GAIDAR INSTITUTE FOR ECONOMIC POLICY

RUSSIAN ECONOMY IN 2019

TRENDS AND OUTLOOKS

(*Issue 41*)

Gaidar Institute Publishers
Moscow / 2020

440

UDC 338.1(470+571)"2019"
BBC 65.9(2Рос)"

R95 ***Russian Economy in 2019. Trends and outlooks. (Issue 41)*** */ [V. Mau et al; scientific editing by Kudrin A.L., Doctor of sciences (economics), Radygin A.D., Doctor of sciences (economics), Sinelnikov-Murylev S.G., Doctor of sciences (economics)]; Gaidar Institute. – Moscow: Gaidar Institute Publishers, 2020. – 596 pp.: illust.*

ISBN 978-5-93255-587-3

The review “Russian Economy. Trends and Outlooks” has been published by the Gaidar Institute since 1991. This is the 41th issue. 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: global economic and political challenges and national responses, economic growth and economic crisis; the monetary and budget spheres; financial markets and institutions; the real sector; social sphere; institutional changes. The paper employs a huge mass of statistical data that forms the basis of original computation and numerous charts confirming the conclusions.
By contrast to the previous publications the present issue includes also a short analysis of the first three months of 2020 from the perspective of the COVID-19 pandemic impact on the Russian economy development.

Reviewer: Faltsman V.K., Doctor of science (Economics), Professor, main researcher, Department of Institutional and Financial Markets Analysis, IAES RANEPA.

UDC 338.1(470+571)"2019"
BBC 65.9(2Рос)

ISBN 978-5-93255-587-3

© Gaidar Institute, 2020

E. Apevalova, N. Polezhaeva, A. Radygin

6.2. The standards and practices of corporate governance: relevant current trends[1]

6.2.1. Phases of the evolvement of 'Russian' corporate governance standards

An analysis of corporate governance practices would be impossible without understanding the corporate governance development in the context of Russian and world practices. With a certain degree of arbitrariness, the following main phases of its development can be distinguished.

During Russia's 'wild 90s', despite the adoption of the basic norms of corporate law, the standards of 'good practices' in Russia not only were not complied with – they were not even viewed as something to be oriented to. At that time, the post-privatization property redistribution was taking place in the corporate sector.

In the United Kingdom during the same period, the first version of the Corporate Governance Code (the Cadbury Code of 1992) was prepared and adopted at a time when the recommendations on best corporate governance practices had been recently developed. The Cadbury Code laid the foundation not only for the British codes of best practices, but also set the stage for the development of similar codes in Europe.

In 1999, the OECD Principles of Corporate Governance were adopted, representing the standards and best practices, as well as recommendations for their implementation, that could be adapted to the specifics and national conditions of each country or region. The principles contained specific recommendations for legislative and regulatory initiatives to be adopted by OECD members, as well as by countries outside of the OECD. They have become an international benchmark for policy makers, investors, companies, and other related entities. The principles formed the basis for a broad cooperation program between the OECD and other countries, and were accepted in the framework of recognized international standards in 12 policy areas for a sound financial system. More particularly, they were incorporated into the Corporate Governance Assessments section of the World Bank and the International Monetary Fund's Report on the Observance of Standards and Codes (ROSC).

The second period (approximately 2000–2003) in Russia is marked by an obvious progress at the level of biggest issuers of securities. Now, major Russian companies began to display their interest in corporate governance issues. Against the general background of ongoing equity capital concentration, mergers and takeovers, reorganization of the already established business groups (holding companies), intra-and inter-industry expansion, and an increasingly proactive

[1] This section was written by *Apevalova E. A.*, Senior Researcher at the Center for Institutions Analysis and Financial Markets of the RANEPA IAES; *Polezhaeva N. A.*, Candidate of Legal Sciences, Senior Researcher at the Center for Institutions Analysis and Financial Markets of the RANEPA IAES; *Radygin A. D.*, Doctor of Economic Sciences, Professor, Head of the Center for Institutional Development, Ownership and Corporate Governance of the Gaidar Institute, Director of the RANEPA IAES, Director of the RANEPA Institute of EMI.

search for overseas funding sources, Russia's first Corporate Governance Code was adopted in 2002.

Its goal was to bridge the gaps in the then existing Russian laws and regulations on joint-stock companies. In the early 2000s, some large Russian companies (Yukos, LUKoil, Wimm Bill Dann, SSA Sistema, Norilsk Nickel, Magnitogorsk Iron and Steel Works, SUAL) disclosed information on their beneficial owners. The number of independent directors on the boards of Russian companies increased, and the relative share of Russian companies that had begun to pay dividends to their shareholders was on the rise. However, these positive practices (which were formal, for the most part) were typical only of biggest private companies.

In the late 1990s and early 2000s, national corporate governance codes were adopted in Austria, Belgium, Germany, France, Switzerland, and Sweden.[1] Over the same period, similar documents were being elaborated in Australia, Canada, the USA, and Japan.

The third period (2004–2005) started in the aftermath of the Yukos affair, its typical feature being deep freeze put on a wide variety of corporate initiatives. At the same time, that period saw the completion of the formal corporate governance infrastructure for companies – their corporate governance codes, internal regulations, quotas for independent directors, shareholder committees, corporate secretaries, etc. The demand for innovations was primarily displayed by the second-tier companies that were preparing to enter the financial market.

The general consequences of the 1998 financial crisis produced several global shifts of the early 2000s. The downfall of Enron and WorldCom in the USA and similar scandals involving Independent Insurance in the UK, Elan in Ireland, Kirch in Germany, Royal Ahold in the Netherlands, and HIH Insurance (HIH) and One.Tel in Australia put to a test the effectiveness of corporate governance and financial regulation practices.[2] The upshot of this series of major corporate scandals was a revision, in in 2004, of the OECD Principles of Corporate Governance. The main areas to be revised were as follows:[3] (a) ensuring the basis of an effective corporate governance framework that had not been previously established (Principle I); (b) the rights of shareholders and key ownership functions; (c) conflicts of interest.

The fourth period (approximately 2006–2008) was characterized by more active involvement of the State and state-owned companies in the Russian market for corporate control. That period saw the establishment of state-owned corporations, an increasing size of state-owned blocks of shares, growth in the number of IPOs and cross-border mergers and takeovers, including by way of protecting businesses through attracting major foreign investors.

The 2008 crisis marked **the start of the next period (2008–2014);** the crisis, in a certain sense, gave a new impetus to the development of corporate governance. The weaknesses of corporate governance and financial risks were recognized to be among the powerful factors that triggered the global crisis. The new Russian Corporate Governance Code (hereinafter – CGC),[4] adopted in 2014 on the initiative of the new mega-regulator – the Bank of Russia, was more consistent with the OECD's framework for corporate governance.

---

[1] 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.

[2] See *Hill* J.G. Regulatory Responses to Global Corporate Scandals // Wisconsin International Law Journal. 2005. Vol. 23. Issue 3. P. 369–373. 375–376.

[3] See *Kirkpatrick* G. (OECD). Improving corporate governance standards: the work of the OECD and the Principles, 2005. P. 2–4.

[4] See Letter of the Bank of Russia dated 10.04.2014 No. 06-52 / 2463 'On the Corporate Governance Code' // Bulletin of the Bank of Russia, No 40, 18.04.2014.

The next few years, **approximately from 2015 until the present time**, may be conventionally described as a period of stagnation in the development of positive corporate governance practices which resulted, among other things, from the completion of the process of adjusting the relevant infrastructure of the major public and private companies to the formal requirements established by the regulator, as well as to the international framework standards. At the same time, certain positive practices were now implemented at the level of medium-sized Russian companies. Moreover, according to some estimates, the companies listed on the Russian stock exchange have largely adopted best corporate governance practices and formally comply with practically all the requirements set forth in the Code.

The most significant global development in this field was the approval, in 2015, of the new OECD/G20 Corporate Governance Principles, which retained the main features and content of the 2004 Principles, but were augmented by more detailed recommendations. Although the new Principles are by no means revolutionary, they aim at raising the standards in several fields across the developed and emerging markets, they are better geared to the existing relevant differences in the global corporate governance system, and they recognize the limits to global convergence of corporate governance practices.[1] Like the earlier principles, they focus on the interests of shareholders and on maximizing companies' stock value.

Meanwhile, there has been much discussion, in the relevant academic literature, on the difference between maximizing the wealth of shareholders and maximizing a company's market value in the context of corporate policy;[2] the issue of an altering balance of relationships between managers and owners in response to globalization (among other things);[3] or financialized corporate governance practices,[4] etc. A 'more applied' discourse has raised the issue of shifting the emphasis in favor of long-term corporate governance goals and the new areas of responsibility of a modern corporation. Over recent years, in the context of reviewing the corporate governance targets, an intense discussion has centered around the interests of all types of stakeholders, social welfare and environmental issues, and also some other problems that have to do with the quality of life, the role of technological advances and digitalization, and so on.[5]

Nevertheless, the principles adopted in 2015 so far have retained their conservative nature and have not been altered in response to some recent, more fashionable trends, as it has

---

[1] See *Wong S.* The 'New' G20/OECD Principles of Corporate Governance: More than Meets the Eye // Hawkamah Journal. Issue 02/2015. P. 22.

[2] See *Hart O., Zingales L.* Companies Should Maximize Shareholder Welfare Not Market Value // Journal of Law, Finance, and Accounting, 2017, 2: 247–274.

[3] See *Schymik J.* Globalization and the evolution of corporate governance // European Economic Review, Volume 102, February 2018, Pages 39–61; *Dignam A., Galanis M.* The Globalization of Corporate Governance. Routledge, 2016.

[4] *Admati Anat R.* A Skeptical View of Financialized Corporate Governance // The Journal of Economic Perspectives, Vol. 31, No. 3 (Summer 2017), pp. 131–150;

[5] See *The Oxford Handbook of Corporate Law and Governance*. Ed. by Jeffrey N. Gordon and Wolf-Georg Ringe. Oxford, 2018; The Handbook of the Economics of Corporate Governance, Volume 1, 1st Edition. Ed. by Benjamin Hermalin, Michael Weisbach. North Holland, 2017; *Pacces A.* Rethinking Corporate Governance. The Law and Economics of Control Powers. Routledge Research in Corporate Law, 2015; *Gelter M.* Comparative Corporate Governance: Old and New. ECGI Law Working Paper N 321/2016, July 2016; *Fenwick M., Vermeulen E.P.M.* The End of the Corporation. ECGI Working Paper N 482/2019, November 2019; *Fenwick M., Vermeulen E.P.M.* Technology and Corporate Governance: Blockchain, Crypto, and Artificial Intelligence. ECGE Law Working Paper N 424/2018, November 2018, etc.

happened with a number of other international documents that establish specific codes of conduct for business entities.

