 2015 research included 120 Russian companies whose common shares were in the list of the first and second levels of the Moscow Stock Exchange (99 companies) and listed on the London Stock Exchange, the New York Stock Exchange and the NASDAQ (21 companies). It is to be noted that 22 percent of the companies of the sample were from the energy sector; 10 percent, from the oil and gas industry; 8 percent, from the banking sector. The government controls directly and indirectly 34 companies, that is, 3 companies less than in 2012, however, the average value of the state participation in those companies increased on the contrary by 7 percent and amounted to 70 percent.

According to the Deloitte CIS Corporate Governance Center, the level of Russian companies' compliance with the best corporate governance practice is not getting higher due to a lack of foreign investors' interest in them as a result of sanctions and falling oil and gas prices. Also, in 2016 the new listing rules and the "comply or explain" approach did not work in full, while the project of establishing the premium listing segment at the Moscow Stock Exchange for companies with high corporate governance standards was frozen.

As regards the *composition* of the board of directors, the Deloitte CIS Corporate Governance Center stated the insufficient number of external (independent) directors in companies' boards

[1] See: The Open Government, the Expert Council under the President of the Russian Federation and the Working Group on Establishment of the International Financial Center. The Corporate Governance Code was introduced in November 2017. URL: http://open.gov.ru/upload/iblock/131/131f73d02f7071214a16614f2a70af8f.pdf.

[2] See: EBRD. Corporate Governance in Transition Economies: Russian Country Report (December 2017). URL: http://www.ebrd.com/documents/ogc/russia.pdf.

[3] See: The Corporate Governance Pattern at Russian Publicly Traded Companies. Research by the Deloitte CIS Corporate Governance Center, 2015 URL: https://www2.deloitte.com/content/dam/Deloitte/ru/Documents/about-deloitte/pressrelease/corporate-governance-structures-of-public-russian-companies-rus.pdf.

of directors; independent directors accounted for 27 percent and 32 percent of the seats at state-owned companies and private companies, respectively, while under the CGC at least one-third of the elected contingent of the board of directors is recommended. This norm was complied with by 41 percent of the companies.

A factor which brought about a situation where the number of independent directors is not sufficient enough was a renewed practice of 2014-2015 of appointing high-ranking government officials to boards of directors of state-owned companies; the share of such officials largely increased as compared to 2012 and amounted to 21 percent. Directors related one way or other to the state accounted for other 42 percent of the seats in companies' boards of directors. (*Fig. 4*).

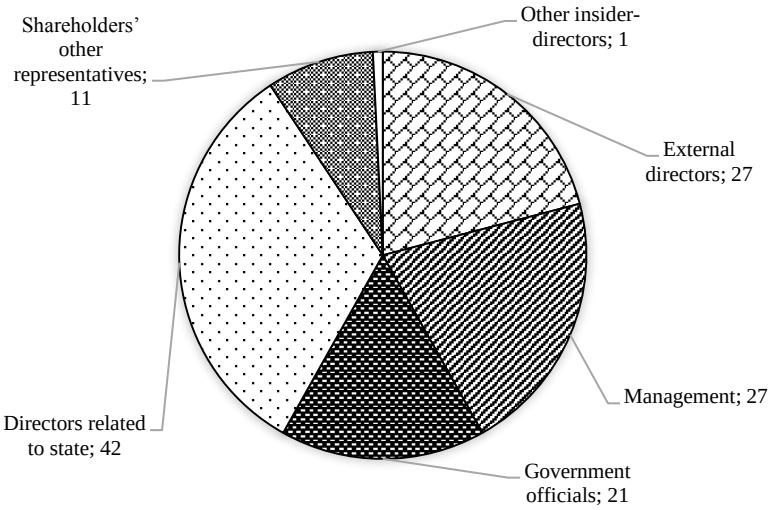

Fig. 4. The pattern of the board of directors at state-owned companies, %

Source: The Deloitte research data for 2015

Also, there is a shortage of efficient independent expert-directors in all the companies. The scope of candidates is limited by the CGC's tough requirements to the notion of independence (no relations with the company's shareholders, including kinship relations; a ban on civil service work within a year prior to election to the board of directors and other).

