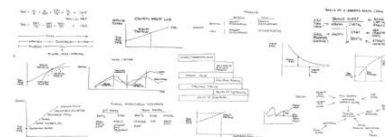


Corporate Governance

Part 1

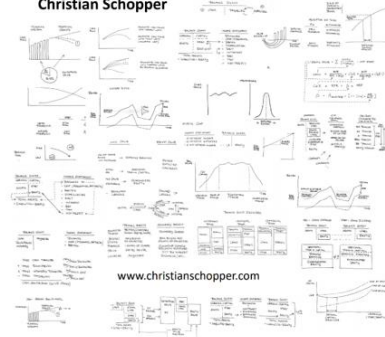
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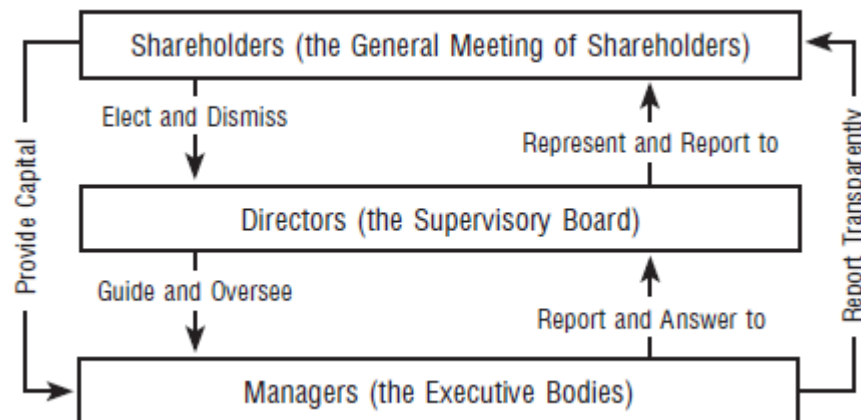
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AN INTRODUCTION TO CORPORATE GOVERNANCE

Corporate Governance Explained

Defining Corporate Governance

- Corporate governance is a **system of relationships**, defined by structures and processes
- These relationships may involve parties with different and sometimes **contrasting interests**
- All parties are **involved in the direction and control of the company**
- All this is done to properly **distribute rights and responsibilities** — and thus **increase long-term shareholder value**



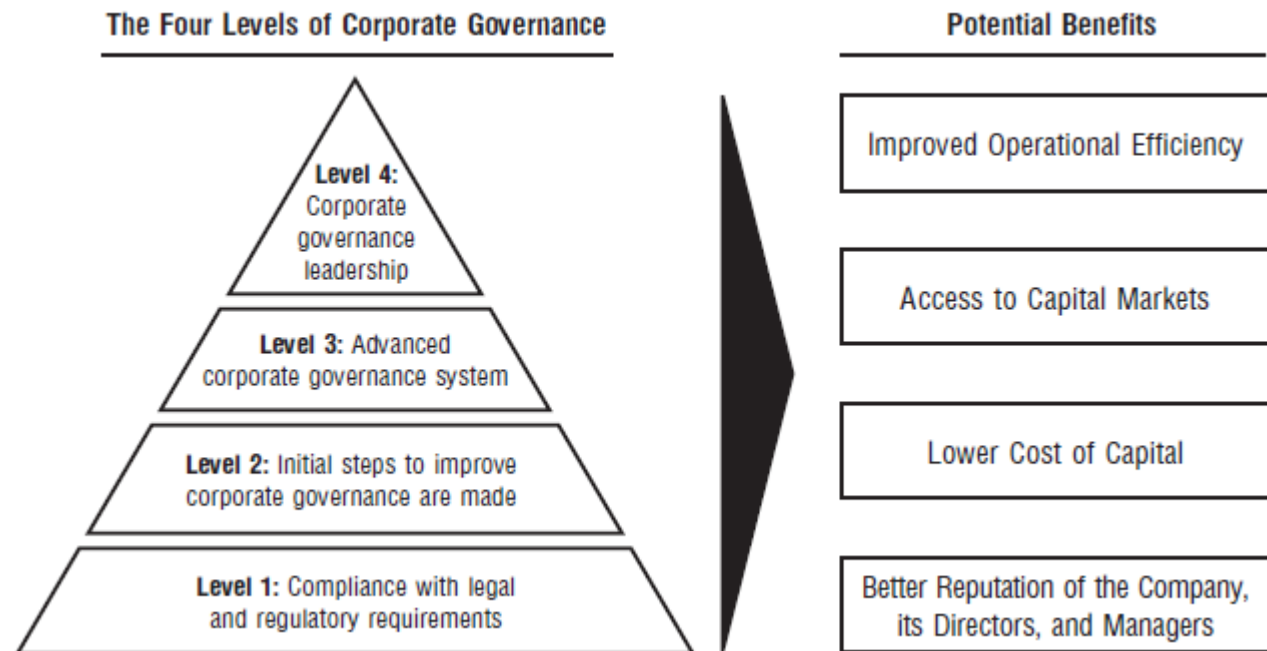
The Role of Stakeholders

- The role of stakeholders in governance has been debated in the past, ...
- ... with some arguing that stakeholders have no claim on the enterprise other than those specifically set forth in law or contract
- Others have argued that **companies fulfill an important social function**, have a societal impact and must, accordingly, act in the broad interests of society

Best Practices: A key aspect of corporate governance is concerned with ensuring the flow of external capital to firms. Corporate governance is also concerned with finding ways to encourage stakeholders to undertake socially efficient levels of investment in firm-specific human and physical capital. The competitiveness and ultimate success of a corporation is the result of teamwork that embodies contributions from a range of resource providers including investors, employees, creditors, and suppliers. Corporations should recognize that the contributions of stakeholders constitute a valuable resource for building competitive and profitable companies. It is, therefore, in the long-term interest of corporations to foster wealth-creating co-operation among stakeholders. The governance framework should acknowledge that the interests of the corporation are served by recognizing the interests of stakeholders and their contribution to the long-term success of the corporation.⁵

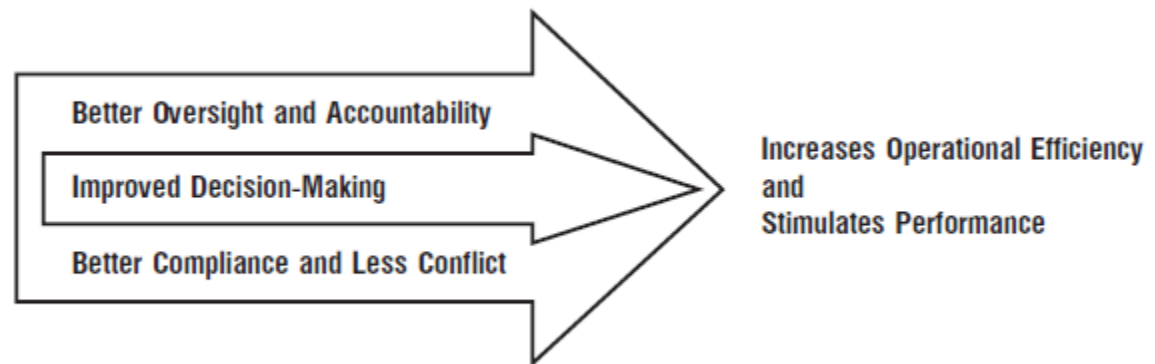
The Business Case for Corporate Governance

Levels and Potential Benefits of Good Corporate Governance

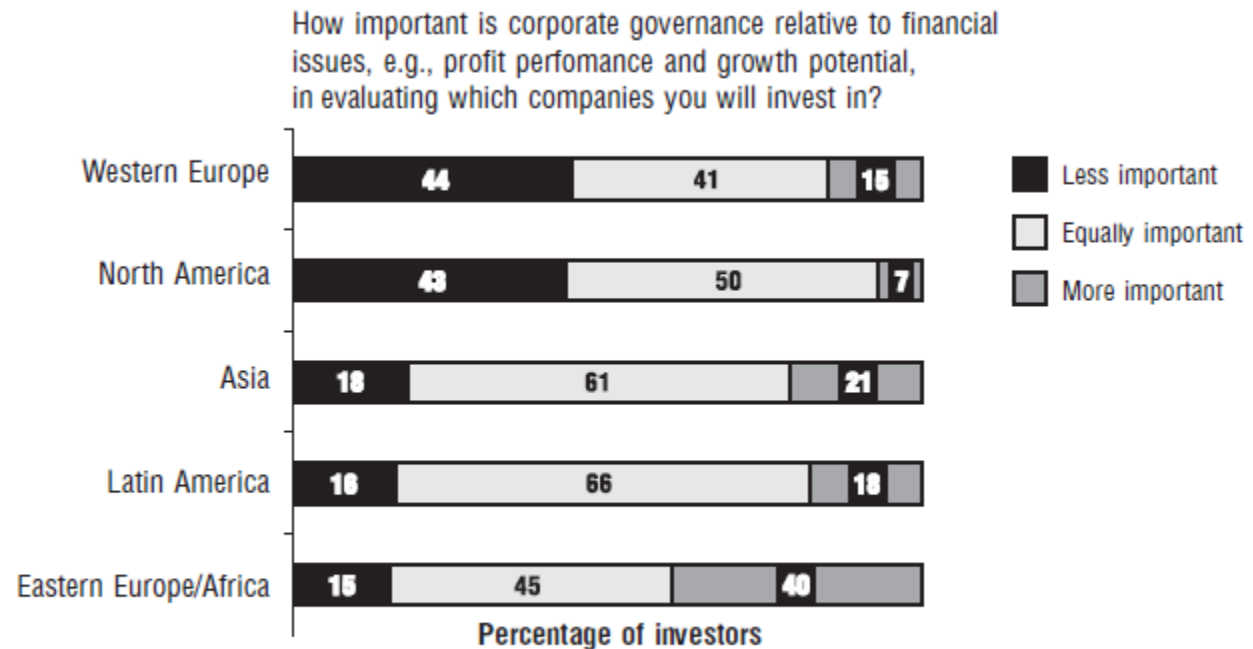


Stimulating Performance and Improving Operational Efficiency

- There are several ways in which good corporate governance can **improve performance and operational efficiency**



Improving Access to Capital Markets



Governance remains important compared to financials, particularly in emerging markets

Lowering Cost of Capital and Raising the Value of Assets

Willingness to pay amongst investors in order to comply with established principles for good corporate governance

Answers from investors, %

■ No
■ Yes



Average premium investors are willing to pay, %



Building a Better Reputation

- A company's reputation and image effectively constitute an **integral**, if intangible, **part of its assets**
- Good corporate governance practices contribute to and improve a company's reputation
 - Thus, those companies that respect the rights of shareholders and creditors, and ensure financial transparency and accountability, will be regarded as being an ardent advocate of investors' interests
- As a result, such companies will enjoy **more public confidence and goodwill**
- This public confidence and goodwill can lead to **higher trust** in the company and its products, which in turn may lead to higher sales and, ultimately, profits
- A company's positive image or goodwill is moreover known to play a significant role in the **valuation** of a company
 - Goodwill in accounting terms is the amount that the purchase price exceeds the fair value of the acquired company's assets
 - It is the premium one company pays to buy another

The Cost of Corporate Governance

The Cost of Corporate Governance

- Good governance entails real costs
 - Some of the costs include hiring dedicated **staff** such as corporate secretaries, experienced and independent directors, internal auditors, or other governance specialists
 - It will likely require the payment of fees to **external counsel, auditors, and consultants**
 - The costs of **additional disclosure** can be significant as well
 - Furthermore, it requires considerable **managerial and Supervisory Board time**, especially in the start-up phase
- These costs tend to make implementation considerably **easier for larger companies** that may have the resources to spare than smaller companies whose resources may be stretched quite thin
- A company will not always see instant improvements to its performance due to better corporate governance practices
 - However, returns, while sometimes **difficult to quantify**, generally exceed the costs in particular over the long term
- Finally, it must be noted that corporate governance is **not a one-time exercise but rather an ongoing process**

A Brief History

- 1600s: The **East India Company** introduces a Court of Directors, separating ownership and control (U.K., the Netherlands)
- 1776: **Adam Smith** in the «Wealth of Nations» warns of weak controls over and incentives for management (U.K.)
- 1844: First Joint Stock Company Act (U.K.)
- 1931: **Berle and Means** publish their seminal work «The Modern Corporation and Private Property» (U.S.)
- 1933/34: The Securities Act of 1933 is the first act to **regulate the securities markets**, notably registration disclosure. The 1934 Act delegated responsibility for enforcement to the SEC (U.S.)
- 1968: The EU adopts the first **company law directive** (EU)
- 1987: The **Treadway Commission** reports on fraudulent financial reporting, confirming the role and status of audit committees, and **develops a framework for internal control**, or COSO, published in 1992 (U.S.).
- Early 1990s: Polly Peck (£1.3bn. in losses), BCCI and Maxwell (£480m) **business empires collapse**, calling for improved corporate governance practices to protect investors (U.K.)
- 1992: The **Cadbury Committee** publishes the first code on corporate governance; and in 1993, companies listed on **U.K.'s Stock Exchanges** are required to disclose governance on a «comply or explain» basis (U.K.)
- 1994: Publication of the **King Report** (S. Africa)
- 1994, 1995: **Rutteman** (on Internal Control and Financial Reporting), **Greenbury** (on Executive Remuneration), and **Hampel** (on Corporate Governance) reports are published (U.K.)
- 1995: The Russian **Law on Joint Stock Companies** is adopted (Russia)
- 1995: Publication of the **Vienot Report** (France)
- 1996: Publication of the **Peters Report** (the Netherlands)
- 1996: The Russian **Law on Securities Market** is adopted (Russia)
- 1998: Publication of the **Combined Code** (U.K.)
- 1999: OECD Publishes the first international benchmark, the **OECD Principles of Corporate Governance**
- 1999: Publication of the **Turnbull** guidance on internal control (U.K.)
- 2001: The Russian **Law on Joint Stock Companies** is significantly amended (Russia)
- 2001: **Enron Corporation**, then the seventh largest listed company in the U.S., declares bankruptcy (U.S.)
- 2001: The **Lamfalussy** report on the Regulation of European Securities Markets (EU) is published
- 2002: Publication of the **German Corporate Governance Code** (Germany)
- 2002: Publication of the **FCSM Russian Code of Corporate Conduct** (Russia)
- 2002: The **Enron collapse** and other corporate scandals lead to the **Sarbanes-Oxley Act** (U.S.); the **Winter** report on company law reform in Europe is published (EU)
- 2003: The **Higgs** report on non-executive directors is published (U.K.)
- 2004: The Parmalat scandal shakes Italy, with possible EU-wide repercussions (EU).