A special note, with some clarifications, should be made of the specific features of the regulatory practices that have been developed to date. Today, a review of world practices points to the existence of both mandatory and hybrid regulation of corporate governance. Within the framework of mandatory regulation (for example, in India and the USA), the regulator, by way of a law, establishes uniform mandatory corporate governance rules that apply to all companies. The law is not concerned with the reasons for their non-compliance with the established rules. This regulation model is not costly, and it is very efficient, but it lacks flexibility, does not create proper incentives for companies, imposes a disproportionate burden on small companies, and is not very attractive for foreign investors.

Hybrid regulation relies on a combination of legislation (hard law) and corporate governance code (soft law). At the same time, the code itself can be applied either on a purely voluntary basis (Belarus, Kazakhstan, Mongolia, Tunisia, Ukraine), or rely on the 'comply or explain' approach. The latter is practiced in the majority of large developed and developing countries (including Belgium, Germany, Spain, Italy, the Netherlands, Estonia, Poland, Hungary, and Greece).[1]

The 'comply or explain' approach means that corporate governance principles and codes are advisory, and therefore must not necessarily be complies with. However, a company that has chosen not to comply with any one or other rule is required to provide a reasonable explanation for doing so. Both the application of the rule and the provision of a substantiated explanation as to why it has not been applied represent two ways of complying with the rule. In the event of a company's failure to provide a proper explanation, or the explanation provided being insufficient, the company may be punished.

The comply-or-explain approach is considered to be more effective, because it allows companies to more flexibly adapt the corporate governance rules to their individual characteristic features, gives them relative freedom in adopting those governance structures that are most suitable for them and help them improve their management results. Nevertheless, it is more expensive to implement, especially in the less-developed economies.

The CGC, in the contest of Russia's current practice of corporate governance regulation, represents soft law which, when applied together with hard law (legislation), translates into a hybrid regulatory system. Under this regulation system, the law regulates only some components of corporate governance, e.g., the organization of a board of directors, shareholder rights, the existence of an audit committee, and the conduct of a mandatory external audit. The codes regulate some other issues that have to do with the independence of board members, internal corporate control and risk management, and the creation of remuneration and appointment committees.

The CGC was adopted in order to make the corporate governance system in this country more transparent and understandable and to boost the confidence of investors, the companies' customers and employees, and the general public in the proper management and control of joint-stock companies. However, this can only be achieved if the code is properly complied with. Otherwise, even if the document itself is of the highest quality from the point of view of its content, it may still prove to be ineffective when applied as a management performance

[1] See *Polezhaeva N.* Compliance with the Corporate Governance Code: are there any improvements? / Russian economy in 2017. Trends and outlooks. The Ye.T. Gaidar Institute for Economic Policy. – Moscow: Gaidar Institute Publishing House, 2018. - P. 452–478.

improvement tool. In this connection, the issue of proper implementation of the code, as well as the use of various mechanisms in the course of its implementation, becomes very important. The compliance with the 2014 CGC is voluntary, but those joint-stock companies that trade their securities in an organized market are required to disclose the information concerning their compliance with the principles established by the CGC, or the reasons for their non-compliance. Thus, the Russian CGC, in its regulation of the activities of listed companies, relies on the so-called comply-or-explain approach.

6.2.2. The board of directors and supervisory board in the corporate governance system

In the modern corporate governance system, is difficult to overestimate the role of the board of directors (and/or supervisory board). It is the most important internal mechanism of corporate governance, designed to secure the interests of a company's shareholders and other stakeholders and to exercise proper control over the activities of its executive bodies.

As is well-known, depending on the supervisory board's formal status of an independent entity, there exist two traditional board of directors models in world practices. Supervisory boards, and thus a two-tier board of directors system, exist in Germany, Poland, France, Italy, the Netherlands, China, and some other countries. In the framework of this model, the supervisory board is a structural component of a two-tier board of directors, alongside the management board. Its functions are clearly defined: it performs only some of the functions delegated to the board of directors, the principal one being that of exercising supervision and control over the management board. The range of its other functions may vary in different countries. The supervisory board consists of independent directors. Nevertheless, it is the one-tier board of directors system with no supervisory board (the USA, the UK, Switzerland, etc.) that is more widespread around the world.[1]

These two systems have their historical origins. Thus, for example, independent entrepreneurial ownership in the UK during its early phase of development was evolving without any participation on the part of the State or any other institution exercising control over the management process. In Germany, mandatory supervisory boards first appeared in the 1870s, when the State delegated its function of overseeing the activities of joint-stock companies to separately established supervisory boards. Both these models have their pros and cons, and comparative law and available experiences provide no evidence that any one of them is clearly superior to the other.

The most significant legal trend is that of providing shareholders with a choice between the one-tier and two-tier systems (France, the Netherlands, Belgium, Luxembourg, Finland, Denmark, and some countries outside Europe). In several countries, including Italy and Portugal, one may choose between a larger number of systems. The European Union also offers shareholders a choice between these systems within the European Company Statute. Germany remains conservative with regard to this issue and refuses to give shareholders any choice (largely due to the existence of strong trade unions), although proposals for reform in this field have already been heard for a long time.

Another trend is the diversity (in terms of age or gender) of the supervisory board.

---

[1] See *Sukhanov, E.A.* Comparative corporate law. Statute, 2014. 620 p. (in Russian); *Rubenko, G.L.* Legal status of management bodies of joint-stock companies. Statute, 2007. 190 p. (in Russian); OECD Corporate governance factbook 2019 // URL: http://www.oecd.org/daf/ca/Corporate-Governance-Factbook.pdf.

In the modern world, the discussion about a possible expansion of the supervisory board's powers has become quite popular. The main alterations introduced into Germany's 2015 Corporate Governance Code emphasized the increasingly prominent role of the supervisory board by endowing it with the right to appoint or dismiss the members of the management board, and to determine their remuneration. In China, by contrast, the supervisory board may only exercise control over the management board. Another issue that has been actively discussed is the age and gender diversity of the supervisory board.

It is noteworthy that Russia adopted a one-tier board of directors system, but a supervisory board is synonymous with a board of directors, because it performs all the functions of the latter. That is why this model is controversial (conflict-triggering), and in this it differs from world practices: in Russia, the board of directors (supervisory board) is the single body that simultaneously carries out general management of a corporation, performs the functions of control and oversight, and also, in some cases, the function of its everyday management. In this format, an inclusion on the board of directors of a certain number of independent directors does not eliminate the controversy of functions.

In Russia, the board of directors (supervisory board) is the central link of a public joint-stock company's corporate governance system. The performance level of this body and the quality of its decision-making determines a company's further successful development, its attractiveness to investors, as well as its trustworthiness in the eyes of its contractors, shareholders, and related parties. The board of directors is entrusted with some important administrative functions, such as approval of a business strategy, achievement of long-term sustainability, organization of a risk management system, appointment, monitoring and evaluation of the performance of a company's executive bodies, creation of a motivation system capable of attracting and keeping highly qualified specialists, and creation of incentives for achieving long-term goals. In this connection, the issues of efficient performance of the board of directors, its committees and members become especially importance, including their ability to achieve the results that correspond to their organization's needs, and to identify on a timely basis those areas where competences of the board of directors can be further improved, as well as the issues that have to do with planned rotation of its members.[1]

RF corporate legislation, as far as the board of directors is concerned, regulates the issues of its sphere of competence and election procedure, and the conduct of its meetings.[2] The CGC deals with issues that have to do with the performance level and professionalism of the board of directors, and independence of its members. The consistency of companies' practices with the provisions of the CGC is controlled by the Bank of Russia. The first review of corporate governance in Russian public companies drawing on their 2015 annual statements was issued by the Bank of Russia in April 2017.[3] The fourth, and so far the latest review based on the year-end results of 2018, was published in November 2019.[4]

For its fourth review, the Bank of Russia studied the reports on their compliance with the principles and recommendations of the CGC submitted by joint-stock companies included in the first and second level quotation lists of the Moscow Exchange (QL1 and QL2, respectively).

---

[1] See the Bank of Russia's Information Letter No IN-06-28/41 dated April 26, 2019 'On recommendations concerning the organization and conduct of a board of directors (supervisory board) performance assessment in joint-stock companies'// Bank of Russia Bulletin, No 29, April 30, 2019.

[2] See, e.g., Chapter VIII of Federal Law No 208-FZ dated December 26, 1995 'On joint-stock companies' // The Russian Newspaper, No 248, December 29, 1995.

[3] URL: https://www.cbr.ru/Collection/Collection/File/24046/Review_17042017.pdf.

[4] URL: https://www.cbr.ru/Collection/Collection/File/25363/Review_29112019.pdf.

Compared to the previous year, the total number of joint-stock companies included in QL1 and QL2 shrank from 75 to 65. And the review relied only on data for those 63 joint-stock companies that submitted their reports in accordance with the established form.

It should be noted that the Bank of Russia, as well as the other institutions that release their analyses of the compliance of Russian companies with the CGC, relied in the main on the information available from the official documents submitted by companies (their quarterly and annual reports, reports on their compliance with the principles of CGC, the lists of their affiliated entities, their statements of relevant facts, etc.), without verifying that information. The joint-stock companies on their own determined the degree of their compliance with one or another principle of the CGC, and the institutions that conducted the analyses noted the highly formal nature and incompleteness of information in the reports provided by companies, especially their explanations for non-compliance with the corporate governance rules.

Based on the analysis of companies' reports for 2018 on their compliance with the principles and recommendations of the CGC, one may note the continuing positive trends with regard to the level of implementation of the CGC rules by companies included in the quotation lists, and the quality of explanations for their non-compliance (or partial compliance) with them provided by those companies.

Compared with 2017, the number of CGC principles that have been fully complied with by these companies is on the rise. Thus, according to their self-assessment, the average level of implementation of the principles of the CGC increased by 5%, to 76% of the total number of principles stipulated in the CGC. The average quality of their explanations of the reasons for non-compliance (or partial compliance) with the principles and recommendations of the CGC jumped by 7%, to 60%.

In 2018, a positive movement was also observed in respect to their compliance with the principles stipulated in each chapter of the CGC (*see Table 14*).

Table 14

The relative share of joint-stock companies that declared their full compliance with the principles stipulated in each chapter of the CGC

Chapter of CGC	Number of principles	All PJSCs, %			
		2015	2016	2017	2018
I. Shareholder Rights	13	5	6	7	21
II. Board of Directors	36	0	0	0	0
III. Corporate Secretary	2	45	77	85	86
IV. Remuneration System	10	6	5	11	13
V. System of Internal Control and Management of Risks	6	42	55	60	65
VI. Information Disclosure	7	15	17	25	33
VII. Significant Corporate Actions	5	7	9	7	10

Source: data from the Bank of Russia's 2018 Year-end review of corporate governance practices in Russian public companies.