Another problem is the concentrated ownership pattern typical of Russian companies with an average size of a large equity package amounting to 57.6 percent; this is different from the normal situation where minority shareholders usually nominate independent directors.[1]

Foreign members of the board of directors can be found with 61 percent of the companies; they account for 30 percent and 72 percent of the seats at state-owned and private companies, respectively, and that is quite a high indicator.

As regards the *composition* of the boards of directors, proceeding from the data of the two research carried out by the Deloitte in 2012 and 2015 it can be stated that the number of companies with some or other committees established has decreased (see *Table 20*).

Table 20

Companies with relevant committees of the board of directors, %

[1] See: *Yu. Petrova, M. Podtserob*, C. Romanova. The Corporate Governance in Russia Has Not Improved Since 2012 – Deloitte // The Vedomosti daily, April 05, 2016. URL: https://www.vedomosti.ru/management / articles/2016/04/06/636572-korporativnoe-upravlenie.

	2015	2012
Audit Committee	95	98
Remuneration and Appointments Committee	64	88
Remuneration Committee	18	–*
Nomination Committee	13	–*
Strategy Committee	53	43
Risk Management Committee	9	8
Ethics Committee or Ethics/Corporate Governance Committee	3	13
Corporate Governance Committee	8	–*

*not available.

Source: The Deloitte research data for 2012 and 2015

In compliance with the CGC, the audit committee is to be made up of independent directors, however, it is so only with 23 percent of companies out of 111 companies with such a committee established and its composition disclosed. It is to be noted that in 47 percent of audit committees the majority is made up of independent directors, while in 19 percent of audit committees there are no independent directors at all. In audit committees, independent directors account on average for 51 percent. It is to be noted that 25 percent of the companies have no independent directors on remuneration and appointments committees, either.

In compliance with the CGC, an independent director is to be elected the chairman of the board of directors or the board of directors has to assign the senior independent director out of the number of independent directors. This provision is complied with only by 27 percent of the companies. It is noteworthy that only 13 percent of the boards of directors have an independent chairman; 18 percent of the boards of directors assign an independent senior director.

Despite the CGC's recommendations, only 22 percent of the companies reported self-appraisal of the activities by the board of directors (16 percent) or external assessment (6 percent).

Though under the CGC it is inadmissible to vote at the company's general meeting of shareholders by *quasi-treasury stocks*, that is, equities whose holder is an entity controlled by the issuer, such equities can be found with 28 percent of the companies and they account on average for 7 percent of the market capitalization of a relevant company. In case of the Uralkaly Company, the share of quasi-treasury stocks amounted to 40 percent.

Summing up the **results**, it is feasible to make the following conclusions:

1. The Russian Corporate Governance Code is a *quality document* with a good pattern and content meeting the global corporate governance standards, including the OECD Corporate Governance Principles. The Russian CGC is in no way inferior to corporate governance codes of other countries and in some ways it is even better (the CGC's Part II is of an advisory, rather than annotative, nature; the Code provides a definition of the independent director and includes a separate chapter on the remuneration system and other). The CGC is aimed at upgrading the governance efficiency of Russian companies and facilitating their long-term and sustainable development.

2. Application by companies of the CGC's principles and recommendations is *voluntary* and based on their willingness to be more attractive to foreign investors. However, in modern Russia where the corporate culture is not yet developed enough pure voluntary participation could considerably slow down implementation of the CGC's provisions. Keeping that in mind, the architects of the CGC envisaged a soft method of compliance based on the "*comply or explain" approach* applicable only to joint-stock companies whose equities are publicly traded; both application of the norms and explanation of the reasons for non-application with them are deemed proper methods of compliance with the norms.

3. If utilized correctly, the "comply or explain" approach is believed to be more effective as compared to mandatory regulation. However, in most developing and developed countries which announced this approach there is *a problem of implementing* it in practice. It often happens that an entity which is obligated to control implementation of the approach is neither designated nor fails to carry out its functions, while companies which do not comply with corporate governance norms provide either formal explanations or no explanations at all.

The fact that companies have to explain the reasons for which they have failed to comply with corporate governance norms makes the "comply or explain" approach the most valuable because by doing so companies may depart, on one side, from the norms, while, on the other side, the regulator is getting a better idea of the regulated entities' essential needs and resources in the field of corporate governance. Consequently, without quality explanations provided, this approach makes no sense.