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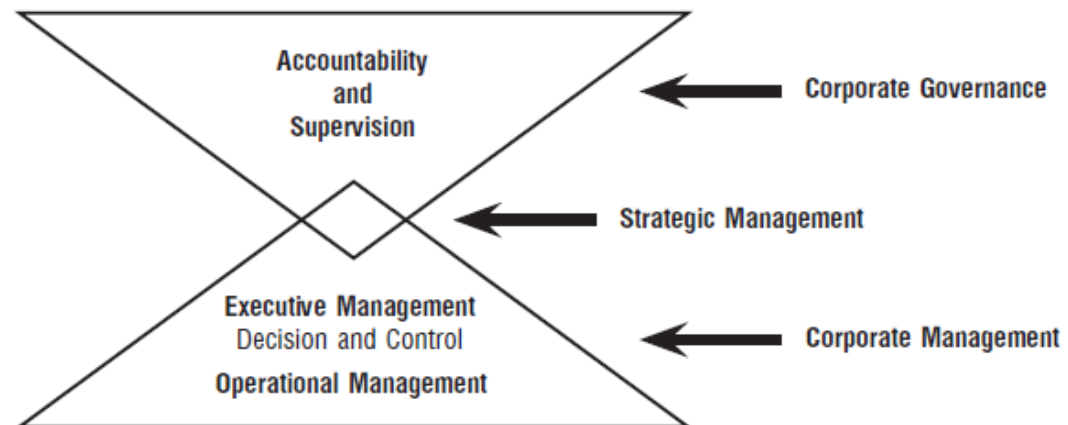
The International Scope of Corporate Governance

The OECD corporate governance framework is built on four core values:

- **Fairness**
 - The corporate governance framework should **protect shareholder rights and ensure the equitable treatment of all shareholders**, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violations of their rights
- **Responsibility**
 - The corporate governance framework should recognize the rights of stakeholders as established by law, and **encourage active co-operation between corporations and stakeholders** in creating wealth, jobs, and the sustainability of financially sound enterprises
- **Transparency**
 - The corporate governance framework should ensure that **timely and accurate disclosure** is made on all material matters regarding the company, including its financial situation, performance, ownership, and governance structure
- **Accountability**
 - The corporate governance framework should ensure the **strategic guidance** of the company, the effective **monitoring of management by the board**, and the board's accountability to the company and shareholders

Distinguishing Corporate Governance

The Activities of Governance and Management Compared



THE GENERAL GOVERNANCE STRUCTURE OF A COMPANY

What Is a Joint Stock Company?

The Definition of a Company

A company can be defined as

- A **commercial entity**,...
- ... whose charter **capital** is **divided** into a specified number of shares, ...
- ... certifying the company participants' (**shareholders**') **rights** in relation to the company
- Companies are the only legal entities that can **issue shares**
- The shareholders are normally **not liable for** the company's **obligations**
- Their **risk** is **limited to the loss of** the **value of the shares** they hold in the company

Open and Closed Joint Stock Companies

	Open Companies	Closed Companies
Number of Shareholders²⁸	No limit.	Maximum of 50.
Minimum Charter Capital²⁹	100,000 RUB	10,000 RUB
Issuance of Shares³⁰	Open subscription. A closed subscription is permitted unless the charter or legislation provides otherwise.	Closed subscription (only among founders or other pre-determined groups of persons). Cannot issue shares through an open subscription.
Transferability of Shares³¹	No restrictions. Neither the consent of other shareholders nor the company is required.	Restricted. Other shareholders (and the company, if specified by the charter) have a right of first refusal.



Open and Closed Joint Stock Companies (cont'd)



	Open Companies	Closed Companies
Supervisory Board³²	Mandatory for an open company with 50 or more shareholders with voting rights.	Voluntary.
Disclosure³³	The company must disclose a wide range of information regarding its financial position and operations.	The company must disclose certain information if it issues bonds or other securities to the public. Otherwise, no legal requirements to publicly disclose information.

Advantages of Open Joint Stock Companies

Legal Forms of Commercial Entities

- Russian law allows for the establishment of the following **types of commercial entities**:
 - Production cooperatives;
 - General partnerships;
 - Limited partnerships;
 - Limited liability companies;
 - Joint stock companies (open or closed); and
 - Additional liability companies

Advantages of Open Compared to Closed Companies and LLCs

- Access to investors
- Free transferability of shares
- Limitation on the risks to shareholders
- Diversification of risks

Disadvantages of Open Companies

- Compliance with securities regulations
- A complex organizational structure
- Compliance with disclosure and other regulations
- Shareholders willing to invest in the company
- Professional management
- Higher minimum charter capital

Distinctions Based on Number of Shareholders

Number of Shareholders	Specific Provisions
One	<ul style="list-style-type: none"> The company may not have as its sole shareholder another commercial entity comprised of one person.³⁷ The rules on preparing and conducting the General Meeting of Shareholders (GMS) are not applicable.³⁸
Fewer than 50 ³⁹	<ul style="list-style-type: none"> The Supervisory Board is optional.⁴⁰
50 and more	<ul style="list-style-type: none"> The legal form of open company is mandatory.⁴¹ An External Registrar is mandatory.⁴² A Supervisory Board with at least five members is mandatory.⁴³
More than 100	<ul style="list-style-type: none"> Mandatory use of voting ballots.⁴⁴ A Counting Commission is mandatory.⁴⁵
More than 500	<ul style="list-style-type: none"> The External Registrar performs the functions of a Counting Commission.⁴⁶
1,000 and more	<ul style="list-style-type: none"> Independent directors decide on the market value of the company's assets.⁴⁷ A minimum of seven Supervisory Board members is required.⁴⁸ A mandatory bid is required.⁴⁹ <ul style="list-style-type: none"> → See also: Part III, Chapter 12, Section B. Voting ballots should be distributed before the GMS.⁵⁰ Special rules on the approval of related party transactions apply.⁵¹ <ul style="list-style-type: none"> → See also: Part III, Chapter 12, Section C.

Distinctions Based on Number of Shareholders (cont'd)

Number of Shareholders	Specific Provisions
More than 10,000	<ul style="list-style-type: none"> • A minimum of nine Supervisory Board members is required.⁵²
More than 500,000	<ul style="list-style-type: none"> • The charter may provide that voting ballots are published.⁵³ • For the rescheduled GMS, the charter may provide for a quorum that is lower than the standard quorum.⁵⁴

The Governance Structure of a Company

The Governance Structure of a Company

For Companies with Less than 50 Shareholders

At least the following bodies:

- GMS;
- General Director; and
- Revision Commission (or a person who performs the functions of the Revision Commission)

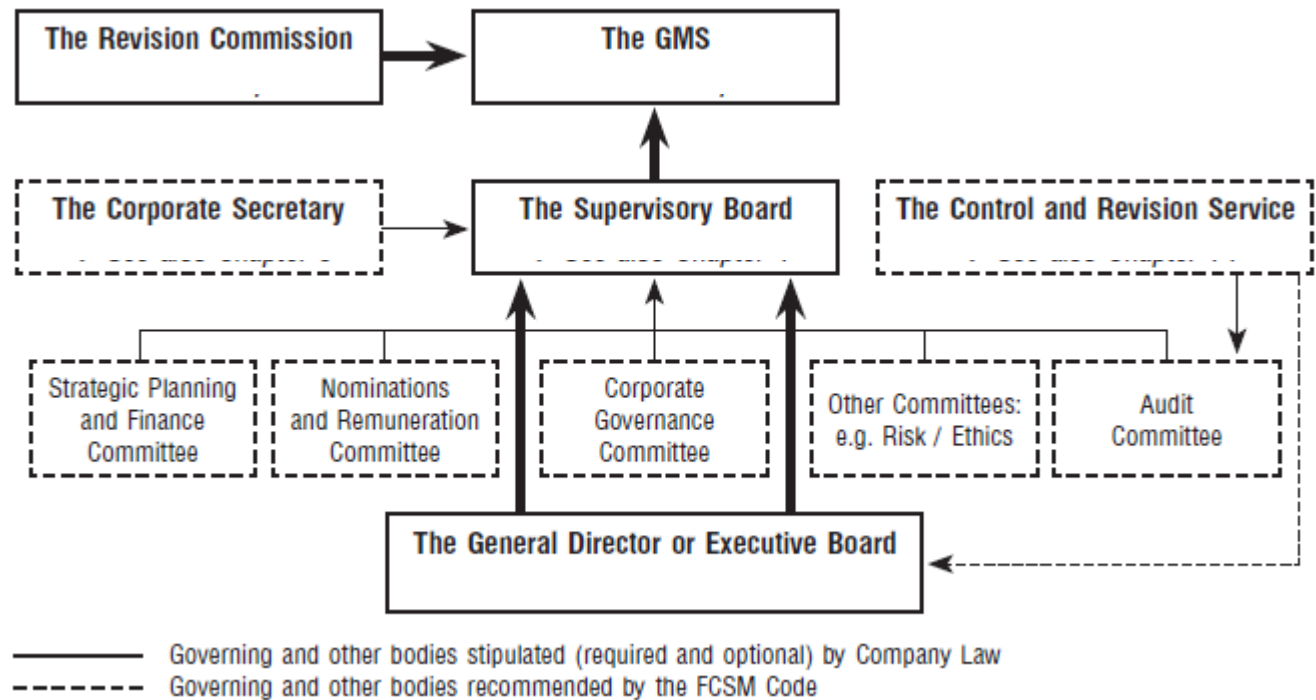
In addition, it may establish the following governing bodies at its discretion:

- Supervisory Board; and
- Executive Board

For Companies with 50 and More Shareholders

Must have a Supervisory Board in addition to the bodies required for a company with less than 50 shareholders

Mandatory and Voluntary Governing and Other Bodies



Mandatory and Voluntary Governing and Other Bodies (cont'd)

- The General Meeting of Shareholders
- The Supervisory Board
 - Russian companies are essentially able to choose between three different corporate governance frameworks, depending on the structure of the company's supervisory body
- The Executive Bodies
 - The General Director
 - The Executive Board
 - The External Manager
- The Revision Commission
- Supervisory Board Committees
- The Control and Revision Service (Internal Audit Function)
- The Corporate Secretary

THE INTERNAL CORPORATE DOCUMENTS

The Company Charter

Charter Provisions

- Full and abbreviated name of the company;
- Location of the company;
- Legal type of company (open or closed);
- Number, nominal value, and types of shares (common or preferred), and the classes of preferred shares issued by the company;
- Shareholder rights by type and class;
- Amount of charter capital;
- Structure and authority of the company's governing bodies, and the procedure for the adoption of decisions by these bodies;
- Procedure for preparing and conducting the General Meeting of Shareholders (GMS);
- Issues that must be resolved by a super-majority or a unanimous vote of the GMS, the Supervisory Board, and the Executive Board;
- Period within which the company holds the Annual General Meeting of Shareholders (AGM);
- Information concerning branches and representative offices of the company; and
- Amount of the reserve fund and the amount of annual deductions from the net profits of the company to the reserve fund

When to Amend the Charter

The charter must be amended when **changes** occur **that affect any mandatory provisions**

For example, amendments to the charter are required when the company:

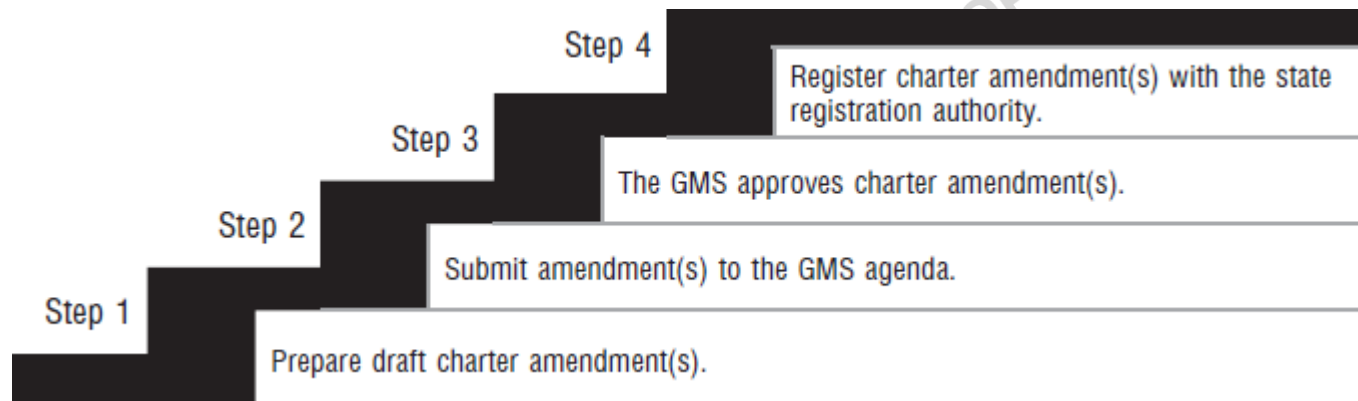
- **Reorganizes;**
- Changes the amount of its **charter capital;**
- Changes the rights attached to different **types and/or classes of shares;** and
- **Establishes** or **liquidates** a branch or a representative office

The charter must also be brought into conformity with **changes in legislation** when new requirements are introduced that affect charter provisions

Who Can Amend the Charter

Circumstances	Competent Body	Legal Requirements
The company increases the charter capital by increasing the nominal value of issued shares.	The GMS	<ul style="list-style-type: none"> Report by the Supervisory Board on the results of the share issue with a new nominal value; and GMS' decision to increase the charter capital.
The company increases the charter capital by issuing additional shares.	The GMS or Supervisory Board	<ul style="list-style-type: none"> Report by the Supervisory Board on the results of the share issue; and Decision of the GMS or the Supervisory Board, if the Supervisory Board has such authority, to increase the charter capital.
The company decreases the charter capital by purchasing outstanding shares.	The GMS	<ul style="list-style-type: none"> Report by the Supervisory Board on the acquisition of shares; and GMS' decision to decrease the charter capital.
The Supervisory Board establishes or liquidates representative offices and/or branches.	The Supervisory Board	<ul style="list-style-type: none"> The Supervisory Board's decision to establish or liquidate representative offices and/or branches.
The government, a state agency, or a municipal entity create or terminate a golden share arrangement.	The government, a state agency, or a municipal entity	<ul style="list-style-type: none"> The decision of the government, the state body, or a municipal entity to create or terminate golden shares.