Chapter II is the most voluminous (36 principles); it outlines the principles of organizing the work of a board of directors, its role in ensuring the efficient performance of a company, and the consistency of its activities with the long-term interests of both the company and its shareholders. The recommendations stipulated in this chapter aim at improving the transparency and efficiency of a company's corporate governance and securing its investment attractiveness. The provisions set forth in Chapter II 'Board of Directors' are those that so far have been the least complied with. Just as it happened in 2015–2017, no joint-stock company declared its full compliance with the principles of this particular chapter of the Russian CGC.

However, the average level of implementation of this chapter’s provisions was 72%, which is 6% higher than in 2017.

As before, the least degree of compliance was reported with regard to principle 2.5.1 (the election of an independent director to chair the board of directors, or the appointment of a senior independent director selected from among the independent directors); principle 2.7.4 (the approval of a decision by a qualified majority, or by a majority of votes cast by all elected members of the board of directors); principle 2.8.2 (the formation of a remuneration committee from among independent directors); and principle 2.9.2 (the performance assessment of the board of directors). More particularly, the number of companies that implemented principles 2.7.4 and 2.8.2 decreased by 3. In 2018, 22 companies (35%) reported their compliance with principle 2.7.4; and 25 companies (40%), with principle 2.8.2.

At the same time, compared with 2017, there has been a slight positive dynamics in the implementation of principles 2.5.1 and 2.9.2 of the CGC. Thus, 25 companies (40%) fully implemented principle 2.5.1, while in 2017 there were 20 such companies (28%). Their compliance with principle 2.9.2 was reported by 26 companies (41%), which is by 2 companies more than in 2017 (24 companies, 33%). A moderately positive dynamics was observed with regard to improved quality of the explanation of the reasons for their non-compliance (or partial compliance) with the CGC principles.

As seen by the year-end results of 2018, the relative share of companies with high-quality explanations increased by 8% relative to the previous year. The explanations provided by 16 societies (25%) exceeded the expert assessment level of 75% (high-quality explanations), which is by 4 companies more than in 2017. The number of companies in need of a significant improvement of their explanations fell nearly twofold. Their relative share shrank from 46% to 27%.

For example, when explaining their reason for deviating from principle 2.5.1 (the election of an independent director to chair the board of directors, or the appointment of a senior independent director selected from among the independent directors), companies often expounded the practice of the board of directors where its members, when choosing their chairperson, look at the candidate’s moral authority, impeccable business reputation, investors’ trust, etc. State-owned companies base their arguments on the specific structure of their equity capital. Some companies note that they are not against the post of senior independent director being instituted, but the board of directors does not initiate the consideration of that issue.

The most common explanation for companies’ non-compliance with principle 2.4.3 (the formation of a board of directors where the number of independent directors should be not less than 1/3 of the number of its elected members) has been their inability to influence the process of nominating candidates and electing the board of directors’ members by a general shareholder meeting in such a way that the board composition could be consistent with the recommendations stipulated in the CGC.

Among the most common reasons for non-compliance with principle 2.8.5 (the formation of committees under the board of directors composed of at least three members, with an independent director appointed to be the committee chairman), companies refer to the heavy workload shouldered by the independent board members, their insufficient number, and the need to appoint to be the committee chairman an individual with extensive experience in the matters to be handled by the committee. In many companies, in addition to the key committees (audit committee, nomination committee, remuneration committee), also some other committees are created (for example, committees on risks, strategy, etc.), but most often such committees and not headed by an independent director (*see Table 15*).

Table 15

The practice of creating board of directors' committees (75 companies reviewed by the Bank of Russia in 2017)

Committee	QL1		QL2	
	Separate committee created	Issue handled by another committee	Separate committee created	Issue handled by another committee
1	2	3	4	5
Audit	44	0	28	0
Nominations and remuneration	44	0	22	0
Remuneration	0	0	2	0
Strategy	32	1	17	0
Investment	5	4	2	2
Risks	3	4	0	1
Budget	4	0	2	0
Corporate Governance	4	6	0	0
Ethics	1	0	0	0
Health, safety and environment	2	1	1	0
Technical (safety/technical policy, etc.)	5	0	9	0
Other	4	–	9	–

Source: data from the Bank of Russia's Third (2017) review of corporate governance practices in Russian public companies.

As the reasons for their deviation from principles 2.9.1 and 2.9.2 (regular performance assessments of the board of directors, its committees, and individual members), some companies cite the high professional level and extensive experience of the board members and the fact that the board composition remains unchanged. However, that explanation is not satisfactory, just as the absence in a company of a well-developed self-assessment system or a procedure for outsourcing such an assessment is not a satisfactory explanation, because it does not explain the reasons for non-compliance, but simply states the fact of non-compliance with the principle.

The CGC does not recommend special payments for the participation in each board or committee meeting, or any form of short-term motivation, or additional material incentives for members of boards of directors (paragraph 4.2.1). In most companies, the board members receive some basic remuneration, but it is often calculated with due regard for the number of meetings attended by each member. It is common practice to pay an allowance for chairing the board of directors and committees. About a third of companies use short-term tools to motivate the board members (payment of bonuses depending on the amount of a company's proceeds, capitalization index growth, position in the industry) that are not recommended by the CGC, because such incentives may stimulate the achievement of short-term goals to the detriment of the company's long-term sustainable development. Besides, companies seldom provide information on their compliance with principle 4.2.2 (long-term ownership of shares in their company in order to bring the financial interests of board members closer to the long-term interests of shareholders).

In general, over the four years that have passed since the start of corporate governance quality monitoring by the Bank of Russia, the companies included in the quotation lists managed to achieve quite good results in introducing the principles set forth in the CGC and improving the quality of their explanations of the reasons for their non-compliance (or partial compliance) with those principles. While previously the companies reduced their explanation to describing the actual circumstances of their non-compliance with the CGC, in 2018 they began to pay attention to a meaningful description of their measures undertaken in order to bring down the risks associated with their deviation from the recommendations of the CGC, and to include the information on the timelines for making their corporate governance practices consistent with the CGC.

Special attention should be paid to the issues that have to do with companies' compliance with the corporate governance principles pertaining to the board of directors of those *13 public joint-stock companies with stakes held by the Russian Federation*, whose shares are traded on the organized securities market, which are considered to be the 'flagships of the market' and treated as specific indicators of the level of investment attractiveness of the Russian market as a whole and of the structural quality of corporate governance in Russian companies. These are Alrosa PJSC, Aeroflot PJSC, Bashneft PJSC, VTB Bank (PJSC), Gazprom PJSC, United Aircraft Corporation PJSC, Rosneft PJSC, PAO Rosseti (PJSC), Rostelecom PJSC, RusHydro PJSC, Sberbank PJSC, Transneft PJSC, and FGC UES PJSC. Their compliance with the CGC is monitored and studied not only by the Bank of Russia, but also by the Federal Agency for State Property Management (Rosimushchestvo), the Open Government, the Government Expert Council of the Russian Federation, the Working Group on Establishing the International Financial Center, as well as a number of research institutes (e.g., the Higher School of Economics).

To analyze the compliance of state-owned companies with the principles of the CGC concerning the board of directors, the annual reports for 2018 of six companies[1] included in the HSE corporate governance rankings[2] were reviewed: two companies with top rankings (Sberbank (4.07 out of 5), ALROSA (3.76)); two with middling rankings (RusHydro (2.96), Rosneft (2.85)); and two with the lowest rankings (Gazprom (1.85), Transneft (1.6)) (*see Table 16*).

Table 16

Compliance with the 36 principles of the CGC concerning the board of directors

	Compliant	Partially compliant	Non-compliant
Sberbank	30	6	0
Alrosa	32	3	1
RusHydro	32	1	3
Rosneft	31	5	0
Gazprom	23	10	3
Transneft	25	9	2

[1] See Sberbank of Russia's 2018 Annual Report. URL: https://www.sberbank.com/common/img/uploaded/redirected/com/gosa2019/docs/sberbank-annual_report_2018_rus.pdf; 2018 Annual Report of ALROSA PJSC. URL: http://www.alrosa.ru/wp-content/uploads/2019/06/%D0%93%D0%9E_2018_%D1%84%D0%BE%D1%80%D0%BC%D0%B0%D0%BB_%D1%84%D0%B8%D0%BD%D0%B0%D0%BB.pdf; 2018 Annual Report of RusHydro PJSC. URL: http://www.rushydro.ru/upload/iblock/7d9/GO-za-2018-god.pdf; 2018 Annual Report of Rosneft PJSC. URL: https://www.rosneft.ru/upload/site1/document_file/a_report_2018.pdf; 2018 Annual Report of Gazprom PJSC. URL: https://www.gazprom.ru/f/posts/01/851439/gazprom-annual-report-2018-ru.pdf; 2018 Annual Report of Transneft PJSC. URL: https://www.transneft.ru/investors/219/.

[2] See *Evaluation of corporate governance in public companies with Russian state participation and publicly traded shares*. HSE, 2017. URL: https://buscom.hse.ru/data/2017/04/18/1169055539/%D0%9F%D0%BE%D1%81%D0%BB%D0%B5%D0%B4%D0%BD%D1%8F%D1%8F%20%D0%B2%D0%B5%D1%80%D1%81%D0%B8%D1%8F%20%D0%BE%D1%82%D1%87%D0%B5%D1%82%D0%B0__%D1%80%D1%83%D1%81.pdf.

Source: the companies' annual reports for 2018.

Thus, the state-owned companies with top and middling rankings based on corporate governance quality differ little by the number of the CGC's principles concerning the board of directors that they actually comply with. Rosneft demonstrates an even better index than that of Sberbank. However, the companies with the lowest rankings comply with a notably smaller number of those principles. Their reasons for non-compliance are for the most part uninformative. An exception is Transneft, which substantively explains its deviations from the principles.

The principles least of all complied with are those regarding the board of directors' responsibility to set up committees for preliminary consideration of the most important issues pertaining to the company's activities (paragraph 2.8), as well as the principles under section 2.4 in the part whereby it is stipulated that the number of independent directors on a board of directors should be not less than 1/3 of the number of its elected members, and in the part whereby independent directors are obliged to play a key role in preventing internal conflicts in the company and in undertaking significant corporate actions.

Our analysis has highlighted the following *problem points*:

1. A meeting of the board of directors cannot be convened by shareholders (Sberbank, Rosneft, Gazprom). Shareholders should be able to influence the activities of the board; however, in order to avoid undue influence on the board of directors, the CGC recommends that the right to demand that a board meeting be held should be granted only to shareholders holding at least 2% of the company's voting shares, and only for the consideration of issues defined in the charter.