4. *Russia has created almost all the conditions* for successful utilization of the "comply or explain" approach and, as a consequence, implementation of the CGC.

The obligation to implement this approach is envisaged in the Statutes of 2014 of the Central Bank of the Russian Federation on Disclosure of the Information by Issuers of Equity Securities. Also, for a company's equities to be included in the quotation list of the first level the Moscow Stock Exchange Listing Rules[1] require from 2015 a disclosure of the information with explanation of the reasons in case of the company's failure to comply with the CGC's recommendations as regards the corporate secretary (Clause 2.18).

The entity with the required competence and authority to supervise companies' compliance with the CGC and appraise the quality of explanations in case of companies' departures from the CGC's norms is the Central Bank of the Russian Federation which has adopted a responsible approach to fulfillment of its duties. The Central Bank of the Russian Federation develops regulatory documents, carries out explanatory work with companies and prepares and releases highly informative reports.

Despite such an activity, the Central Bank of the Russian Federation does not resort to tough enforcement measures and prefers to carry out explanatory work with companies without burdening them with its interference; it is believed that at the initial stage of implementation of the CGC's norms such a policy is a reasonable solution.

5. Based on the information from companies' disclosed documents, the Central Bank of the Russian Federation assessed positively the average level of compliance by Russian listed companies with the *CGC's principles and recommendations*; in 2016 it amounted to 69 percent of all the principles, an increase of 11 percent on the previous year. In 2017, the Central Bank of the Russian Federation expects growth in the compliance level, though a more moderate one.

A number of institutions (the Rosimuschestvo, the Open Government, the Expert Council under the Government of the Russian Federation and the Working Group on Establishment of the International Financial Center) dealing with introduction of the CGC's principles at some Russian companies despite some discrepancies in the results rated highly the level of compliance with the CGC's principles. In 20 joint-stock companies controlled by the state, this level of compliance was equal on average to 90 percent.

All the institutions, including the Central Bank of the Russian Federation have come to the conclusion that companies complied the least with the principles dealing with the board of directors.

[1] URL: http://fs.moex.com/files/257/24914.

Unlike the level of compliance with the CGC and its dynamics, the average *level of the quality of companies' explanations* of departures from the CGC's provisions did not virtually change and amounted only to 39 percent in 2016 as per the data of the Central Bank of the Russian Federation; the above is evidence of the need for the regulator to step up its work in this area.

At the same time, the above indicators do not completely reflect the current state of things due to the established approach to assessment of companies' compliance with the CGC's principles and recommendations: companies determine on their own the extent of compliance with the principles, doing it often for the sake of appearance, while the entities carrying out the analysis examine mainly the information provided by companies, rather than the actual corporate governance practices.

It is to be noted that outputs of some research into Russian companies' compliance with the CGC are not very positive. For example, the Deloitte CIS Corporate Governance Center came to a conclusion that corporate governance in Russia had not changed for the better since 2012. The difference between research results can be partially explained by different compositions of company groups subjected to the analysis. Also, the specified research does not provide assessments of companies' explanations of reasons for noncompliance with the CGC's recommendations.

6. In the end, it can be stated that *there is undoubtedly progress* in compliance with the Russian CGC and the activities of the Central Bank of the Russian Federation in this area will definitely facilitate promotion of the CGC's principles and recommendations with expansion of the range of legal entities which the "comply or explain" approach is going to be applied to.

A particular attention is to be paid to the quality of companies' explanations because at this stage the regulator has to identify the factors behind the low quality of explanations, rather those behind noncompliance with the CGC's provisions. *It is necessary to switch over from assessment of formal statements to assessment of actual corporate governance practices*, but it is quite a complicated process and it requires substantial resources. It is to be noted that some steps have already been taken in that direction: the Central Bank of the Russian Federation is networking with some companies on the individual basis to upgrade the quality of their explanations. The regulator is planning to network more actively with companies to eradicate the formal approach and ensure the situation where companies' explanations of departures from the CGC's norms meet shareholders' and investors' expectations. The proper implementation of the "comply of explain" approach will facilitate promotion of transparency, upgrade the existing corporate governance rules with companies' comments taken into account and further develop the corporate culture in Russia.