How to Amend the Charter



- The GMS has the authority to approve the charter amendments with a **3/4-majority** vote of shareholders participating in the GMS
 - ... unless the charter provides for a higher percentage of votes

The By-Laws of the Company

Types of By-Laws

By-laws are internal company documents that **supplement and specify charter provisions**

The following by-laws are **mandatory**:

- By-laws for the **Revision Commission**;
- By-laws for the **executive bodies** if established; and
- By-laws for **branches and representative offices** if established
- Other by-laws are optional

Overview of Company By-Laws

By-Laws by Topic	Who Approves the By-Laws	Required	Recommended	See in Annexes
Executive Board	GMS	✓	✓	✓
Revision Commission	GMS	✓	✓	✓
Branches and Representative Offices ¹⁰³	Supervisory Board or Executive Bodies ¹⁰⁴	✓		
GMS	GMS		✓	✓
Supervisory Board	GMS		✓	✓
Control and Revision Service (Internal Audit Function)	Supervisory Board		✓	✓
Information Policy	Supervisory Board or Executive Bodies		✓	✓
Dividend Policy	Supervisory Board or Executive bodies		✓	✓
Corporate Secretary	Supervisory Board or Executive Bodies		✓	✓
Ethical Standards	Supervisory Board		✓	✓
Risk Management	Supervisory Board or Executive Bodies		✓	✓
Supervisory Board Committees	Supervisory Board		✓	✓

Company Codes of Corporate Governance

Company codes and guidelines may cover a vast number of topics including:

- **General issues of corporate governance:**
 - Goals and objectives of the company;
 - Relationship between the shareholders and the Supervisory Board;
 - Relationship between the Supervisory Board and the General Director or Executive Board; and
 - Relationship between controlling shareholders and minority shareholders.
- **Good Supervisory Board Practices:**
 - Composition, including the number of independent directors;
 - Number and structure of committees;
 - General working procedures; and
 - Remuneration of non-executive directors.
- **Good Executive Board Practices:**
 - Executive remuneration; and
 - Interaction and relationship with the Supervisory Board.
- **Shareholder Rights:**
 - On organizing and conducting the GMS;
 - Minority shareholder protection;
 - Disclosure of related party transactions; and
 - The company's dividend policy.
- **Disclosure and Transparency Issues:**
 - Internal control function, including risk management;
 - Policy on the use of audit and consulting services and External Auditor rotation; and
 - Accounting and disclosure policies and standards.
- **Accountability of the Company to Stakeholders:**
 - Communications with investors and investor relations.

Which topics to cover will depend upon the issues of greatest relevance to the company.

As a rule, company codes are approved by the Supervisory Board, communicated to shareholders and investors, and published on the company's internet site. Company codes or guidelines must be consistent with legislation, as well as the charter and by-laws, and should generally follow the provisions of the FCSM Code. They cannot, however, replace the charter and by-laws.

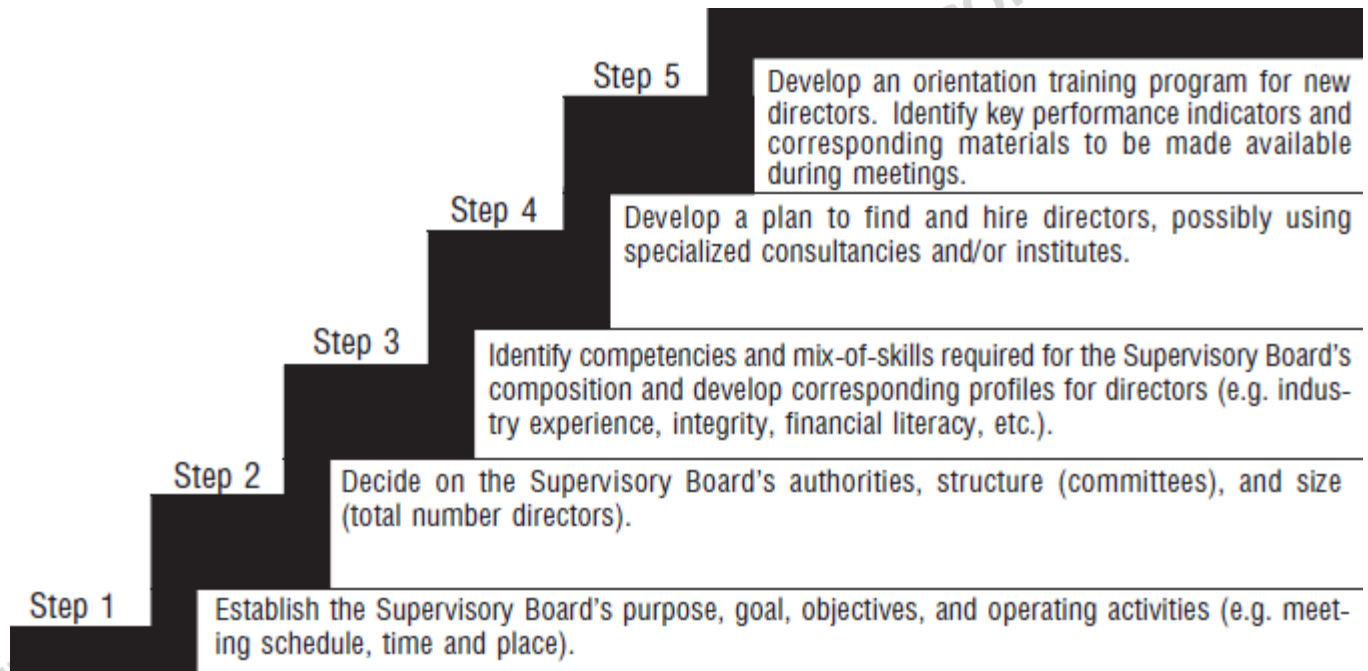
THE SUPERVISORY BOARD

The Supervisory Board's Authority

When to Establish a Supervisory Board

- A company **with 50 or more shareholders** with voting right **must establish** a **Supervisory Board**
- Companies with **fewer** than 50 shareholders with voting rights **may choose** not to establish a Supervisory Board

Five Steps in Developing a Supervisory Board



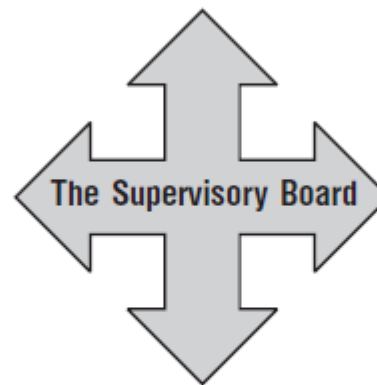
Overview of the Supervisory Board's Authority

Strategic oversight and control

- Determines the strategic direction of the company
- Establishes the executive bodies
- Terminates the powers of executive bodies
- Appoints the General Director or suspends the powers of the General Director if delegated by the GMS
- Suspends the External Manager
- Appoints an interim Executive Board
- Establishes branches and/or representative offices
- Determines the remuneration of the executive bodies
- Supervises the operations of the executive bodies and requests minutes of the Executive Board meetings
- Authorizes directors and managers to occupy a position in a governing body of another legal entity
- Authorizes individuals other than the Chairman to sign contracts
- Appoints and dismisses the Corporate Secretary
- Approves by-laws and other internal documents

Control, Disclosure, and Transparency

- Requests the Revision Commission to conduct extraordinary inspections
- Recommends to the GMS the remuneration of Revision Commission members
- Recommends to the GMS the remuneration of the External Auditor
- Preliminarily approves the annual report
- Determines the list of additional documents that must be kept by the company
- Establishes internal control and risk management mechanisms



Charter Capital and Assets

- Increases the charter capital
- Issues non-convertible bonds
- Issues convertible bonds
- Determines the market value of assets, and the placement and redemption price of shares and other securities
- Buys back company shares
- Appoints the company's External Registrar
- Utilizes the company's reserve and other funds

Shareholder Rights

The GMS

- Organizes the GMS
- Reviews agenda proposals
- Places additional items on the agenda and nominates candidates
- Approves the agenda
- Organizes EGMs

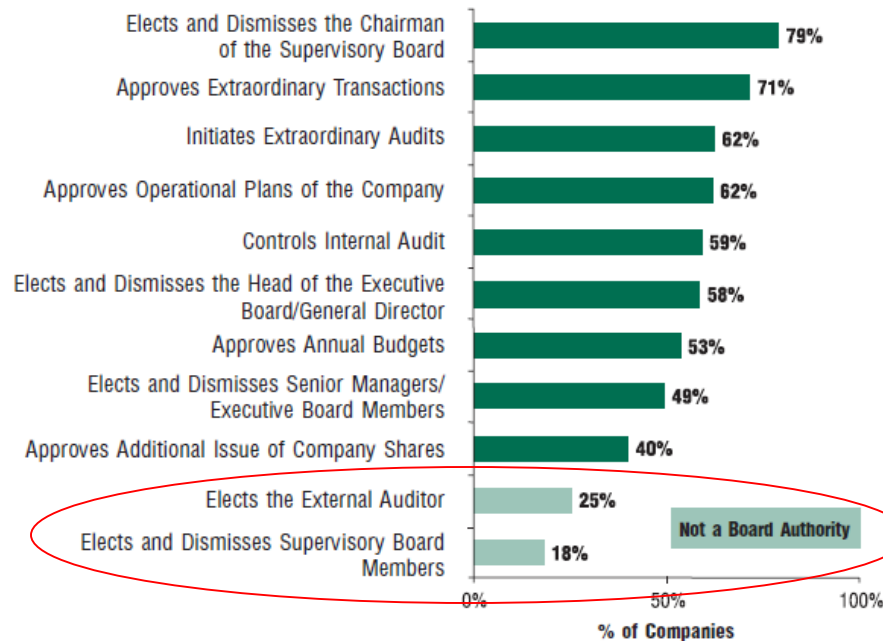
Dividends

- Recommends to the GMS the amount of and procedures for paying dividends

Transactions & Conflict Resolution

- Approves extraordinary transactions
- Approves related party transactions
- Resolves corporate conflicts

Functions Performed by Supervisory Boards in Russia



- Note: One in four Supervisory Boards decides upon the selection of an independent External Auditor, and 18% elect and dismiss their own members
 - **Under Russian legislation, these rights are reserved for shareholders**
 - Companies that violate rules regarding the election of Auditors also tend to violate rules regarding the appointment and dismissal of Supervisory Board members

Authority in Regards to Strategic Oversight & Control

- Setting Company Priorities and Strategic Direction
- Establishing the Executive Bodies
- Terminating the Executive Bodies' Powers
- Suspending the Executive Bodies' Powers
- Appointing Interim Executive Bodies

An interim General Director²⁰



- When the Supervisory Board has exercised the right to suspend the powers of the General Director provided by the charter; or
- When the General Director is unable to fulfill his duties; or
- When the Supervisory Board has exercised the right to suspend the powers of the External Manager provided by the charter; or
- When the External Manager is unable to fulfill its duties.

An interim Executive Board²¹



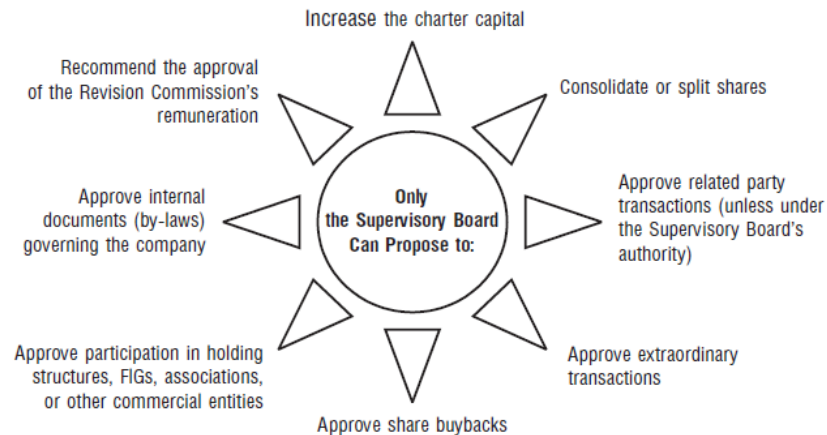
- When the charter has reserved the power to establish the Executive Board for the GMS; and
- When the number of acting Executive Board members is less than the quorum set by the charter or by-laws.

Authority in Regards to Strategic Oversight & Control (cont'd)

- Concluding Contracts with the Executive Bodies
- Supervising the Executive Bodies' Operations
- Appointing the Corporate Secretary
- Approving By-laws
- Establishing Branches and Representative Offices

Authority in Relation to Shareholder Rights

- **Organizing the General Meeting of Shareholders**



- **Resolving Corporate Conflicts**

- The Supervisory Board's responsibility is to take all necessary steps to prevent and resolve conflicts that may arise **between shareholders and the company**
- It **may appoint officers to implement systems of enforcement**
- The Supervisory Board **may also form a Conflict Resolution Committee** to this end

Authority in Relation to Assets and the Charter Capital

- The **Supervisory Board** has the authority to decide on whether to **issue non-convertible bonds and other non-convertible securities** if the charter does not provide otherwise
- In contrast, the Supervisory Board has the authority to decide on the issue of **convertible bonds and other convertible securities only if this authority has not been provided to the GMS** in the charter
- In addition, the Supervisory Board has the authority to **set the market value of assets**, the **placement price**, and the **redemption price** of shares and other securities

Authority in Relation to Control, Disclosure, and Transparency

- Preliminarily Approving the Annual Report
- Implementing Risk Management



- Specifying Additional Documents that Must Be Kept by the Company

The Election and Dismissal of Directors

The Election and Term of Directors

- The GMS elects directors for a term that starts from the moment that they are elected until the next AGM
- There are **no limitations** as to how many times a directors can be **reelected**

The Nomination of Candidates for the Supervisory Board

- A shareholder (or a group of shareholders) owning **at least 2% of voting shares** has the **right to nominate** candidates for the Supervisory Board

Information About Supervisory Board Nominees

- **Information** about Supervisory Board nominees must be submitted to persons entitled to participate in the **GMS before the Meeting**

Best Practices: Shareholders should receive sufficient information to determine the ability of Supervisory Board nominees to fulfill their duties and, if applicable, to ascertain their independence. Some useful items of information include:⁶⁷

- The identity of the candidate;
- The identity of the shareholder (or the group of shareholders) that nominated the candidate;
- The age and educational background of the candidate;
- The positions held by the candidate during the last five years;
- The positions held by the candidate at the moment of his nomination;
- The nature of the relationship the candidate has with the company;
- Other Supervisory Board memberships or official positions held by the candidate;
- Other nominations of the candidate for a position on the Supervisory Board or official positions;
- The candidate's relationship with affiliated persons of the company;
- The candidate's relationship with major business partners of the company;
- Information related to the financial status of the candidate, and other circumstances that may affect the duties and independence of the candidate as a Board member; and
- The refusal of the candidate to respond to an information request of the company.