2. There is a low proportion of in-person meetings of the board of directors and its committees (RusHydro, Rosneft, Gazprom, Transneft). Moreover, due to the concentration of ownership, absentee ballots take place quite often (sometimes several times a week). A face-to-face meeting of the board is preferable for discussing the most important issues, because it involves the joint presence of board members.

3. The board of directors' agenda sometimes includes a section titled 'miscellaneous', which is fraught with the risk of some significant issue being considered without proper notice to all the board members. The dates of the decisions to hold absentee voting and the dates of such voting almost always coincide (Sberbank). The very limited time assigned for preparing for such voting may prevent the adoption of a well-considered decision by the board of directors.

4. The recommendations of the CGC concerning the need to ensure a qualified majority in the board of directors or the majority of its elected members on important issues (less than half of the issues belonging to the category of the most important ones under the CGC) are not implemented in full (Alrosa, Rosneft, Gazprom). This also gives rise to the risk of poor decision-making on significant issues.

5. A number of problems have to do with the limited powers of the board of directors, for example:

- the powers of the board of directors do not include their right to appoint, or to dismiss prior to their term of office expiry date, the president or chair of the company's board (Sberbank); and the board of directors has no power to form the management bodies of relevant companies controlled by the core company (Rosneft);
- independent directors and the human relations and remuneration committees do not participate in compiling the list of candidates for the board of directors of Rosimushchestvo for the next corporate year, which creates a situation where the management has to submit

such a list in the context of a potential conflict of interest (no information on such participation is available from RusHydro or Rosneft);

– no powers to review the budget of the internal audit subdivision and determine the remuneration to its head are envisaged for the board of directors (Gazprom, Transneft). The CGC recommends that the internal audit unit should be made independent, which can be achieved by distinguishing between its functional and administrative accountability. It is recommended that the internal audit unit should be administratively subordinate to the sole executive body. The functional subordination of the internal audit unit to the board of directors means, inter alia, that the board approves (the audit committee preliminarily reviews) the internal audit's activity plan and budget. The absence of such a separation of accountability in a number of state-owned companies may impede the maximum independence of internal audit from the management of the organization;
– the board of directors does not pay enough attention to the company's development strategy, while full-fledged strategic sessions with the participation of management and board members should be held on an annual basis (Alrosa).

6. The reports on the board of directors' decisions do not disclose the voting results and roll-call of board members in the event of absence of unanimity (Sberbank, Rosneft, Gazprom, Transneft).

7. Lack of a proper remuneration system for board members.

The CGC recommends that the amount of remuneration for members of the board of directors should be set so as not to be too high, on the one hand, while on the other, to be adequate to the time, qualifications and responsibilities of the directors, and also take into account the level of remuneration of the other employees of the company. Despite this, in RusHydro, Rosseti, and FGC UES, the remuneration tends to zero, including in relation to the average remuneration of board members. The amount of remuneration that does not comply with the recommendations of the CGC prevents proper involvement of the directors and their concentration primarily on their professional work on the board. In the Russian state-owned companies considered here, the level of remuneration paid to members of the board of directors is significantly lower than in the international companies of a similar status. The exceptions are Rosneft, Gazprom, Transneft, Bashneft and Sberbank, which are not inferior in this respect to European companies, but significantly lag behind their US and Canadian counterparts. In electric power companies, this situation was caused, among other things, by the use of outdated recommendations of the RF Ministry of Economic Development for determining the amount of remuneration of independent directors and professional attorneys in state-owned joint-stock companies, adopted in 2009.[1]

The CGC also recommends not to use the various available forms of short-term motivation for members of the board of directors, including those pegged to capitalization or profit. However, Aeroflot, Bashneft, and Gazprom have introduced certain components of premium annual remuneration depending on capitalization or profit. At the same time, these remuneration programs are not replicas of the programs for the participation of board members in capital that are typical of American companies, where part of the remuneration is distributed by means of conditional shares (issued free of charge, with their number calculated at a conditional fixed price), and is paid only after the term of office of a board member has expired.

---

[1] See Letter of the Ministry of Economic Development of Russia No D08-3156 dated September 28, 2009 'On recommendations on determining the size of remuneration to be paid to independent directors and professional attorneys in joint-stock companies with state participation' // Consultant Plus.

It seems that in state-owned companies, which for the most part pursue economic goals and operate in a competitive environment, the level of remuneration of board members should reflect the current market conditions, to the extent necessary for attracting and retaining highly qualified members in the board directors.

There also exist some other negative corporate practices of biggest state-owned companies that have to do with the operation of their boards of directors.

8. One problematic issue is how to organize the board of directors' work. Most frequently, their schedule is centered around their need to consider the proposals of the company's management and to discuss the issues suggested by the board members; whereas the scheme that involves the elaboration, by the board of directors, of its own standpoint as to the scope of its competence and responsibility (with due regard for the management's proposals), including the development of joint proposals and various decision-making scenarios, is not commonly seen (e.g., Alrosa), and such a scheme is usually applied only to some specific issues.

9. The CGC recommends that an independent director should be elected to chair the board of directors, or that a senior independent director should be appointed from among the elected independent directors. Generally, state-owned companies prefer the second option (paragraph 2.5.1).

It seems that what the decisive factor here is not the independent status of the board's chair, but their personal attitude. The interest on the part of the chair inevitably gives rise to a meaningful discussion participated by all representatives of shareholders and independent directors. A proactive chair allows the independent directorate to communicate their viewpoints, which are then given maximum consideration during the process of generating or issuing decisions concerning each item on the meeting's agenda. The personalities of the key participants in corporate governance, and not only the personality of the chair of the board of directors, present an eternal problem, because this is something that cannot be fully controlled by regulatory norms.

10. Some questions also arise in connection with the issues of liability insurance of the members of the board of directors, because the insurance, among other things, provides a compensation for losses, otherwise it would have been difficult to recover from an individual. Big state-owned companies actively insure the liability of members of their board of directors, board members, and other officials, by way of compensating for the losses incurred by other entities, for which claims can be presented to the insured individual for their wrong actions committed in the course of their management activities (insurance amounts vary from RUB 3 billion to USD 250 million). However, this may result in unjustifiably risky behaviors of the board members in the course of their decision-making.

Thus, in spite of the good overall picture, it is still recommended that state-owned companies should provide proper solution to the issues relating to their boards of directors.

6.2.3. Prescriptive decision making on the part of the State

The issues involving prescriptive decision making on the part of the State are not covered by the Russian CGC because they represent a specific feature of state-owned companies. However, even the OECD Guidelines on Corporate Governance of State-Owned Enterprises[1] say nothing about any distinctive ways for the State to exercise its shareholder rights, and only

[1] OECD Guidelines on Corporate Governance of State-Owned Enterprises, 2015 // URL: https://read.oecd-ilibrary.org/governance/oecd-guidelines-on-corporate-governance-of-state-owned-enterprises-2015_9789264244160-en.

point out that the State should exercise its ownership rights in accordance with the legal structure of each company, and that one of its main responsibilities is to organize a clearly structured and transparent process of nominating the candidates to the board of directors of an enterprise where the State holds a 100% stake or a controlling stake, and to actively participate in the formation of boards of directors of all state-owned enterprises (Principle IIE2).

In the OECD countries, the State has long been playing a continually diminishing role in the direct management of state-owned companies while steadily tightening its control over their economic activities. Thus, in Denmark, Norway, the Netherlands and the UK, there are no government representatives in state-owned companies. In Sweden, Germany and Finland, there are no more than 2 government representatives on a company's board of directors.[1] The OECD members strive to implement efficient management, by the State, of the property of joint-stock companies by strengthening its control over their reporting procedures and financial indicators, as well as by regulating corporate relationships so as to promote transparency, accountability, and social responsibility.

In Russia, the State exercises its shareholder rights through the Federal Agency for State Property Management (Rosimushchestvo) (in certain cases, the RF Ministry of Defense and the Executive Office of the President of the Russian Federation), which acts on behalf of the Russian Federation, by appointing government representatives to the management bodies of joint-stock companies (boards of directors, general shareholder meetings), who participate in voting in the course of the decision-making process. On some issues (approval of the agenda of a general shareholder meeting, recommendations concerning the amount of dividends on shares, consent to a major transaction, etc.), representatives vote in accordance with the directives in the form of written instructions issued to each representative (or representatives) of shareholders about the specific actions that should be undertaken.[2]

This mechanism for managing the stakes held by the State is fraught with a number of problems. The directives are always drawn up on behalf of Rosimushchestvo, regardless of the branch ministry or government department that each joint-stock company is actually subordinate to. Because Rosimushchestvo by no means always knows in detail the state of affairs in each company, it usually does not issue directives to state representatives, thereby blocking the decision-making process or preventing state representatives from taking part in voting, and so the State cannot take full advantage of its opportunities to participate in a company's management.

The negative consequences of such distribution of powers could be mitigated by following Rosimushchestvo's practice of drawing up its directives on the basis of resolutions issued by the body of authority or administrative body responsible for each joint-stock company. However, this approach has not become a widespread practice – its application seems to be the exception rather than the rule.

Another problem is that the state representatives in the management bodies of joint-stock companies prefer not to participate in voting on those issues that can be voted without a prescriptive directive.

Although the existing approach to representing the interests of the State in the management bodies of joint-stock companies with RF stakes has its limitations, it is still too early, in order

---

[1] See *Bottaev A.Yu.* Foreign experience of corporate governance in state-owned companies // University Herald. No. 10. 2015. P. 165.

[2] See Decree of the RF Government No. 738 dated December 3, 2004 'On management of federal shares in joint-stock companies and the use of the Russian Federation's special right to participate in the management of joint stock companies ('golden share')' // Collection of RF legislation, December 13, 2004, No 50, p. 5073.

to promote the independence of company management in its decision-making, to abolish the procedure of issuing directives concerning specific issues on the agenda of board of directors' meetings. The board members can be liable for their actions under civil or criminal law. Meanwhile, the criteria for instituting guilt, integrity and reasonableness are still in their formative phase, and the board members, who sometimes make important decisions in the absence of sufficient information, will be forced to operate in an unregulated space, should the directives be abolished.[1]

The form of a directive, the timeline and procedure for its issuance need to be improved. One option could be a 'soft' directive - either a directive on a 'mandatory issue', that the State does not insist on being complied with, or a directive that outlines the desirable standpoint to be taken by a member of the board of directors, without going into specific details. Also, as a transitional measure, directives may be issued only for those biggest companies that under existing legislation are recognized to be 'strategic'.