The Election of Directors

- All directors must be elected with **cumulative voting**
 - Cumulative voting is a system that helps minority shareholders **pool their votes** to elect a representative for the Supervisory Board

How Cumulative Voting Works

- Candidates for the Supervisory Board are voted on collectively, i.e. as a group;
- Each shareholder has a maximum number of votes equal to the number of directors that must be elected (according to the charter or a decision of the GMS) multiplied by the number of voting shares held;
- Shareholders **can allocate their votes to one candidate or divide them among several candidates** as they please;
- The top X candidates with the most votes are considered elected, whereby X equals the number of Supervisory Board members to be elected as specified by the charter or the decision of the GMS

The Election of Directors (cont'd)

Mini-Case 1: The following mini-case illustrates how shareholders, in particular minority shareholders, can calculate the minimum number of votes required to elect one Supervisory Board member. Once they know this, it will help them organize their collective action to put their representative on the Supervisory Board.

In this case, a company has 2,500 minority shareholders holding a total of 3,000 (or 20% of) voting shares, and one majority shareholder holding a total of 12,000 (or 80% of) voting shares. The charter states that the Supervisory Board has nine members. The 2,500 minority shareholders hold 27,000 votes (3,000 shares \times 9 votes) and the majority shareholder has 108,000 votes (12,000 shares \times 9 votes). The nine candidates that receive the most votes are elected to the Supervisory Board.

A formula can be used to calculate a minimum number of votes to elect one director:

$$\frac{nS}{D + 1} + 1 = \frac{9 \times 15,000}{9 + 1} + 1 = 13,501 \text{ shares}$$

where D — the number of directors to be elected, S — the number of outstanding voting shares and n — the total number of directors the majority shareholder wants to elect ($n = 9$ directors in this example).

For this formula to work, shareholders must know the number of voting shares the company has in total (S), how many directors must be elected (D), and how many candidates they want to elect to the Supervisory Board.

The formula indicates that shareholders must have 13,501 votes to ensure that one director is elected. Minority shareholders in this example hold 27,000 votes which will enable them to elect at least one director, should they vote collectively.

The Election of Directors (cont'd)

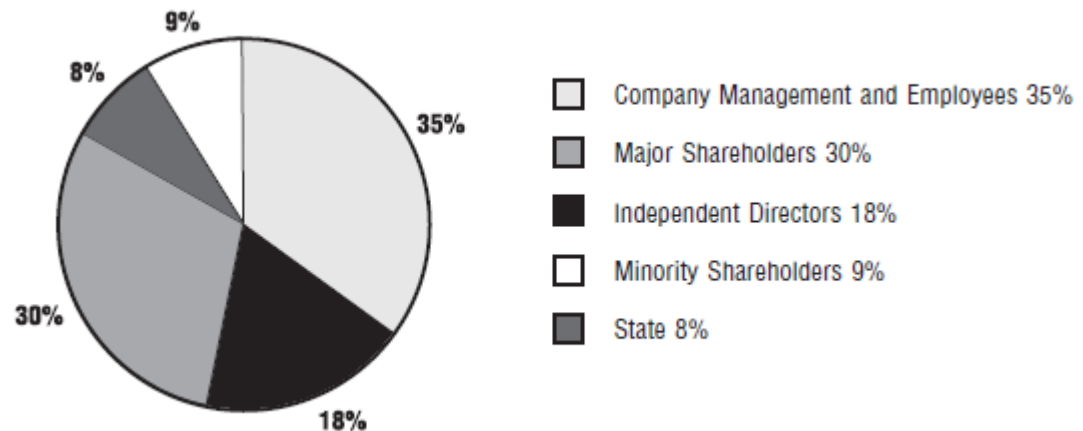
Cumulative Voting and Collective Action

- Cumulative voting increases the chance that minority shareholders elect a representative to the Supervisory Board
- In order **to be effective, minority shareholders must organize themselves** to vote. For this, they must:
 - Have the resources and skills to **campaign for candidates**;
 - Make use of the shareholder list to **contact other shareholders**; and
 - Be able to **use cumulative voting strategically**

Cumulative Voting and Fractional Shares

Mini-Case 2: Shareholder A has 5.1 voting shares. During the GMS, the shareholders are to elect nine Supervisory Board members through cumulative voting. Shareholder A is able to cast 45.9 votes (5.1×9). In this case, Shareholder A will cast the 45 votes as desired. Shareholder A must cast the remaining 0.9 votes for one candidate and cannot divide the fraction (0.9) into smaller fractions (for example, 0.4 to Supervisory Board candidate B and 0.5 to Supervisory Board candidate C).

The Structure of the Average Russian Supervisory Board



The Dismissal of Directors

- In the ordinary course of business, directors are elected at every AGM
- **Only the GMS can dismiss directors** before the end of their term
- **Since the Supervisory Board is elected with cumulative voting, the GMS can only terminate the authority of all directors collectively, not of individual members**
- Such a GMS will in practice be an EGM

The Composition of the Supervisory Board

The Number of Directors

- The total number of directors must be **fixed in the charter or by decision of the GMS**
- The **Company Law** provides for the following **minimum number of directors** depending on the number of shareholders:
 - At least 5 directors for companies with 1,000 and fewer shareholders with voting rights;
 - At least 7 directors for companies with more than 1,000 shareholders with voting rights; and
 - At least 9 directors for companies with more than 10,000 shareholders with voting rights
- The charter or decision of the GMS can, however, provide for a greater number of directors than the minimum number legally required

Who Can Be a Director

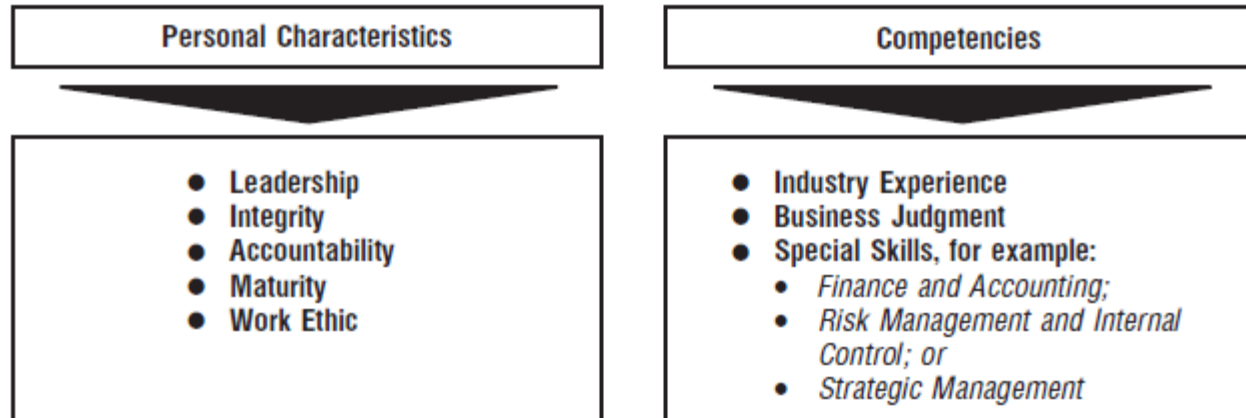
- Only individuals with “**full dispositive capacity**” can be directors
- A legal entity cannot be a director, although an **individual** who happens to be a representative of a legal entity can be elected to the Supervisory Board
- An **Executive Board member** or the General Director of Company A can **only** be a director of Company B **after** the **Supervisory Board of Company A has given its consent**

Best Practices: To avoid conflicts of interest, individuals should not be elected to the company's Supervisory Board when they are:⁸⁸

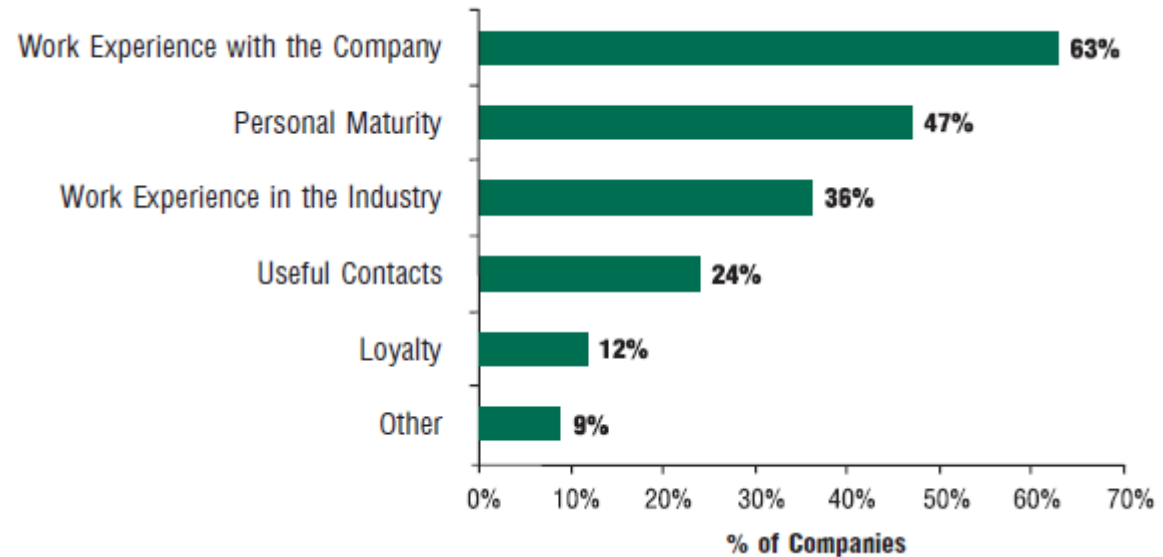
- A director of a competing company;
- A manager of a competing company; or
- An employee of a competing company.

Nominees for the Supervisory Board should also not be related to suppliers, affiliated persons, as well as employees of the independent External Auditor.

Qualifications of Directors



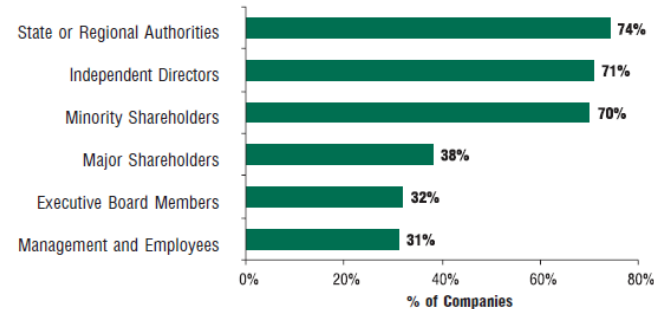
Election Criteria for Supervisory Board Members in Russia



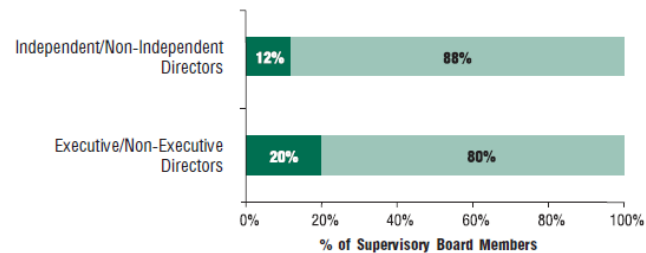
Categories of Directors

- International practice distinguishes between different categories of directors according **to the degree to which such directors are involved in the affairs of (or are related to) the company**: Executive, non-executive, and independent directors

Companies that Do Not Have Certain Categories of Directors (in Russia)



Ratio of Different Categories of Directors (in Russia)



Categories of Directors (cont'd)

Executive Directors

Executive directors can be defined as those that also hold an **executive position** in the company, namely that of:

- The General Director;
- An Executive Board member; or
- A manager of the company who is not an Executive Board member

Non-Executive Directors

Non-executive directors are Supervisory Board members that **do not hold an executive position** in the company. Effective non-executive directors should have the following personal attributes:

- Integrity and high ethical standards;
- Sound judgment;
- The ability and willingness to challenge and probe; and
- Strong interpersonal skills

Independent Directors

- **Russian law does not define the concept** of independent directors
- Requirements for the “independence” of directors are wider than those for a nonexecutive position: At time of approval **during one year immediately preceding the approval of such not in a company-liked / -affiliated position**

Restrictions on Executive and Non-Executive Directors

Can a director be a member of the Executive Board?	Yes, but Executive Board members cannot occupy more than 25% of Supervisory Board seats.
Can a director be a General Director?	Yes, unless prohibited by the charter.
Can the Chairman of the Supervisory Board be the General Director?	No.
Can the Chairman of the Supervisory Board be a member of the Executive Board other than the General Director?	Yes, unless prohibited by the charter.

Are Directors on Your Supervisory Board Independent?

	Yes	No
Is the director an officer or an employee of the company, or the External Manager of the company? Has the director been an officer or an employee of the External Manager of the company over the last three years?	<input type="checkbox"/>	<input type="checkbox"/>
Is the director an officer of another company in which any of the officers of the company is a member of the Nominations and Remuneration Committee of the Supervisory Board of that company?	<input type="checkbox"/>	<input type="checkbox"/>
Is the director an affiliated person of an officer of the company, of the External Manager or of an officer of the External Manager of the company?	<input type="checkbox"/>	<input type="checkbox"/>
Is the director an affiliated person of the company or an affiliated person of persons affiliated with the company?	<input type="checkbox"/>	<input type="checkbox"/>
Is the director a party to a contract with the company whereby the director could acquire property of the company (or receive money) with a value of 10% or more of the total annual income of the said director, excluding the remuneration he receives for his work as a director?	<input type="checkbox"/>	<input type="checkbox"/>
Is the director a major business partner of the company (i.e., a business partner involved in transactions with the company where the total annual amount of transactions is 10% or more of the book value of company assets)?	<input type="checkbox"/>	<input type="checkbox"/>
Is the director a representative of the state?	<input type="checkbox"/>	<input type="checkbox"/>
Has the director been a Supervisory Board member of the company during the last seven years?	<input type="checkbox"/>	<input type="checkbox"/>

The Structure and Committees of the Supervisory Board

Chairman

- The Supervisory Board members elect their Chairman by a simple majority vote of all directors if the charter does not provide otherwise
- The Chairman has the authority to:
 - **Prepare, organize, and preside over Supervisory Board meetings;**
 - **Preside over the GMS** when the charter does not provide otherwise;
 - **Enter into contracts with the General Director, Executive Board members, and the External Manager;** and
 - Perform any other duties as specified in the charter and by-laws.

Supervisory Board Committees

- Supervisory Board committees are widely considered a key tool for Supervisory Boards to effectively deal with such challenge

More specifically, committees:

- **Permit** the Supervisory Board **to handle a greater number of complex issues** in a more efficient manner, by allowing specialists to focus on specific issues and provide detailed analysis and recommendations back to the Board;
- Allow the Supervisory Board to **develop subject-specific expertise** on the company's operations, most notably on financial reporting, risk, and internal control; and
- **Enhance** the **objectivity and independence** of the Supervisory Board's judgment insulating it from potential undue influence of managers and controlling shareholders

Different Types of Committees

	Functions	Recommendations for the Committee's Composition
Audit Committee¹²⁰	<ul style="list-style-type: none"> • Develops recommendations for the Supervisory Board on the selection of the External Auditor; • Interacts with the company's External Auditor and Revision Commission; • Supervises the company's financial and business operations, and the implementation of the financial and business plan; • Monitors the Internal Audit Function; • Evaluates internal control procedures; • Develops internal control and risk management procedures; and • Develops recommendations for the Supervisory Board's approval of non-standard operations.¹²¹ <p>→ For more information on the Audit Committee, see Part IV, Chapter 14, Section C, and Annex 7.</p>	<p>The Audit Committee should be composed entirely of independent directors. If this is not possible, the Audit Committee should be chaired by an independent director and be composed solely of non-executive directors.</p> <p>The charter (or by-laws) should set forth the qualifications of Committee members. In particular, Audit Committee members need to be financially literate, and understand accounting and financial reporting.¹²²</p>
Strategic Planning and Finance Committee¹²³	<ul style="list-style-type: none"> • Defines strategy and objectives, as well as key performance indicators; • Determines operational priorities; • Develops dividend policy; and • Evaluates the long-term productivity of the company's operations. <p>→ For a model by-law for the Supervisory Board's Strategic Planning and Finance Committee, see Part VI, Annex 10.</p>	<p>(No specific recommendation made by the FCSM Code.) Members of the Committee need experience in the industry in which the company is active. The Committee will likely benefit from members with other areas of expertise such as finance and operations.</p>
Ethics Committee¹²⁴	<ul style="list-style-type: none"> • Ensures that the company complies with ethical standards and contributes to the creation of an atmosphere of trust within the company. • Detects and prevents violations by the company of legislation and ethical standards. <p>→ For a model Code of Ethics, see Part VI, Annex 5.</p>	<p>(No specific recommendation made by the FCSM Code.) Members of the Committee must be of the highest integrity, enjoy the trust of all shareholders, and be knowledgeable on legal and ethical standards.</p>

Different Types of Committees (cont'd)

	Functions	Recommendations for the Committee's Composition
Nominations and Remuneration Committee ¹²⁵	<ul style="list-style-type: none"> • Defines the qualifications of Supervisory Board members; • Develops the company's remuneration policy, specifies basic principles and criteria for determining the amount of remuneration payable to: <ul style="list-style-type: none"> – Supervisory Board members; – The General Director; – Executive Board members; and – Heads of major divisions of the company. • Develops criteria for the performance evaluation of these persons; • Performs periodic evaluations of the General Director and Executive Board members; • Defines benefits available to these persons (including life insurance, health insurance, and non-governmental pension benefits); • Determines qualifications of candidates for positions in executive bodies and heads of major divisions of the company; • Prepares the terms and conditions of employment contracts between the company and the General Director and Executive Board members; • Conducts preliminary assessments of candidates for the positions of General Director and Executive Board members; • Prepares recommendations for the Supervisory Board with respect to the reappointment of the General Director and Executive Board members; and • Considers the company's personnel policy, including matters related to wages and salaries. <p>→ For a model by-law for the Supervisory Board's Nominations and Remuneration Committee, see Part VI, Annex 9.</p>	<p>The Nominations and Remuneration Committee should be composed of independent directors. If this is not possible, the Committee should be chaired by an independent director and be composed of non-executive directors.¹²⁶</p>
Corporate Conflicts Resolution Committee ¹²⁷	<ul style="list-style-type: none"> • Ensures that shareholder rights are appropriately and specifically defined in the company's charter, by-laws, and company-level corporate governance code, and develops policies and procedures for the protection of these rights; • Develops and periodically conducts reviews of the company's conflict resolution policy and procedures; and • Develops recommendations for the Supervisory Board on how to effectively deal with corporate conflicts between and among the company, its shareholders, directors, and managers. <p>→ For a model by-law for the Supervisory Board's Corporate Governance Committee, see Part VI, Annex 8.</p>	<p>The Corporate Conflicts Resolution Committee should be composed of independent directors. When this is not possible, an independent director should chair the Committee. Members should, at a minimum, be non-executive directors.</p>

Authority of Supervisory Board Committees

The **Supervisory Board** is a **collective body** in which:

- All **members have equal rights and duties** (the charter may provide that the Chairman have a decisive vote in case of a tie vote);
- All **members bear joint and several liability**; and
- **Members act together** as a body according to specific decision-making procedures

The Composition of Supervisory Board Committees

- Supervisory Board committees should **only be composed of Supervisory Board members**
- Other parties, most notably **managers**, may be invited to **present or elaborate** on particular issues, but **have observer status only**, i.e. are precluded from conferring or deciding on particular issues

The Chairman of a Supervisory Board Committee

- The Chairman of a committee is **responsible for its effectiveness**, regardless of his other duties
- The committee Chairman forms an effective team, **organizes** productive committee meetings, and provides intellectual **leadership** on complex issues

The Working Procedures of the Supervisory Board

The Working Procedures of the Supervisory Board

- The Chairman has the authority to:
 - **Call, organize, and preside over Supervisory Board** meetings;
 - **Prepare the minutes** of Supervisory Board meetings;
 - **Cast a deciding vote** at Supervisory Board meetings in case of a tie vote (if this is provided for by the charter); and
 - **Sign the minutes** of the Supervisory Board meeting (when it is presided over by him)
- The Supervisory Board must follow legal requirements in making valid decisions, or risk having them overruled by the courts upon complaints
- The charter or the by-laws must specify the procedures for convening and conducting Supervisory Board meetings
 - **Supervisory Boards of Russian companies meet 8-11 times a year**
- The Chairman normally convenes regular Supervisory Board meetings and has the obligation to **convene a Supervisory Board meeting upon the request of:**
 - Supervisory Board members;
 - The Revision Commission;
 - The External Auditor;
 - The General Director and the Executive Board; and
 - Other persons specified by the charter

The Working Procedures of the Supervisory Board (cont'd)

- A **quorum** is the **minimum number** of directors that must participate in a meeting for decisions to be valid
 - The **charter must specify the quorum**, which cannot be less than one half of the number of elected directors
- Supervisory Board **decisions must be approved by a simple majority vote unless** the Company Law, the charter, and/or by-laws **require a higher percentage** of votes

Supervisory Board decisions requiring unanimity:

- Increasing the charter capital by issuing and placing additional shares (when the Supervisory Board has this authority).¹⁶²
 - Approving an extraordinary transaction.¹⁶³
- *For more information on extraordinary transactions, see Part IV, Chapter 12, Section A.*

Supervisory Board decisions requiring the approval of a 3/4-majority:

- Suspending the powers of the General Director or the External Manager for any reason.¹⁶⁴
- Approving an interim General Director.
- Conducting an EGM to approve the new General Director or the External Manager.¹⁶⁵

The Working Procedures of the Supervisory Board (cont'd)

- Directors can participate in voting when they are:
 - **Physically present** at the meeting;
 - Participating by **conference call** or other means of communication (when allowed by the charter or by-laws); or
 - Absent, but have presented a **written opinion** (when allowed by the charter or by-laws)
 - A director **cannot delegate his right to vote** at a Supervisory Board meeting to another person, including to another director
- The charter or by-laws can specify that written opinions of directors can be considered in determining the existence of a quorum for Supervisory Board meetings, and the validity of the voting results
- The Supervisory Board must keep **minutes** of its meetings
 - Minutes must be prepared **within 3 days** after the meeting and must be kept in the company archives
 - At a **minimum**, the minutes must **contain the following**:
 - Location and time of the meeting;
 - Names of the persons who participated in the meeting;
 - Agenda of the meeting;
 - Agenda items and the voting results; and
 - A description of Supervisory Board decisions.
 - The **Chairman** is responsible for the accuracy of the minutes and **must sign them**

The Duties and Liabilities of Directors

The Duty of Care

- Supervisory Board members are responsible for exercising their rights and discharging their duties in **good faith**, with **care**, and in a **professional manner**

Best Practices: A director should:¹⁷⁹

- Act honestly and in good faith;
- Refrain from being passive;
- Use care and prudence to the maximum extent that could be expected from a good director in a similar situation under similar circumstances;
- Not cause the company to act unlawfully;
- Regularly attend and actively participate in Supervisory Board meetings;
- Place matters on the agenda of Supervisory Board meetings, and demand such meetings when necessary;
- Ensure that an efficient and effective system of internal control is in place;
- Demand that the General Director and Executive Board members provide adequate information to the Supervisory Board so that its members are properly informed on corporate matters;¹⁸⁰ and
- Exercise a reasonable amount of supervision over management.

The Duty of Loyalty

- The duty of loyalty usually **prohibits** directors from:
 - **Participating in a competing company;**
 - **Entering** into any **transaction** with the company **without** first **disclosing** the transaction and obtaining Supervisory Board or GMS approval;
 - **Using** corporate **property** and **facilities** for **personal needs**;
 - **Disclosing non-public, confidential information**; and
 - Using company information or business opportunities for private advantage, i.e. personal profit or gain

Best Practices: The duty of loyalty requires the director to act in the best interest of the company regardless of:¹⁸²

- Who nominated and elected such member; and
- Pressures from other directors, shareholders, or other individuals to take actions or make decisions that are not in the best interest of the company.

It is of fundamental importance that, in carrying out its duties, the Supervisory Board should not be viewed, or act, as an assembly of individual representatives for various constituencies.¹⁸³ While specific directors may indeed be nominated or elected by certain shareholders (and sometimes contested by others), it is an important feature of the Supervisory Board's work that directors when they assume their responsibilities carry out their duties in an even-handed manner with respect to all shareholders. This principle is particularly important to establish in the presence of controlling shareholders that are able to select all directors.

Further, directors and affiliated persons (for example, family, friends, and business partners) should not accept gifts from persons interested in Supervisory Board decisions, or accept any other direct or indirect benefits. An exception can be made for symbolic gifts that are given as a common courtesy or souvenirs that are given during official events. These exceptions should be described in by-laws or other internal documents of the company.

The Duty of Loyalty (cont'd)

Conflicts of Interest

- A director **should not discharge his duties if there is a conflict of interest** between him and the company and its shareholders

Best Practices: A conflict of interest may arise when:¹⁸⁴

- The company enters into a transaction in which a director is interested;
- A director, directly or indirectly, acquires shares of the company;
- A director accepts an official position on the Supervisory Board of a competing company; and/or
- When a director enters into contractual relations with a competing company.

- The Company Law addresses the issue of conflicts of interest **within the context of related party transactions**
- Directors should refrain from actions that may potentially result in a conflict between their own interests and the interests of the company
- A director **must disclose** to the Supervisory Board, the Revision Commission and the External Auditor information about **areas of potential / exiting conflicts**

The Duty of Loyalty (cont'd)

- **Confidentiality of Information**

Best Practices: Directors should not disclose confidential information or use their access to company information for their personal interests or the interests of third parties. The personal use of confidential information ultimately damages shareholders.¹⁸⁸ It is recommended that:¹⁸⁹

- Directors take steps to protect confidential information;
- Directors not disclose information or use it in their own interests;
- Standards for the use of confidential information be specified in the internal documents of the company; and
- Contracts between the company and directors stipulate the obligation of directors to not disclose confidential information for a period of ten years after they leave the company.

To create an effective mechanism to prevent the unauthorized use of confidential information, the company should require directors to:¹⁹⁰

- Notify the Supervisory Board in writing of their intention to enter into transactions that involve securities of the company or its subsidiaries; and
- Disclose information about previous transactions with securities of the company in accordance with the procedures for disclosing material facts as specified by securities legislation.

Formalization of the Duties of Directors

- The company should develop and incorporate into its internal documents a list of clearly defined duties of Supervisory Board members

Director Access to Information

Best Practices: It is essential for directors to have access to the information they need to properly discharge their duties, including full and accurate responses to their inquiries from members of the executive bodies, and other company officers.¹⁹²

The company should create a mechanism to ensure that directors are provided with information about the most important financial and business developments of the company, as well as other developments that may have an impact on shareholder interests. The by-laws or other internal documents should provide that the General Director, Executive Board members, and heads of major divisions have the duty to promptly submit full and reliable information to the Supervisory Board.¹⁹³

The company's internal documents should include the right of directors to demand information from the executive bodies.¹⁹⁴

Liabilities of Directors

- Directors **can be held liable** for losses caused to the company resulting from their wrongful behavior
- The preconditions for establishing liability are:
 - **Specific conduct or a failure to act;**
 - **Fault**, including both negligent and intentional conduct;
 - **Losses** to the company; and
 - **Causality between** the director's **behavior and losses**

When Directors Are Relieved from Liability

- Directors **cannot** generally **be held liable** for decisions made in **good faith** and cannot be held liable for losses if they:
 - Voted against the decision taken by the Supervisory Board that resulted in adverse circumstances; or
 - If they did not participate in the Supervisory Board meeting when such a decision was made
- Directors **are not relieved from liability after they have resigned from the Supervisory Board or when they are dismissed** from the Supervisory Board for actions and decisions made during their tenure as a director

Liabilities of Directors (cont'd)

Who Can File a Claim Against Directors

- The **company or a shareholder** (or a group of shareholders) holding at least 1% of common shares have the right to file a claim in court against directors to cover the losses of the company that resulted from decisions taken by the Supervisory Board

The Minutes of Supervisory Board Meetings and Director Liability

Best Practices: To effectively enforce provisions that regulate the liability of directors, it is recommended that the company keep detailed minutes (and possibly verbatim reports) of meetings.²⁰² As stated above, if a decision passed by the Supervisory Board results in the company incurring losses, only those directors who voted for such a decision are liable. Therefore, it is important for the Supervisory Board to keep detailed minutes of Supervisory Board meetings to determine who voted for a certain decision and who can be held liable.²⁰³

Protection from Liability for Directors

- Most companies should allow their directors to protect themselves from, or at least limit the liability for, losses incurred while they fulfilled their duties

Evaluation and Education of the Supervisory Board and Directors

Self-Evaluation by the Supervisory Board

- A self-evaluation is a useful tool for the Supervisory Board to privately **assess the quality of its work**
- Through critical reflection and self-evaluation, directors can be more responsive to shareholders, investors, and other stakeholders
- **Self-evaluation** methods include:
 - Organizing a **retreat** and inviting an outside facilitator;
 - Organizing a special Supervisory Board meeting to evaluate the work of the Supervisory Board or, alternatively, setting aside time during a regular meeting to address performance issues;
 - Designing **checklists** that Supervisory Board members can use to assess their work; and
 - Participating in **specialized training programs**, thereby providing directors the opportunity to critically reflect on their performance, and develop and share new ideas
- Performance evaluation of the Supervisory Board and its members may also be carried out by Consultants, professional associations, and corporate governance rating organizations.