6.2.4. Dividend policy

In 2017–2019, the dividend policy of companies was shaped under the influence of several economic, geopolitical and institutional factors.[2]

In October 2019, the Guidelines for the Fiscal, Tax, and Customs and Tariff Policy for 2020 and the 2021–2022 Planning Period were adopted, whereby a significant input into the non-oil and gas revenues of dividends of state-owned companies was envisaged. A gradual transition to the payment of dividends in the amount of 50% by state-owned companies is expected, in accordance with International Financial Reporting Standards (IFRS). The dividends to be received by the State should amount, in 2020, to RUB 760.6 billion; in 2021, to RUB 930.9 billion; and in 2022, to RUB 1076.8 billion, in other words, over the period in 2020–2022 they should increase by more than 40%.

As early as 2016, Government Directive No. 705-r dated April 18, 2016 was issued, whereby it was ordered that state-owned companies should pay dividends amounting to 50% of their net profit. That order was not implemented, but it largely determined the growth of dividend payments.

Thus, in 2018, the level of dividend payments by Gazprom PJSC doubled relative to 2017, increasing to RUB 393.2 billion. This is the historic high of the amount of dividends ever paid by the company: 27% of its profits in accordance with IFRS. The shareholders of Sberbank received 1.3 times more, the level of their dividends amounting to 43.45% of Sberbank's net profit for the previous year under IFRS. Rosneft's year-end indicators of 2018, including interim dividends, amounted to only RUB 274.6 billion; however, that indicator grew 2.5 times relative to 2017, amounting to exactly 50% of net profit under IFRS.[3]

On December 24, 2019, Gazprom PJSC approved its new dividend policy of a gradual transition, over a 3-year period, to a level of dividends amounting to 50% of its adjusted net profit under IFRS (in 2020, this index will be 30%; in 2021, 40%; in 2022, 50%). Previously,

[1] See *Osipenko, O.V.* Corporate control: expert problems of efficient management of subsidiaries. M.: Statute, 2014. Book. 2: Corporate control implementation.

[2] For further details, see *Abramov, A.E., Radygin, A.D., Chernova, M.I., Entov, R.M*. The 'dividend puzzle' and the Russian stock market. Part 1. Voprosy Ekonomiki. 2020;(1):66-92. (In Russian). Parts 1–2. // Voprosy Ekonomiki, 2020, No. 1, p. 66–92; 2020, No. 2, p. 59–85.

[3] *Gaydaev, V.* The RF Ministry of Finance chases away dividends. - Kommersant No. 98, July 6, 2019. URL: https://www.kommersant.ru/doc/3993002.

its dividends were paid under Russian Accounting Standards (RAS).[1] According to some estimates, under the previous scheme the State withdrew part of the income by raising taxes, thus bypassing the other shareholders.[2] Thus, in particular, in Q4 2018, a federal law was passed whereby the rate of mineral extraction tax (MET) for Gazprom was raised. According to RF Deputy Minister of Finance Ilya Trunin, this was done so as to compensate the RF budget for the loss of RUB 72 billion that Gazprom had not paid as dividends to the State as its main shareholder in 2017; RUB 72 billion equals almost 40% of Gazprom's total dividend payments for 2017. The negative aspect of the situation where MET is paid at a higher rate is that the controlling shareholder (the State) received it in lieu of dividends, thus effectively putting its priorities above those of the other shareholders, who receive reduced dividends.[3]

The new dividend policy is more transparent. However, no market response followed, because these principles had already been known.

Over the next few years, the level of dividend payments amounting to 50% of their net profit will be achieved, according to their plans, by Sberbank PJSC (by 2020)[4], Rosneftegaz PJSC[5], and Gazprom Neft PJSC (from 2020).[6]

According to the RF Ministry of Finance, by increasing dividends to 50%, it will not only become possible to boost government revenues and improve the quality of investment projects implemented by state-owned companies, as well as their capitalization, but also to create equal, competitive conditions across the economy. An artificial reduction of return on invested capital creates an unreasonable advantage for state-owned companies over private ones. Thus, for example, in Central and Eastern Europe, state-owned companies give their shareholders, on average, 70% of their profits.

The growth of companies' dividend payments was stimulated by the following factors:

1) improvement of the financial results of all exporters due to the ruble weakening and rising oil prices;
2) a revision of the dividend policy, followed by an increase in the payout ratio (MTS, Sberbank, Tatneft, Alrosa, RusHydro);
3) the majority of oil and gas companies doubled their dividends relative to the previous year. Thus, for example, LUKoil altered its dividend policy by determining that it would pay its shareholders at least 100% of the adjusted cash flow, which will be adjusted for interest payments and repurchase costs. In addition, dividends will have priority in terms of capital gains distribution. Until then, dividends amounted to 25% of net income under IFRS. In 2018, taking into account interim dividends, LUKoil paid 30% of its net profit. According to some forecasts, the expected dividend payments for 2019 will be the highest in the history of the company.[7]

[1] URL: https://www.gazprom.ru/press/news/2019/december/article496461/

[2] Razumnyi, E. Gazprom's board approved a new dividend policy. – Vedomosti, December 12, 2019.

[3] *Peskov, A.* Taxes against dividends. How the State passed over Gazprom shareholders. – URL: https://quote.rbc.ru/news/article/5b3f68f79a7947508aed57b7, 6.07.18.

[4] National Rating Agency. Analytical review 'Dividend payments of russian companies for 2013–2018'.– URL: http://www.ra-national.ru/ru/node/63468.

[5] Interview of RF Minister of Finance Anton Siluanov with Reuters – URL: https://www.minfin.ru/ru/press-center/?id_4=34789-intervyu_ministra_finansov_rossii_antona_siluanova_agentstvu_reuters.

[6] Gazprom Neft from 2020 to increase its dividends to not less than 50% under IFRS.– URL: https://finance.rambler.ru/markets/43662747-gazprom-neft-s-2020-goda-vyhodit-na-dividendy-ne-menee-50-ot-pribyli-po-msfo, 14.02.20.

[7] *Razymny E.* LUKoil disclosed the principles of its new dividend policy. - Vedomosti, 10.16.19.

When speaking about the **problems** associated with the dividend policies of Russian companies, it should be noted, first of all, that most companies still *do not pay dividends*. The reasons for their doing so include but are not limited to:

– attraction of investment from the market without using an open subscription offering; the reasons for this are the risks of raiding, and the low investment activity of the population;

– 'entrenched management', without significant shareholdings, but using various means to secure a high level of influence on company policy and turnover income, thus reducing or nullifying dividends;

– creation of a group of companies with cross-ownership of shares, transfer pricing, and an offshore profit center, with no need to pay dividends as a result.

All this translates into the orientation of businesses toward non-transparent business dealings, the lack of motivation for long-term investments, and mistrust of the authorities.

The next problem of the dividend policy of Russian companies is *their non-compliance with the minimum rate of return set by them for the payment of dividends*. A fixed rate of return floor has a positive effect on the shareholders' investment decisions; however, it is not uncommon for this rate to become just a formality which is subsequently not implemented, or a company may set a wide rate band for its dividends. Thus, for example, until December 2019, Gazprom PJSC followed this practice, by fixing its dividend rate in the range of 17–35% of RAS net profit.[1]

Quite often, we can observe a conflict of interests between majority and minority shareholders, when cash flows are directed so as to serve the interests of the former, i.e. to solve the problems faced by majority shareholders.

For shareholders and future investors, the problem is the frequency of dividend payments. As is well known, quarterly payments are the most common world practice, which allows shareholders to reinvest their dividends, and also testifies to the company's financial sustainability. In Russia, only a small number of biggest companies pay dividends every six months or in a quarterly basis (Tatneft PJSC, LUKOIL PJSC, Novatek PJSC, Rosneft PJSC, Gazprom Neft PJSC, NLMK PJSC, Severstal PJSC).

6.2.5. New technologies and corporate governance

Digitalization and Corporate Governance

The concept of a digital economy based on the transition of man, in his economic activity, to processing electronic bits (digital interaction) was formulated at the end of the 20th century. Its advantages are the virtuality of business linkages, lower need for raw materials and transport infrastructure, rapid global movements, etc.[2] It is believed that the transition to a digital economy will result from the fourth industrial revolution, or Industry 4.0.

In accordance with the official definition adopted in the Russian Federation, the digital economy refers to economic activities where the key production factor is digital data.[3] It is also

[1] URL: https://www.gazprom.ru/press/news/2010/october/article104767.

[2] See *Negroponte N.* Being Digital. New York: Alfred A. Knopf. 1995. 243 p.

[3] See Directive of the Government of the Russian Federation No 1632-r dated July 28, 2017 'On approving the Program 'Digital Economy of the Russian Federation'' // Collection of RF legislation, August 7, 2017. No 32. Art. 5138 (no longer effective due to the adoption of a new identically-titled national program, see Directive of the RF Government No. 195-r dated February 12, 2019 // Collection of RF legislation, February 25, 2019, No 8, Art. 803). Certificate of the National Program 'Digital Economy of the Russian Federation'. URL:

defined as an economy where economic activity is conducted using electronic or digital technologies, with an emphasis on goods, services and networks operated by electronic business and electronic commerce methods;[1] or, as economics multiplied by new technologies, primarily those capable of collecting, storing and transmitting huge data sets.[2]

To date, Russia has adopted a number of documents aiming at digitalization of the national economy,[3] including a law whereby, from October 1, 2019, digital rights have been made a new object of civil rights.[4] This innovation was necessary to prepare the Civil Code of the Russian Federation for the adoption of laws on digital financial assets (cryptocurrency and tokens) and crowdfunding (attracting investments through electronic platforms).[5]

In July 2017, the Program 'Digital Economy of the Russian Federation'[6] for the period until 2025 was launched, which further develops the main provisions of the 2017–2030 Strategy for the Development of an Information Society in the Russian Federation',[7] its ultimate goal being to boost Russia's competitiveness, quality of life, economic growth, and national sovereignty.

While speaking of digitalization of law, it should be noted that its 'machinizing' is impeded by the periodic deviation of legal norms from the laws of formal logic, and by the free will of man.[8] Thus, for example, the conversion into machine code of ambiguous terms will require either a huge number of reservations and exceptions, or a significant simplification of the terminology and, accordingly, legislation as a whole. In the latter case, simplification of legislation may translate into its tightening; without human intervention, that 'machinized law' can become a replica of totalitarian society's law. In most cases, artificial intelligence, when applied in law, should be treated as an auxiliary tool to identify contradictions, duplication, and lack of logic. However, a human must make the final decision on the application of a legal norm.

---

https://digital.gov.ru/uploaded/files/natsionalnaya-programma-tsifrovaya-ekonomika-rossijskoj-federatsii_NcN2nOO.pdf.

[1] See *Vaipan V.A.* Fundamentals principles of legal regulation in a digital economy // Law and Economics. 2017. No 11. P. 5–18. (In Russian).

[2] See *Aliev V.M.* Political and legal aspects of the transition to a digital economy in Russia // Russian Investigator. 2018. No 9. P. 48–52. (In Russian).