The Remuneration of Directors

The Remuneration of Directors

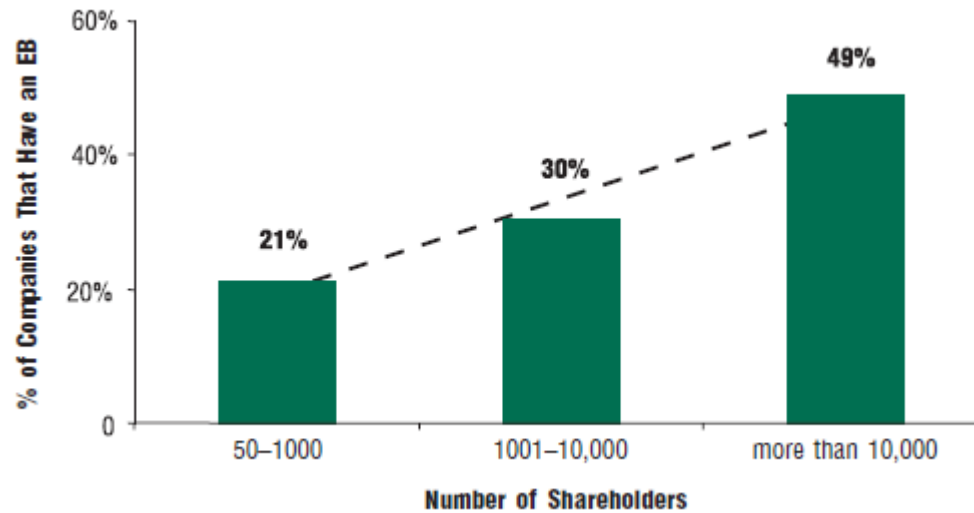
- Directors may be remunerated for their work. The amount of such remuneration is **determined by the GMS**
- For example, directors can receive:
 - An **annual fee** (which may be paid in the form of shares in lieu of cash);
 - A fee, based upon **meeting attendance**;
 - Fees for **additional work**, such as for work on Supervisory Board committees; and
 - Fees for **additional responsibilities**, such as for serving as the Chairman of the Supervisory Board or one of its committees

Company Practices in Russia: Some 70% of companies do not have a remuneration policy for Supervisory Board members.²¹¹ The average annual compensation of Supervisory Board members in companies with less than 1,000 shareholders is U.S. \$ 475. Larger companies tend to pay higher fees. Companies with over 1,000 shareholders pay fees of U.S. \$ 1,200 per annum. The low level of remuneration compared to the importance of the Supervisory Board is striking. Whatever the explanation, it seems clear that director remuneration needs to receive greater attention. Transparent systems of remuneration, capable of attracting qualified directors, need to be put in place.

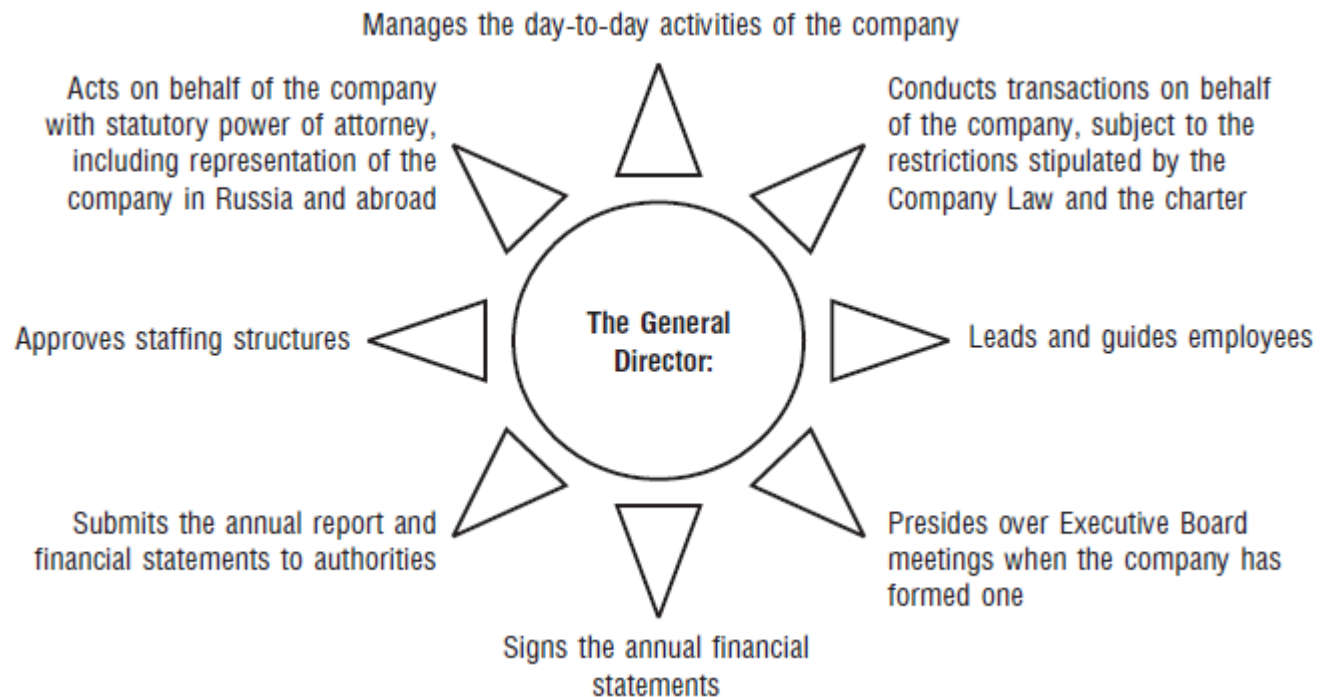
THE EXECUTIVE BODIES

The Executive Bodies and Their Authorities

Existence of an Executive Board in Russia



The Authority of the General Director

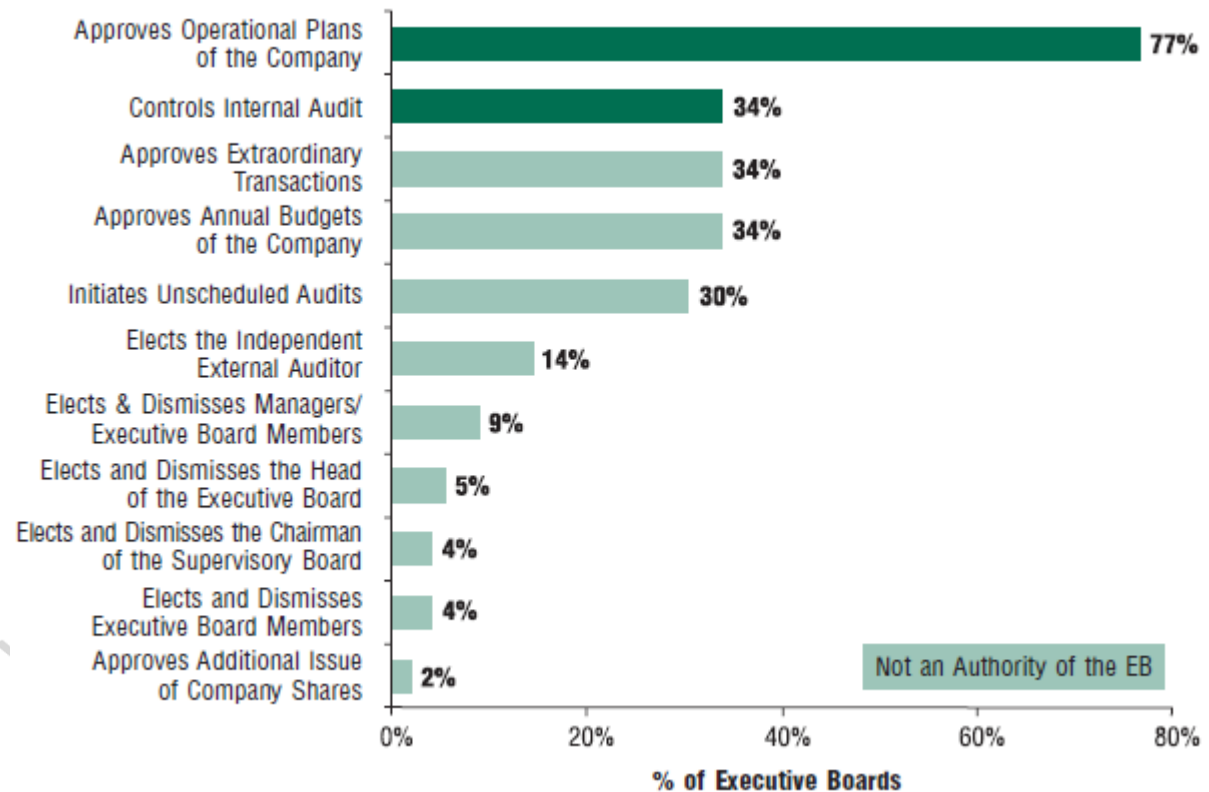


The Authority of the Executive Board

Best Practices: The company charter should define the Executive Board's authority to:²²⁵

- Develop documents on the priority area(s) of the company's operations;
- Develop the business plan(s) of the company;
- Approve by-laws or other internal documents;
- Approve transactions with a value of 5% and more of the company's assets with the requirement that the Supervisory Board be immediately notified;
- Approve real estate transactions and loans that are not part of the ordinary course of business;
- Appoint the heads of the company's branches and representative offices;
- Approve issues on the agenda of the GMS of wholly-owned subsidiaries unless these issues must be approved by the Supervisory Board of the parent company;
- Appoint individuals who represent the company during the GMS of wholly-owned subsidiaries and instruct them on how to vote during the GMS;
- Nominate candidates for the General Director, the Executive Board, the External Manager, the Supervisory Board, and other governing bodies of wholly-owned subsidiaries;
- Approve internal work schedules;
- Approve job descriptions for all management-level employees of the company;
- Approve employment contracts for mid-level managers; and
- Approve collective labor contracts.

Functions Performed by Executive Boards in Russia



The Composition of the Executive Bodies

Who Can Be a General Director or an Executive Board Member

- **Any individual** can be the General Director or an Executive Board member
- Restrictions do, **however**, exist:
 - Only individuals with “**full dispositive capacity**” can be members of the executive bodies
 - This means that a person must have the capacity to acquire and exercise civil law rights by his actions, be able to create for himself civil law obligations, and be able to fulfill these rights and obligations
 - A legal entity cannot be an Executive Board member;
 - The Chairman of the Supervisory Board cannot be the General Director;
 - Revision Commission members cannot be a member of the executive bodies;
 - Counting Commission members cannot be a member of the executive bodies; and
 - A member of the company's executive bodies can only be a member of the executive bodies or Supervisory Board of another company after the Supervisory Board has given its consent

Best Practices: Best practices dictate that individuals should not be appointed to executive bodies when they are:²³⁸

- Directors of a competing company;
- Managers of a competing company; or
- Employees of a competing company.

The General Director should not be engaged in any business activities other than those related to the management of the company and the governance of its subsidiaries.²³⁹

Qualifications of the General Director and EB Members

Best Practices: The charter or by-laws should specify the qualifications of members of the executive bodies as well as heads of major divisions.²⁴¹ Members of the executive bodies, including the External Manager, should generally satisfy the following requirements:²⁴²

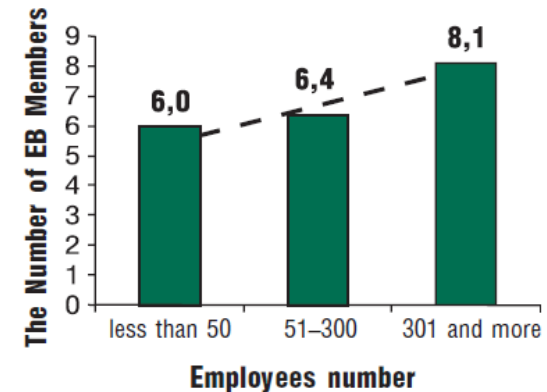
- To enjoy the trust of shareholders, directors, other managers, and employees of the company;
- To own the ability to relate to the interests of all stakeholders and to make well-reasoned decisions;
- To possess the professional expertise and education to be an effective General Director and manager;
- To possess (international) business experience, knowledge of national economic, political, legal, and social issues, as well as trends and knowledge of the market, products, and competitors (national as well as international); and
- To have the ability to translate knowledge and experience into practical solutions that can be applied to the company.

Moreover, a background check on candidates should be conducted for a possible record of criminal or administrative offenses. Evidence of such offenses would likely result in the rejection of a candidate.