[3] See, for example, Executive Order of the President No 203 dated September 5, 2017 'On the 2017–2030 Strategy for the Development of an Information Society in the Russian Federation for 2017–2030' // Collection of RF legislation, May 15, 2017, No 20, Art. 2901; Decree of the Government of the Russian Federation of September 7, 2018 No. 1065 'On the Government Commission on Digital Development and the Use of Information Technology to Improve the Quality of Life and the Conditions for Doing Business' // Collection of RF legislation, September 17, 2018, No 38, Art. 5846; Decree of the Government of the Russian Federation No. 234 dated March 2, 2019 'On the management system for the implementation of the national program 'Digital Economy of the Russian Federation''// Collection of RF legislation, March 18, 2019, No 11, Art. 1119.

[4] Federal Law No. 34-FZ dated March 18, 2019 'On Introducing Alterations into Parts One, Two, and Article 1124 of Part Three of the Civil Code of the Russian Federation' // Collection of RF legislation, March 25, 2019, No 12, Art. 1224.

[5] Draft Federal Law No. 419059-7 'On Digital Financial Assets' // URL: https://sozd.duma.gov.ru/bill/419059-7.

[6] Directive of the Government of the Russian Federation No 1632-r dated July 28, 2017 'On approving the Program 'Digital Economy of the Russian Federation'' // Collection of RF legislation, August 7, 2017. No 32. Art. 5138 (no longer effective due to the adoption of a new identically-titled national program, see Directive of the RF Government No. 195-r dated February 12, 2019 // Collection of RF legislation, February 25, 2019, No 8, Art. 803).

[7] Executive Order of the President No 203 dated September 5, 2017 'On the 2017–2030 Strategy for the Development of an Information Society in the Russian Federation' // Collection of RF legislation, May 15, 2017, No 20, Art. 2901.

[8]See *Ivanov, A.A.* On the depth of law mechanization // Law. 2018. No 5. P. 35–41. (In Russian).

Corporate practice and law have not been standing aside from the digitalization process. As noted above, the issues related to corporate governance appeared alongside the first joint-stock companies. However, we may say that modern corporate governance was born with the adoption, in the UK in 1992, of the first Corporate Governance Code, or the Cadbury Code, when the Cadbury Committee on the Financial Aspects of Corporate Governance developed recommendations on best corporate governance practices. The Cadbury Code laid the foundation for other national codes and the international corporate governance principles. Together with the Sarbanes-Oxley Act of 2002 (OECD) and the Corporate Governance Principles of the OECD, the Cadbury Code gave rise, in the late 1990s and early 2000s, to a comprehensive system of principles and standards of corporate governance conventionally called *Management 1.0*.

The global financial and economic crisis of 2008 gave a new impetus to the revision and further development of corporate governance standards. As a result, experts began to actively exploit the concept of *Management 2.0* which, along with the involvement of employees in the corporate decision-making process, is characterized by the exclusively technological aspects of management that must be viewed in the context of informatization of economic activity. At the same time, inclusiveness increases in response to the growing digitalization of society in the form of the increasingly widespread big data processing technologies, dematerialization of productive assets, and the widespread use of digital activity formats, in other words, the emergence of a new digital economy.

Management 2.0 focuses on the accumulation of intangible assets, development of network formats for conducting economic activities, creation of corporate data sets not only for the purpose of reporting, but also with a view towards future development; all this will contribute to better long-term planning and the inclusion of shareholders and other related parties in the corporate decision-making process. Further digitalization of the economy, with an increasingly prominent role of artificial intelligence in management processes, may pave the path towards *Management 3.0*.

It should be noted that the active development of information technologies not only improves corporate governance, but also modifies its inherent potential for a conflict of interests, and produces qualitative changes in the information disclosure requirements, as well as in the information itself (on the activities of joint-stock companies). It is not yet clear whether corporate governance will become more rational as a result of these changes, or whether it will be necessary to deal with new conflicts and contradictions.[1]

Nevertheless, digitalization is becoming an integral part of corporate practices, and three degrees of its penetration into the activities of corporations and legislation can be distinguished.

First, *the ability to automate certain actions*. Thus, for example, an application for the purchase of issued securities can be submitted by an individual with a preemptive right to purchase additional shares and equity securities either by sending a signed written document to the registrar of the issuer, or by sending an electronic document signed by qualified electronic signature.[2] To make such an opportunity possible, no significant changes to corporate law will be required.

[1] See *Milovidov V.D.* Corporate governance 2.0: evolution of the system of corporate relations in an information society // National Strategy Issues. 2017. No. 4 (43). S. 171–189. (In Russian).
[2] Paragraph 3.1 of Article 41 of Federal Law No 208-FZ dated December 26, 1995 'On joint-stock companies' // The Russian Newspaper, No 248, December 29, 1995.

Second, *the execution of a specific action only in electronic form*. For example, the document flow between a registry holder and a nominee holder with a personal account.[1]

Third, *the system's transformation resulting from the introduction of information technology*. Here, we mean primarily a decentralized automated organization (hereinafter - DAO), which may be either part of a classical corporation or a fully virtual organization. Legal regulation of the activity of such an entity will require a significant transformation of legislation.

Thus, considering the impact of new technologies on corporate governance, we may speak of corporate governance digitalization *and* corporate governance in digital organizations.[2]

The elements of new technologies in corporate governance

Blockchain Electronic registries. Electronic document management. Electronic voting

In studies on the issues of digitalization in corporate practices, one of the central places is given to blockchain technology.[3] It is believed that this technology has many advantages and can reduce corporate risks due to its transparency and high reliability.

Blockchain is a decentralized database network and includes two components: asymmetric cryptography and Distributed Ledger Technology (DLT). The key benefits of blockchain technology are as follows: (1) creation of indelible electronic records; (2) value transfer as a result of updating these records; (3) the updates are automated. Blockchain can reduce the role of third parties, i.e., guarantors, intermediaries, etc.[4]

Blockchain technology is still suffering from some significant technical, operational, and scalability issues. The majority of up-to-date blockchain applications lack complete decentralization. Although blockchain systems are considered to be safe, this technology has not yet become widespread enough to be found reliable. Besides, there is also the problem of high costs associated with a switchover to constantly developing new technologies. And finally, a high degree of uncertainty has to do with the existing normative legal base for regulating blockchain and smart contracts. The blockchain system is in conflict with national regulatory requirements, and so the latter need to be upgraded across all jurisdictions. In addition, the current blockchain technology is too slow to cope with the current volume of operations.[5]

Blockchain technology can be applied in a variety of fields, although it should be noted that its implementation in Russia is progressing at a slow pace because of lack of relevant legislation. So, today this technology is developing only where there are no legislative constraints.

The imperfection of the mechanism for keeping records of corporate rights in joint-stock companies is the trigger of the majority of corporate disputes related to establishing the ownership structure of share capital.

---

[1] For more details, see Article 8.9 of Federal Law No 39-FZ dated April 22, 1996 'On the securities market' // The Russian Newspaper, No 79, April 25, 1996.

[2] See *Chekhovskaya S.A.* New contours of corporate law // Entrepreneurial Law. 2018. No. 3. P. 31–41. (In Russian).

[3] Blockchain projects are subdivided into financial (cryptocurrencies – e.g., bitcoin) and non-financial ones (data storage, distribution and transmission), which are the subject of our discussion here.

[4] See *Smirnov F.A.* Transformation of the global financial system: blockchain, smart contracts and over-the-counter derivatives // Auditor. 2017. No. 6. P. 49–54. (In Russian).

[5] See Technology and Corporate Governance. ECGI Roundtable, hosted by Allen & Overy. London. 26 November 2018. URL: https://ecgi.global/sites/default/files/technology_and_corporate_governance_1.pdf.

A shareholder list is kept and updated by the registrar in accordance with the Bank of Russia's requirements for shareholder record-keeping, whereby it is established that the list should be kept in the form of an electronic database. At the same time, the methods for storing the shareholder account data should ensure a correct and recoverable temporal sequence of events and all the entries on the list made by the registrar, as well as the ability to identify the individuals or software that made every entry or alteration thereto.[1] The registrar is obliged to carry out daily shareholder data backups. In this way, the regulator represented by the Bank of Russia seeks to reduce the risks of data loss and unlawful alterations to the shareholder list.

The use of a distributed database of records, which includes a blockchain, a database, and distributed ledgers, could minimize these risks. However, in order to achieve the desired result, it is first necessary to solve a number of issues, including the issue of reliable access to the Internet (it is not required for modern registries), i.e. the issue of digital inequality.

Another problem has to do with the authentication of the owner of shares (the issue of depersonalization), when the shares are recorded on a digital wallet that links the digital transaction to an IP address, and not to a certain individual – the subject of law.

The uniqueness of a distributed ledger results from the impossibility of interference by a third party. This raises questions as to what could be done in the event of a loss of the password to a digital wallet, and how to enforce court decisions.[2]

Electronic registries are not the only area where blockchains can be applied. Corporations with a complex organizational structure have a particularly complicated system of internal acts, the clarity of which ensures the organizational design and maintenance of a proper legal feedback. However, in actual practice, corporate acts often have flaws, contain contradictions, are not consistent with legislation, etc.

The measures outlined in the Program 'Digital Economy of the Russian Federation' in the part concerning corporations (an inventory of reporting forms and its optimization; elimination of excessive regulation; implementation of the principles of automatic data exchange between legal entities and government bodies, etc.) are designed to encourage companies to actively digitalize their legal bases. Although many companies already use electronic document management systems, the capabilities of the latter are limited.[3] A closed blockchain could contain all the information necessary for corporate governance (the charter, advisory legal norms, etc.). However, this system has a potential flaw – it may be impossible to delete or modify the data stored in the previous blocks, as only new data can be entered.[4]

Today, the most elaborate and well-substantiated products offered in the Russian market of corporate procedure services are the voting systems using blockchain technology (e-proxy voting). The possibility for applying this technology can be explained by fewer legislative constraints compared with other fields (the law does not prohibit the use of blockchains for voting, and does not create insurmountable obstacles to its application), a large number of

[1] See Article 8 of Federal Law No 39-FZ dated April 22, 1996 'On the securities market' // Collection of RF legislation, No 17, April 22, 1996, p. 1918; Bank of Russia Regulation No. 572-P, dated 27 December 2016, 'On the requirements for keeping the register of securities holders' (registered with the RF Ministry of Justice on February 15, 2017, No 45649) // Bank of Russia Bulletin No 25, March 1, 2017.

[2] See *Laptev, V.A.* Blockchain technology in the corporate compliance system // Law and Digital Economy. 2018. No. 2. P. 31–33. (In Russian).

[3] Workflow provides automation of local, corporate and business processes; ECM is corporate content management, CRM is customer relationship management. The modifications of these programs are also applied.