The Composition of the Executive Board in Russia

The **size of the Executive Board** will need to be **adapted to the specific circumstances** of the company and, consequently, will vary in composition. It may include:

- The General Director;
- The Chief Operating Officer;
- The Chief Financial Officer;
- Chief Legal Counsel;
- Marketing and Sales Director;
- Head of Purchasing;
- Head of Research and Development;
- Head of Information Technology;
- Head of Public/Investor Relations;
- Heads of Business/Product Lines;
- The General Director of a dependent company or subsidiary; and/or
- The Human Resources Director



The Formation and Termination of the Executive Bodies

Company Law Flexibility

The Company Law is flexible on who elects the executive bodies. It allows for the following options:

- The election of the General Director and Executive Board members **by the GMS**; or
- The election of the General Director and Executive Board members **by the Supervisory Board if the charter provides so**; or
- The election of the General Director by the GMS and of Executive Board members by the Supervisory Board if the charter provides so (**mix**)

Election by the General Meeting of Shareholders

- **Legislation does not specify the minimum and maximum periods** for which members of the executive bodies are elected
 - The charter, by-laws, or the employment agreement can specify the period for which the General Director and Executive Board members are elected
 - Members of the executive bodies can be reelected at will
- Nomination of Candidates for Executive Bodies
- Information About Candidates for the Executive Bodies
- The Election of the Executive Bodies by Written Consent
- The Election of Members of the Executive Bodies When the Executive Board Has an Insufficient Number of Members
- The Authority of the Interim General Director
- The Termination of the Authority of the Executive Bodies

Best Practices: Shareholders should have the opportunity to receive sufficient information (in writing and/or electronic form) about candidates for the position of General Director and the Executive Board before the GMS. Up-to-date information should also be made available to all shareholders during the GMS.²⁴⁷ The information about candidates for the executive bodies should include the:²⁴⁸

- Identity of the candidate;
- Age and educational background of the candidate;
- Position(s) held by the candidate during the last five years;
- Position(s) held by the candidate at the moment of his nomination;
- Relationship(s) that the candidate has with the company;
- Membership(s) of the candidate in the Supervisory Board of other legal entities, or any other positions held in such entities;
- Information on the nomination(s) of the candidate for a position in the executive bodies and other positions of other legal persons;
- Relationship(s) of the candidate with affiliated persons;
- Relationship(s) that the candidate has with major business partners of the company;
- Information related to the financial status of the candidate and other circumstances that may affect the duties of the candidate as a member of the executive bodies; and
- Refusal of the candidate, if any, to provide information to the company.²⁴⁹

It is recommended that candidates present a written statement to the GMS that indicates their willingness to accept the position of General Director or Executive Board member, should they be elected.²⁵⁰ In the absence of such statement, candidates should verbally confirm that they are willing to accept the position during the GMS.

Appointment by the Supervisory Board

- The procedures for the appointment and dismissal of members of the executive bodies are less onerous when the Supervisory Board has the authority to establish executive bodies
- When the charter allows, the executive bodies are **appointed** by the **Supervisory Board** and can be **dismissed** at any time by this same body
- The company will, **however**, as mentioned above, **need to comply with employment contracts** regarding notice, cause, and possible severance payments
- A **simple majority** of votes of Supervisory Board members is sufficient to appoint members of the executive bodies, unless the charter or by-laws require a higher percentage

The Working Procedures of the Executive Bodies

The Chairman of the Executive Board

- The **General Director presides** over Executive Board meetings
- For Executive Board meetings, the General Director (or Chairman of the Executive Board) has the authority to:
 - **Convene, organize, and preside over Executive Board meetings;**
 - **Sign all documents, decisions, and minutes** of the Executive Board; and
 - **Perform any other duties** as specified in the charter and by-laws

Best Practices: In addition, the Chairman of the Executive Board can:

- Facilitate discussions and decision-making, and create a constructive atmosphere; and
- Take steps to ensure that all members are sufficiently prepared to contribute to the work of the Executive Board.

Executive Board Meetings

- The charter and the by-laws shall establish:
 - The **frequency of Executive Board meetings**;
 - The **procedures for organizing and conducting Executive Board meetings**; and
 - The **procedures for making decisions during Executive Board meetings**

Best Practices: The precise frequency of meetings should, however, ultimately depend on the unique circumstances of each company.

The Right to Call an Executive Board Meeting

- The Right to Call an Executive Board Meeting

Best Practices: The Executive Board is a hands-on, problem-solving mechanism. Other Executive Board members should also have a voice in calling Executive Board meetings and setting the meeting agenda.²⁶⁴

Meeting Notification

- Since the Executive Board is a management tool, it will likely need to respond to the changing demands of the company and its external environment, and be prepared to act quickly

Best Practices: Executives should not vote on agenda items unless they are well informed. Whenever possible, materials should be sent to Executive Board members in advance, together with the notice and the meeting agenda.²⁶⁶ This may, however, not always be the case and, under some circumstances, sound decision-making may not be possible. Decision-making may be postponed when members:

- Cannot be notified in a timely manner; or
- Have not received the required information on time; or
- Have not been provided with sufficient time to prepare for the meeting.

Modus Operandi of Executive Board Meetings

The Quorum of Executive Board Meetings

- The **quorum** of Executive Board meetings refers to the number of members that must participate in the meeting before it can make a valid decision
- The **charter or by-laws** set the quorum, which **cannot be less than one half** of the total number of Executive Board members
- Any Executive Board meeting that lacks a quorum cannot make valid decisions

Voting During Executive Board Meetings

- A simple majority of Executive Board members who participate in the meeting is sufficient to approve Executive Board decisions, unless the charter or by-laws require a super-majority vote

The Minutes of Executive Board Meetings

- The Executive Board must keep minutes of each of its meetings

The Duties and Liabilities of the Members of the EB

The Duties and Liabilities of the Members of the EB

- The members of the executive bodies have the **same duties of care and loyalty as Supervisory Board members**, and are subject to the same liability standards as Supervisory Board members, unless either the charter, by-laws, or employment contract provide for stricter standards

Performance Evaluations, Remuneration and Reimbursement of the Executive Bodies

Performance Evaluations

- Periodic performance evaluations of the executive bodies are an important oversight tool
- They can help create a system of constant performance management and improvement

Starting with Best Practices ...

Best Practices: Executive remuneration is an important aspect in attracting managerial talent. Excessive executive remuneration packages on the other hand are often perceived as an unjustified privilege of power. Consequently, it is of the utmost importance that executive compensation be competitive, yet stay within reasonable limits, ideally in relation to a peer group of companies.

The remuneration of executive should not be left to the sole discretion of the executive bodies themselves.²⁷⁶ This should fall under the Supervisory Board's authority.²⁷⁷ Companies should state in their charters that the approval of executive remuneration is a prerogative of the Supervisory Board. It is important that the Supervisory Board take into consideration performance-related factors that are based on the company's key performance indicators when determining the remuneration of executives. Some of the issues that have a bearing on remuneration are:²⁷⁸

- Scope of responsibilities;
- Required type and level of qualifications;
- Experience of the candidates;
- Personal and business qualities of the candidates;
- Typical level of remuneration in the company and in the industry in general; and
- The financial performance of the company.

An executive's base salary is usually a function of his background and experience, whereas variable compensation is generally based upon the executive's performance.

Remuneration Policy

- The remuneration of managers can consist of **both a fixed and a variable component**
 - The fixed component typically consists of a base salary
 - The most important factor in determining an executive's base salary is compensation practice among a peer group of similar companies
 - The most important factor in determining an executive's variable remuneration is his contribution towards the short and long-term financial performance of the company
 - The variable component often consists of an annual **bonus** and is **based on key performance indicators**

Best Practices: The FCSM Code recommends that remuneration be based upon performance-related criteria.²⁷⁹ There is a multitude of ways to link executive pay to individual and company performance. Some common financial indicators utilized in variable compensation plans are:

- Earnings before interest, taxes, depreciation and amortization (EBITDA);
- Operating profit;
- Return on Assets (ROA);
- Return on Investment (ROI) or Equity (ROE);
- Return on Capital Employed (ROCE);
- Economic Value Added (EVA); and
- Achievement of specific individual objectives.

There are many other financial indicators. Non-financial indicators are equally important and valuable in managing executive performance, and can be organized around:

- Customers — for example, customer satisfaction levels, retention rates and customer loyalty, and acquisition;
- Operational processes and efficiency — for example, quality measures, cycle time measures, cost measures, and after sales service; and
- Internal growth/knowledge management — for example, training programs, employee satisfaction rates, employee absenteeism, and employee turnover.

The Supervisory Board will want to carefully develop key performance indicators, and link executive remuneration to these indicators.

Employment Contracts for Executives

- Legislation requires that the company conclude employment contracts with the General Director and Executive Board members
- These contracts must include:
 - The name of the General Director, or Executive Board member;
 - The name of the company;
 - The starting date of the contract;
 - The rights and duties of the General Director, or Executive Board member;
 - The rights and duties of the company;
 - Remuneration; and
 - The term of the contract

Severance Payments to the General Director and EB Members

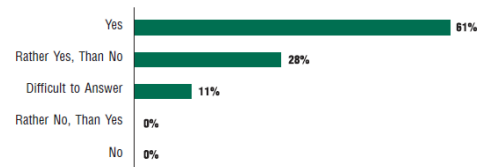
- Executives **may**, under certain circumstances, **be dismissed** without cause and yet receive severance payments
 - This may **occur when a company has been acquired** and the acquirer wishes to install new management
 - These severance plans are sometimes referred to as **golden parachutes**
 - Golden parachutes can be defined as a clause in an executive's employment contract specifying that he will receive large benefits in the event that the company is acquired and the executive's employment is terminated
 - These benefits can take the form of severance pay, a bonus, stock options, or a combination thereof. Like other forms of compensation, golden parachutes are often the object of criticism
- **Severance agreements may**, however, **be in the interest of shareholders** since they can **avoid prolonged** and costly **litigation** and public relations problems
 - Nevertheless, caution should be applied when putting them in place, and the assistance of competent outside advisors should be sought
 - The approval of severance payments should be a priority for the Supervisory Board and, possibly, the GMS

THE ROLE OF THE CORPORATE SECRETARY

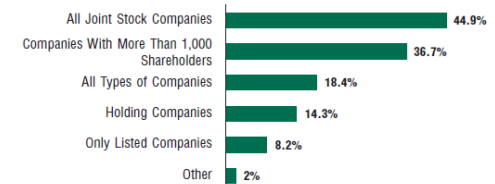
The Role of the Corporate Secretary

The Need for and Importance of the Corporate Secretary

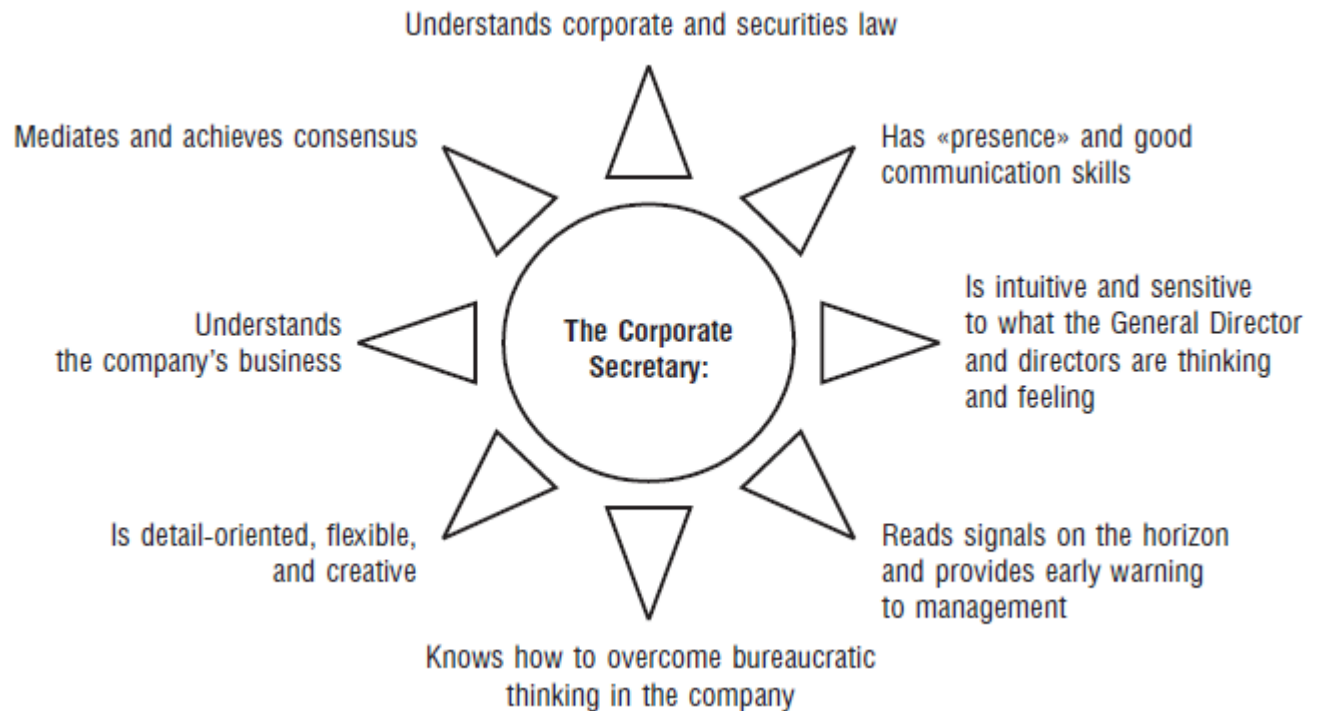
- Does the Corporate Secretary's Work Improve Corporate Governance?