[4] See *Koroleva A.N.* Digitalization of local and corporate rulemaking by legal entities // Civil Law, 2018, No. 5. P. 16–18. (In Russian).

participants with equal rights, the simple confidentiality requirements, the finite set of possible alternatives in the voting process, and its autonomy.[1]

Blockchain can make the electronic voting by shareholders more transparent and reliable. The voting, in its turn, can help solve the problem of shareholder inclusion, reduce transaction costs, and give up the practice of costly in-person general shareholder meetings[2] (non-public companies have already been granted such an opportunity (Article 66.3 of the Civil Code of the Russian Federation)). Blockchains can also be used in other types of collective decision-making, for example, meetings of the board of directors or its committees, or board meetings.

However, the use of blockchain technology in corporate practice is also fraught with some problems. Blockchains can aggravate the problem of shareholder depersonalization, create the illusion of their involvement in the corporate affairs, while in reality it is intermediaries, with their own vested interest, who would be acting for them in the course of electronic voting.

Artificial Intelligence

At the current level of technology development, artificial intelligence can play only a limited role in corporate governance. It is quite capable of handling simple issues, but not the complex ones that are frequently dealt with in corporate governance practices. To be able to solve complex problems, artificial intelligence progress so as to come close to human intellect, and this means that because the conflicts typically occurring in human relationships are not going to disappear, there will be little sense in introducing artificial intelligence in that field.

The presence of artificial intelligence cannot rule out all conflicts. Thus, in the classic corporate governance model, there can arise the agency problem, when managers put their interests above the interests of shareholders. With the introduction of artificial intelligence, the danger of someone acting in his own interests to the detriment of shareholders *comes from the program developers*. There is also the possibility that artificial intelligence may act contrary to the corporation's interests if it is capable of functioning independently both of its creator and customer. Thus, artificial intelligence, while providing solutions to some problems, can give rise to others.

Today, the artificial intelligence issues have become the focus serious attention in foreign countries,[3] where one can already observe some examples of it being applied in corporate governance. Thus, for example, Deep Knowledge Ventures introduced the computer algorithm Vital (Validating Investment Tool for Advancing Life Sciences) as an unofficial director participating in the board decision-making. Vital processed huge amounts of data and quickly provided optimal solutions in matters relating to investments in certain projects, and the directors relied heavily on these solutions.

Depending on whether such a robot is used as a consultant, as in the described example, or is assigned an official director status, the question as to the scope of its liability for the losses incurred as a results of its decision and the scope of responsibility should also be properly settled.

---

[1] See *Novoselova L., Medvedeva T.* Blockchain for shareholder voting // Economy and Law. 2017. No 10. P. 10–21.

[2] See Articles 47-63 of Federal Law No 208-FZ dated December 26, 1995 'On joint-stock companies' // The Russian Newspaper, No 248, December 29, 1995.

[3] See, for example, Horizon 2020, the European Union's research and innovation program.

In Russia, electronic services for shareholders are rarely used in corporate governance systems (such services were introduced, for example, by VTB Registrar, the National Settlement Depository, Independent Registrar Company JSC, and R.O.S.T. Registrar).

A new algorithm based approach to the selection of candidates to the board of directors is also being developed.[1] Compared with the traditional procedures, algorithms can overcome the negative consequences of cognitive distortions and thus improve the management performance level.

At present, the process of electing a board of directors often results in a situation where the directors turn out to be well-known personalities (as a rule, they are male and have extensive connections with the company's past and current management, as well as some financial experience), but this by no means always is the best option from the point of view of the interests of shareholders. The algorithm based approach to the board selection will make it possible to expand the list of candidates and identify those of them who possess the necessary skills for a successful director, but who would not be considered as such in the usual approach. The directors who are not 'old buddies' of the management are more likely to exercise proper control over it, and also to be able to express their different and potentially more useful opinions about corporate policies.

However, the application of an algorithm is not without its drawbacks, and if a director is chosen solely on the basis of an algorithm, some of the candidates' characteristics that are valuable for the management, such as their industry knowledge, can be overlooked, thus resulting in less than perfect decisions. In this connection, it is suggested that the tools based on algorithms should be used only as auxiliaries, not replacing, but only complementing human judgment in the course of decision-making.

Platforms and Virtual Corporations

Corporations in their traditional most common form are characterized by centralized power and a clear hierarchy. The State provides them with an appropriate political and legal environment that allows such corporations to operate efficiently. Corporate law and corporate governance are designed to support businesses that are organized in this way. However, the problem faced by centralized organizations is their slow, cumbersome and costly decision-making process in a rapidly changing consumer-oriented economy.

New technologies are undermining the 'old world'. By triggering changes in the practices and thinking of modern society, they give rise to more flat decentralized organizations (Facebook, Twitter, Uber, Airbnb, Spotify, etc.), which attract customers by their speed and ease of use.

All the most successful companies of the digital age strive to create an open corporate culture without intermediaries, based on technology, data and algorithms. A technology-driven business culture helps companies maintain their high profile in the digital network market, by developing and redesigning products and services that continuously deliver customer satisfaction. Advanced companies understand that in order to achieve this goal, they need to introduce new technologies in every aspect of their organization and management.

---

[1] See *Erel I., Stern L.H., Tan C., Weisbach M.S.* Selecting Directors Using Machine Learning (May 12, 2019). Fisher College of Business Working Paper No. 2018-03-005; European Corporate Governance Institute (ECGI) – Finance Working Paper No. 605/2019. URL: https://ssrn.com/abstract=3144080.

Modern companies use new technologies to create for all their stakeholders a more decentralized and inclusive corporate culture without intermediaries. This culture provides the companies with competitive advantages in attracting talent, capital, suitable partners, and maintaining relevance in the hyper-competitive global markets. As a result, there is a widening gap between traditional regulatory models and the more modern forms of business organization.[1]

A. Platforms

The digitalization of the economy has spawned new business models that rely on a combination of digital platforms, telecommunication technologies, and the commercial operations based on such technologies.

The emergence of platform companies, which are both virtual and real places, has become one of the significant developments in the economy over the past two decades. The term ‘platform’ is usually associated with a technology company, i.e. a company that uses a social platform (Facebook, Instagram), an ‘exchange’ platform (Amazon, Airbnb, Uber), a content platform (YouTube, Medium, Netflix), a ‘software’ platform (GE’s Predix), or a blockchain platform (Ethereum, EOS). Each platform, by using digital networking technologies, creates value when it facilitates the exchange between two different but interdependent groups (for example, groups of friends (Facebook, Instagram), content providers and consumers (YouTube, Medium, Netflix), service providers and users (Amazon, Airbnb, Uber), in the end generating profit for themselves, i.e. for their owners - shareholders in the platform.

Interconnected technologies like the Internet, which rely on code-based algorithms, personal computers and smartphones, have boosted the popularity of platforms, facilitating the rapid and widespread exchange of products and information through decentralized networks without traditional intermediaries. Thus, it has become possible to create global ecosystems that encourage their registered users and content consumers to add value to the platform by constantly creating their own content, which in its turn attracts new content creators and consumers (network effects).

It should be noted that the use of the platform model goes beyond the technology sector. Thus, many traditional retailers are moving their product distribution channels from ‘physical’ stores to online platforms. Meanwhile, new technologies are a key element in any platform business. Any company seeking to function as a platform must act as if it were a technology company.

The common feature of all platform companies is the organization of their internal operations in such a way that cooperation between many related parties (managers, employees, investors,

[1] See *Fenwick M., Kaal W.A., Vermeulen E.P.M.* Why ‘Blockchain’ Will Disrupt Corporate Organizations (August 7, 2018). Lex Research Topics in Corporate Law & Economics Working Paper No. 2018-3; U of St. Thomas (Minnesota) Legal Studies Research Paper No. 18–17; European Corporate Governance Institute (ECGI) – Law Working Paper No. 419/2018. URL: https://ssrn.com/abstract=3227933; *Fenwick M., McCahery J.A., Vermeulen E.P.M.* The End of ‘Corporate’ Governance: Hello ‘Platform’ Governance (August 16, 2018). Lex Research Topics in Corporate Law & Economics Working Paper No. 2018-5; European Corporate Governance Institute (ECGI) – Law Working Paper No. 430/2018. URL: https://ssrn.com/abstract=3232663; *Fenwick M., Vermeulen E.P.M.* Technology and Corporate Governance: Blockchain, Crypto, and Artificial Intelligence (October 9, 2018). Lex Research Topics in Corporate Law & Economics Working Paper No. 2018-7; European Corporate Governance Institute (ECGI) – Law Working Paper No. 424/2018. URL: https://ssrn.com/abstract=3263222.

consumers, developers, etc.) generates continuous innovation in the platform's activities and the products and services being produced.

Today, not only businesses, but also governments, investors, charitable organizations, etc. are experimenting with platform thinking. Among its main advantages, they often point out cost saving resulting from the elimination of intermediaries, as well as higher transparency. Besides, platforms also contribute to individual self-realization and creativity by providing people with a new and safe environment.[1]

<u>B. Virtual corporations</u>

Modern corporations are centralized and hierarchical, and corporate governance aims at maintaining such a structure. However, with the advent of new technologies, it has become possible to use automation solutions for managerial functions, the development of which has been underway since the 1970s. One of these solutions is the Decentralized Autonomous Organization (DAO), fully formalized by a smart contract.[2, 3] So, for example, a digital organization that unites participants (i.e. shareholders) who have joined it through the acquisition of tokens[4] (i.e. shares) can be considered to be a joint-stock corporation, which also needs its own management rules. It is possible, to a certain extent, for it to apply the existing principles and rules of corporate governance, especially those based on the comply-or-explain approach, which can also be suitable for digital organizations, in particular an analogue of a board of directors. This issue, as well as a number of other issues - the legal status of a DAO (is it, or not, just an autonomous code operated independently of legal systems);[5] the high degree of uncertainty[6] associated with a decentralized system; or the jurisdiction of digital organizations, etc., are yet to be resolved.

Hitachi was one of the first companies to attempt the 'industrial' implementation of DAOs by proposing, in 2016, the concept of autonomous decentralization.[7] Essentially, it means the creation of systems with a high degree of reliability and extensibility, where the subsystems exchange real-time information by using controlled equipment, so that each subsystem can work autonomously. This concept has been practically implemented on the basis of the control systems used in the transport sector and steel industries. It was intended to implement that idea on a systemic level and to achieve company-wide optimization of value creation, including other companies, through joint analysis and use of information up to the management level.

[1] See *Fenwick M., Kaal W.A., Vermeulen E.P.M.* Why 'Blockchain' Will Disrupt Corporate Organizations (August 7, 2018). Lex Research Topics in Corporate Law & Economics Working Paper No. 2018-3; U of St. Thomas (Minnesota) Legal Studies Research Paper No. 18–17; European Corporate Governance Institute (ECGI) – Law Working Paper No. 419/2018. URL: https://ssrn.com/abstract=3227933.