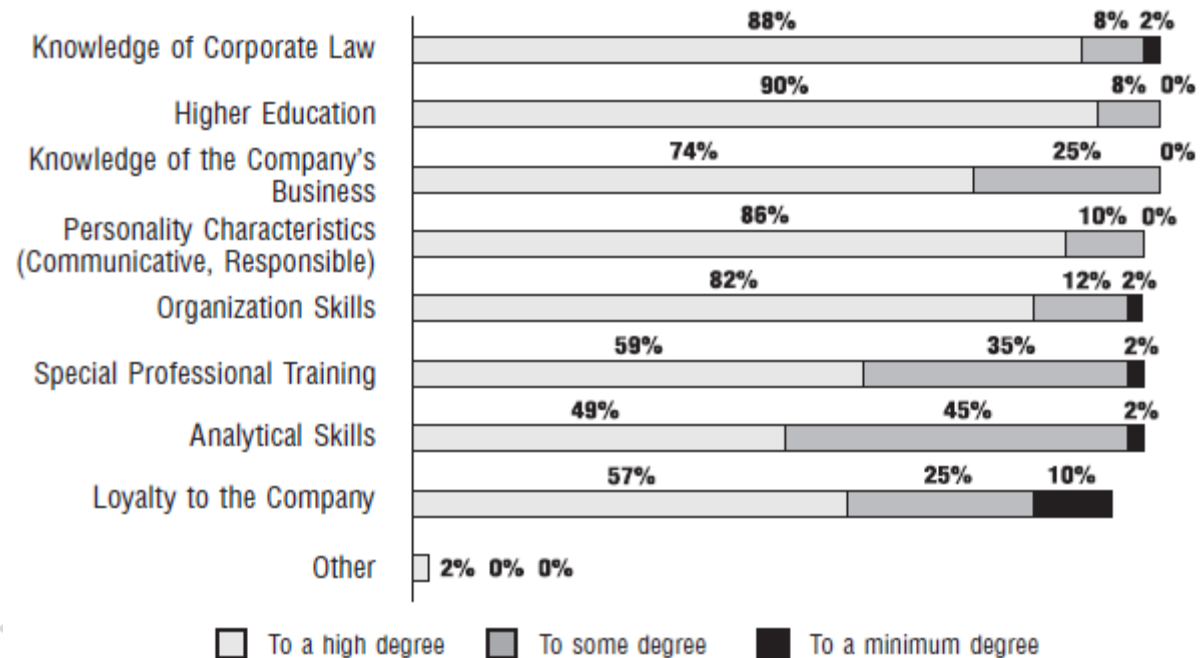
- Types of Companies that Require a Corporate Secretary?



The Qualifications of a Corporate Secretary

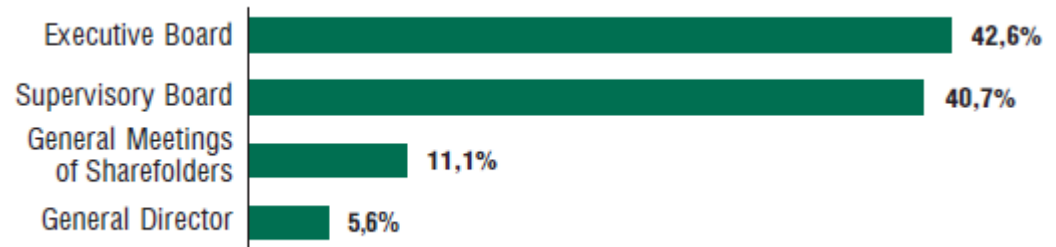


The Skills and Qualifications Required of a Corporate Secretary



The Independence of the Corporate Secretary

The Corporate Secretary Is Accountable to the



The Appointment of the Corporate Secretary

Information About Candidates

- Educational background;
- Employment in other companies;
- Any relationship they may have with affiliated persons and/or major business partners of the company; and
- The number and type (class) of company shares they own, if any;
- Any other aspects and circumstances that may influence their performance as Corporate Secretary

The Contract with the Corporate Secretary

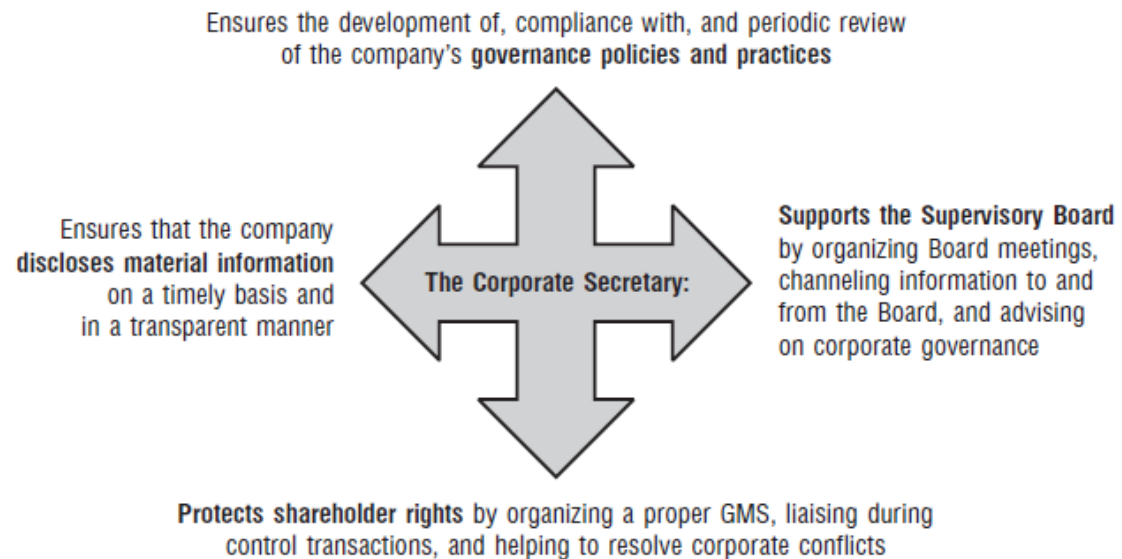
- The Supervisory Board may offer an employment contract to the Corporate Secretary

The Office of the Corporate Secretary

- Large companies may even find it necessary to establish an Office of the Corporate Secretary, staffed by several assistants

The Authority of the Corporate Secretary

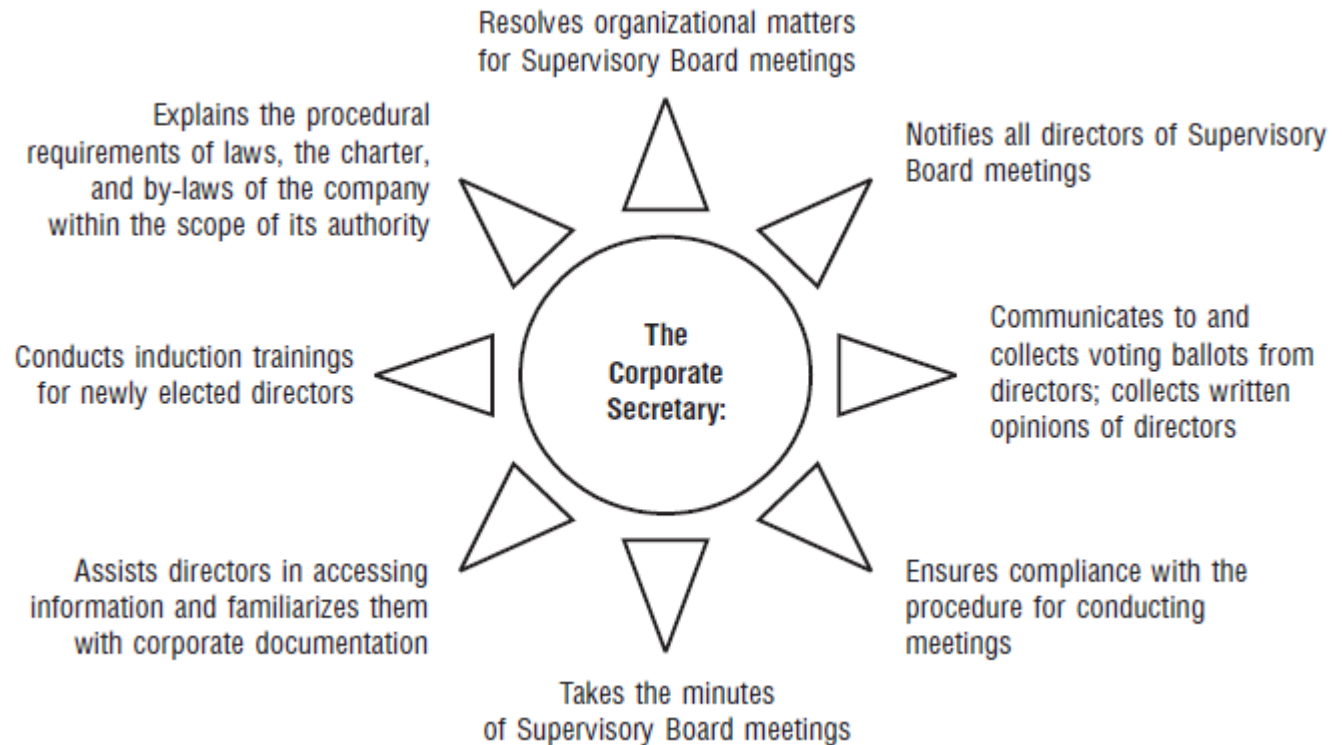
The Authorities of the Corporate Secretary



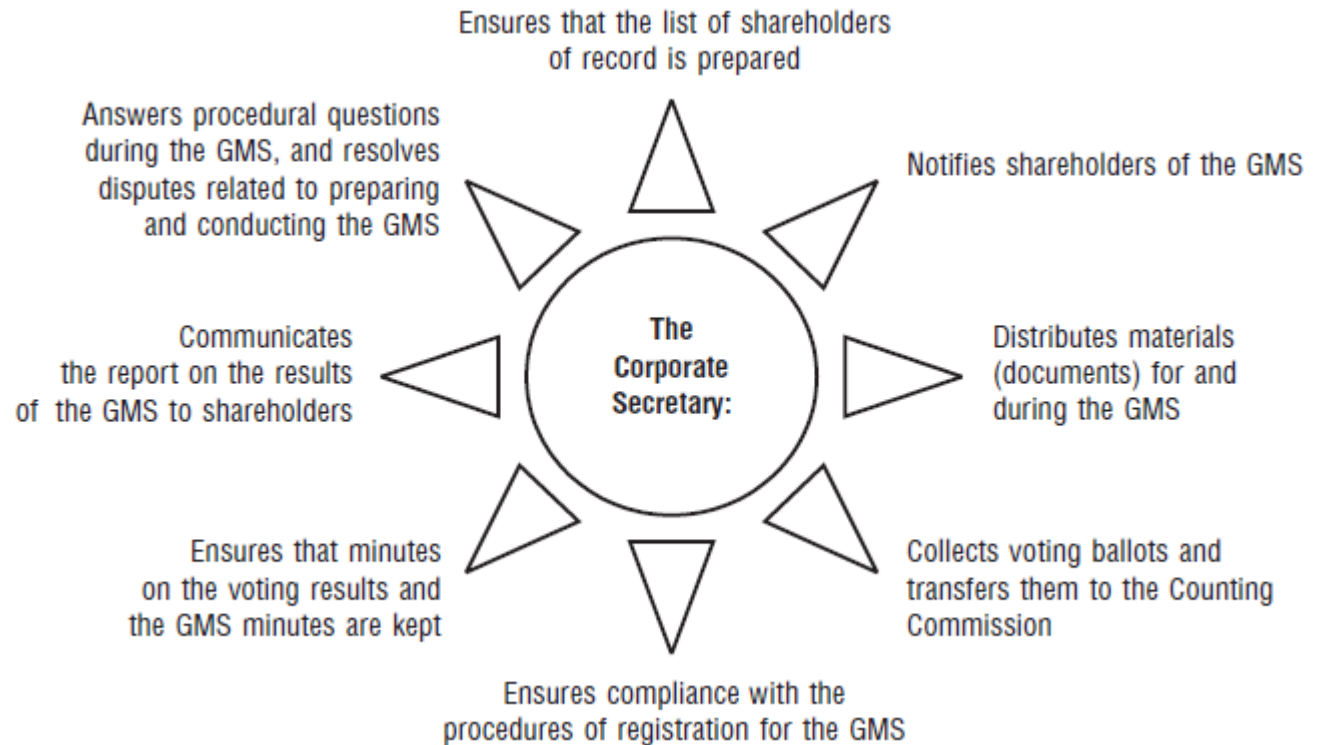
Developing Corporate Governance Policies and Practices

- The Corporate Secretary is ideally suited to help the company and its Supervisory Board develop a system of corporate governance
- More specifically, the Corporate Secretary can play an important role in the development of, compliance with, and periodic review of the company's governance policies and practices

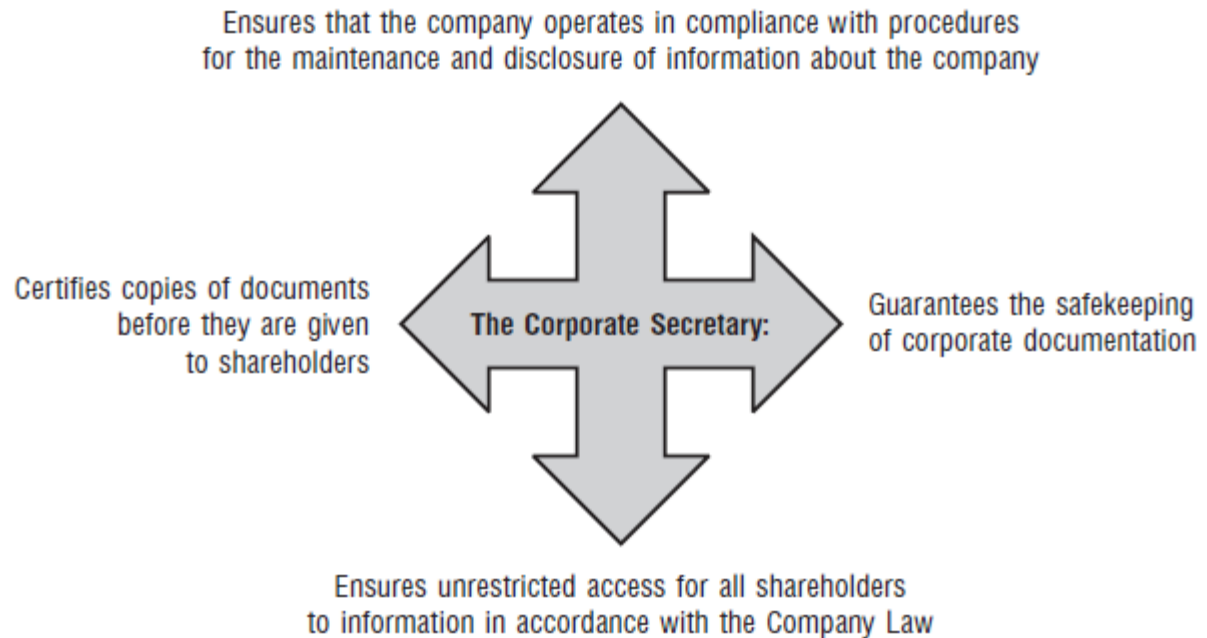
Functions in Relation to the Supervisory Board



Functions in Relation to the GMS



The Authorities Related to Information Disclosure



Corporate Secretary Coordinating Information Flows



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