[2] See *Chekhovskaya S.A.* A new outline of corporate law // Entrepreneurial Law. 2018. No. 3. P. 31–41. (In Russian).

[3] A smart contract is an algorithm whereby a set of conditions is laid down, the fulfillment of which serves as the basis for making a transaction. Blockchain provides an opportunity to verify that the transaction participants have fulfilled the obligations set forth in a smart contract.

[4] With this approach, tokens are considered to be an investment asset, and not a means of payment.

[5] It should be noted that in the USA, the DAO is treated as a virtual organization whose activities fall under the requirements of federal securities laws.

[6] The risk of uncertainty of investing in DAOs associated with the possibility of the system being changed at any time by any participant conducting operations in it.

[7] See Hitachi Integrated Report 2016 // URL: https://www.hitachi.com/IR-e/library/integrated/2016/ar2016e.pdf.

The ultimate goal is to use the concept as a basis for creating platforms that share value by combining different systems.[1]

Also in 2016, the first DAO was created, which was an alternative investment platform. It had no physical address because it was a computer code - an organization of a corporate type without a traditional centralized management system, which used blockchain technology and smart contracts. It was assumed that a computer code was better suitable for running the organization than people, because the latter do not always follow the rules.

There were no directors, managers, or employees in the DAO. The management system was based on the software, computer code and smart contracts that used the Ethereum public decentralized blockchain platform. This automated system provided DAO participants with real-time direct control over the funds deposited and the ways these funds were being distributed. Anyone could become a member of the DAO by buying its tokens. The DAO attracted more than $ 150 million from about 10,000 investors. DAO tokens were fully transferable and could be traded like shares in a traditional listed corporation. A number of smart contracts granted the token holders a voting right. Thus, a blockchain-based smart contract imitated a company's charter. Because the code of the DAO was open-source, the token holders could vote for any changes made to the code, which ensured transparency and security.

Among the advantages of the DAO over a traditional corporation, one can name its cheapness and the simplicity of its creation, which can translate into increased competition. The distributed and anonymous nature of a decentralized autonomous organization prevents the emergence of natural and political monopolies.

Although the flaws in the DAO code made it possible for hackers to withdraw a third of its funds, this does not mean the end of such organizations. In 2017, the creator of the DAO announced the launch of a new decentralized autonomous organization in the field of non-profit and charitable activities, which should pave the way for further development of corporate organizations on the blockchain platform.[2]

Thus, new technologies are actively penetrating corporate practices. Digitalization influences not only some minor elements of corporate activities (electronic registers, voting, etc.), but also begins to radically change the structure of corporations (platform and virtual organizations).

In spite of the imperfection of the existing blockchain and artificial intelligence technologies, they are gradually being introduced into corporate management due to their potential advantages. Platforms are becoming widespread, virtual corporations are evolving. Digitalization is progressing at an increasingly faster pace, and legislators have to catch up with this process, pre-calculate its possible directions and the associated risks in order to timely elaborate an appropriate regulation. It seems that in the digital world, where speed and flexibility come to the fore, laws alone will not be enough, and the comply-or-explain principle will become the mainstay of regulation. It should be noted that the Russian Corporate

---

[1] Symbiotic Autonomous Decentralized Platforms for Faster Fusion of Control and Information // Hitachi Review Vol. 65 (2016), No. 5. P. 9.

[2] See *Fenwick M., Kaal W.A., Vermeulen E.P.M.* Why 'Blockchain' Will Disrupt Corporate Organizations (August 7, 2018). Lex Research Topics in Corporate Law & Economics Working Paper No. 2018-3; U of St. Thomas (Minnesota) Legal Studies Research Paper No. 18–17; European Corporate Governance Institute (ECGI) – Law Working Paper No. 419/2018. URL: https://ssrn.com/abstract=3227933.

Governance Code is already based on this approach. We can also note that legislators must not actively intervene in the ongoing digitalization processes until they gain a more comprehensive understanding of those processes, as well as their own role in the new world.

* * *

In 2017–2019, the most problematic issue in the field of legal regulation of corporate governance in Russian companies remained the function of the board of directors. The least observed principles were those of electing an independent director to chair the board of directors or appointing a senior independent director selected from among the independent directors; those of adopting a decision by a qualified majority or a majority of all elected members in the board of directors, or setting up a remuneration committee composed of independent directors; and the principles of performance assessments of the board of directors, its committees, and each of its members.

An analysis of the activities of state-owned companies also revealed that among the least observed principles, there was the principle whereby the board of directors was obliged to create committees for a preliminary consideration of the most important issues pertaining to the company's activities (paragraph 2.8); and principle 2.4, in the part whereby it is recommended that independent directors should constitute at least 1/3 of the elected members of the board of directors, and the part whereby independent directors are obliged to play a key role in preventing internal conflicts in the company and in executing significant corporate actions.

Our analysis highlighted the following problem areas in the activities of state-owned companies:

– a meeting of the board of directors cannot be convened by shareholders;

– the proportion of in-person meetings of the board of directors and its committees is low, although absentee ballots take place quite often (sometimes several times a week);

– the item titled 'miscellaneous' is sometimes put on the board of directors' agenda which, because its content is not specified, is fraught with the risk of some significant issue being considered without proper notice to all the board members. The dates for decision-making on absentee voting and for voting on such an agenda almost always coincide. The very limited time assigned for preparing for such voting may prevent the adoption of a well-considered decision by the board of directors;

– the recommendations of the CGC concerning the need to ensure a qualified majority in the board of directors or the majority of its elected members on important issues (less than half of the issues belonging to the category of the most important ones under the CGC) are not implemented in full. This also gives rise to the risk of poor decision-making on significant issues;

– a number of problems have to do with the limited powers of the board of directors, for example, the powers of the board of directors do not include their right to appoint, or to dismiss prior to their term of office expiry date, the president or chair of the company's board, or their right to form the management bodies of relevant companies controlled by the core company, or the right to review the budget of the internal audit subdivision and determine the remuneration to its head, etc.;

– the reports on the board of directors' decisions do not disclose the voting results and roll-call of board members in the event of absence of unanimity;

– there is no transparent remuneration system for the board of directors' members;

– most often, the schedule of the board of directors is arranged so that they predominantly consider the proposals put forth by the company's management, and discuss the issues suggested by the board members; while the option of forming their own standpoint on issues that have to do with their competence and responsibility (with due regard for the proposals by the management), including the elaboration of joint proposals and various decision-making scenarios, is not commonly observed, and it only happens in some cases;

– some questions arise with regard to insuring the liability of the members of the board of directors because on the one hand, the insurance, among other things, provides a compensation for losses that otherwise would have been difficult to recover from an individual, while on the other, it may translate into an unjustifiably risky stance of the management in the course of their decision-making.

The problems that have to do with the implementation of government directives are as follows: the non-transparency of the system for appointing state representatives in the management bodies of a joint stock company, the system of distribution of powers with regard to the issuance of directives, and the tendency of the government representatives in the management bodies of companies not to participate in voting on those issues that can be voted without a mandatory directive.

As far as the dividend policy of Russian companies over the period 2017–2019 is concerned, there was an increase in the amount of dividends paid both by state-owned companies and by some private companies. The reasons behind that trend were the government policy towards state-owned companies, the lack of interest on the part of the companies in investing their funds, etc. Among the problems associated with the dividend policy, there are the continuing non-payment of dividends by most companies, their non-compliance with the minimum rate of return set by them for the payment of dividends, a conflict of interests between majority and minority shareholders, when cash flows are directed so as to serve the interests of the former; as well as the frequency of dividend payments, which often makes their reinvestment impossible.

New technologies are actively penetrating corporate practices, and legislators have to catch up with this process and to pre-calculate its possible directions and the associated risks in order to elaborate an appropriate regulation in a timely manner. It seems that in the digital world, where speed and flexibility come to the fore, laws alone will not be enough, and the comply-or-explain principle will become the mainstay of regulation. We may also note that that legislators must not actively intervene in the ongoing digitalization processes until they gain a more comprehensive understanding of those processes, as well as their own role in the new world.

As has already been noted, Russia has currently adopted and is implementing hybrid regulation based on the comply-or-explain approach, and this choice seems to be quite correct because it is consistent with the interests of companies.

However, in order to apply this method, the regulator should be properly prepared. The RF Central Bank is developing the necessary normative documents, but does not hamper companies by unduly interfering with their activities, which seems to be a reasonable decision during this phase of the Code's implementation. Special attention should be paid to the quality of explanations provided by companies, because at present, the Bank of Russia is obliged to identify the reasons for the low quality of these explanations, and not the reasons for companies' non-compliance with the provisions of the Code. In the near future, it will become necessary to proceed from reviewing their formal reports to assessing their actual corporate governance practices, and this is a very complex process, the implementation of which will require a lot of resources.

On the whole, the formal regulatory model that so far has been established in Russia (in the form of hard law, represented by the RF Civil Code and the Federal Law 'On joint-stock companies'; and also soft law, represented by the CGC) is no worse and no better than any other national model, including the OECD members and the EU. As in other developed and developing countries of the world, it follows its own historical traditions, covers all significant areas of corporate governance, and has its pros and cons, which largely can be regarded as a matter of taste.

The principal question in the context of our discourse on corporate governance quality improvement is concerned with the steps that should be taken next. The easiest way would be to follow *the path of formal, or inertial, improvement*, which will entail, in particular:

– some minor cosmetic amendments to the legislation on joint-stock companies (for example, the corporate law development project, launched in 2018 by the RF Ministry of Economic Development);

– simulation activities aimed at implementing the provisions of the Corporate Governance Code (monitoring of private and state-owned companies, increased administrative pressure on companies to improve their indicators, etc.);

– academic discussions (for example, on the controversial nature of the Russian model of board of directors/supervisory board, or on the panacea in the form of independent directors).

However, here we come across an objective qualitative limit to development. As the authors have repeatedly noted, Russia has developed a strictly majoritarian model of shareholding ownership and corporate governance, where the classical corporate governance system of checks and balances that gives consideration to the interests of all parties does not actually work. For obvious reasons, this is even more typical of companies with significant state stakes, where the strategic and fiscal interests of the State can radically diverge from those of private minority shareholders.

The external factors of corporate governance are also of great importance. Any serious qualitative changes at the micro level can be possible only in adequate financial, economic and institutional conditions (the situation in the Russian stock market, the general institutional environment, the incentives for foreign and internal investment, etc.). The anti-Russian economic sanctions and their possible long-term character have become an additional negative incentive for Russian companies to achieve some real progress in their compliance with the civilized principles and best practices of corporate governance.