

DR Abstract

The Practical Application of Corporate Governance

As part of its ongoing educational program for issuer clients, J.P. Morgan's DR Group held two seminars in Russia in October. The first of these seminars took place in Moscow and was titled 'The Practical Application of Corporate Governance'. It was led by Peter Russell, a member of the DR Group's IR Advisory Services team. The event's expert speakers included:

- Olga Demchuk, Adviser to Senior Vice-President Strategy and Business Development, TMK
- Alexander Filatov, Director, MICEX Stock Exchange and Head of Russian Independent Directors Association
- Stephen Page, Partner, Tricor Aldridge
- Mike Conroy, Partner, Tricor Aldridge
- Lyubov Nissemboim, Director, Consulting, PriceWaterhouseCoopers
- Dmitri Bolgov, Head of Corporate Governance, Promsvyazbankp

Corporate governance is commonly referred to as the way in which companies are directed and controlled. The governance landscape has changed dramatically in recent years. As the composition and influence of shareholders has shifted, so regulation has increased, imposing substantial disclosure requirements and other responsibilities on companies. However, while the principles of good governance are broadly known and there is widespread recognition that corporate governance does matter, the problem many companies face is with implementation. Moreover, as corporate boards defer to legislation and rules, corporate governance fatigue has set in. The J.P. Morgan event sought to bring to life the key governance principles for Russian corporates throughout their lifecycle. Governance specialists from Russia and abroad discussed the practical steps and behaviours necessary to deliver best practice governance solutions.

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Seminar highlights and a summary of the key issues discussed

Adhering to Governance Codes

Opening the event, Stephen Page from Tricor Group, a specialist in corporate governance advisory, pointed to a recent poll by Governance Metrics International that currently ranks Russia 26 out of 39 countries surveyed in terms of its overall quality of corporate governance (#1 ranking = Ireland; #2 ranking = UK; #5 ranking = US). Investment in corporate governance in Russia is necessary to expand and diversify its economy and effectively integrate with global markets. Focusing on the UK listing experience as a corporate governance exercise, Tricor highlighted the key disclosure requirements of a corporate governance statement under the London Stock Exchange's (LSE) Premium and Standard listing labels:

- The governance code to which the company is subject, or with which it voluntarily complies;
- Where the corporate governance code is available for review and reasons for any code departures;
- Main features of its financial internal control and risk management systems;
- Composition of its administrative, management and supervisory bodies and their committees.

The use of corporate governance codes is now common across Europe and the rest of the world. As regards compliance with UK governance code by issuers with a UK listing, there may be circumstances where non-compliance with certain aspects may be sensible. By ensuring transparency, the code provides an issuer with an opportunity to justify any non-compliance and allows a shareholder the opportunity to determine whether or not it accepts the explanation. Russian issuers with a GDR listing on the LSE are encouraged to respect the five main principles of the UK corporate governance code: leadership; effectiveness; accountability; remuneration; and relations with shareholders.

Shareholder Engagement

An important consideration for Russian GDR issuers listed on the LSE is that shareholders in the UK historically play an active role in corporate governance and are accorded genuine power and influence through company law to hold boards to account, hence the often cited reference to a shareholder-led approach. (This compares to the US regulator-led system that is seen to be predominantly enforced through SEC regulation, stock exchange listing rules and state law.) While a foreign listing and international shareholder base can influence corporate governance in the domestic market, there are many barriers to engagement, including ill-defined voting rights, practical difficulties in casting votes, lack of information and language difficulties. All shareholders therefore need to receive relevant information on time and vote without encountering unnecessary obstacles, wherever they are located.

Board Effectiveness

Building board effectiveness was a central theme to the speaker panel's discussion. According to Alexander Filatov, Director of Russia's MICEX Stock Exchange and Head of the Russian Independent Directors Association, an effective Board balances professional experience, financial acumen and good judgement. In Russia's current economic climate, there is an emerging trend for industrial and technological companies to reduce Board dependency, as opposed to financial services companies, which are increasing their number of Board directors. This is seen as a result of the need for a significant rebalancing of boards and assurance functions in companies that are of societal importance, such as major banks.

Board Directors of Russian companies can be distracted by poorly presented accounts, weak corporate presentations and day-to-day tactical concerns. Generally, a Board should focus on exercising its oversight role to control the company's overall situation, sustain the company's vision and mission, direct strategy and policy, and monitor the exercise of any delegated authority.

Risk is Good! No Reward without Risk

Non-executive oversight is often stretched in that directors have numerous responsibilities but only a limited amount of time to devote to the organisation. Additionally, investor pressure for higher returns continues unabated, leading many businesses to undertake risks that simply are not in the best long-term interests of the organisation. Effective risk governance starts at the top with the Board and executive group, focusing on the current and expected future capital requirements. It ensures a company's capital is central to all discussions about risk.

The Issuer Viewpoint

Olga Demchuk from the publicly-listed company and industry leader TMK, where she holds the position of Adviser to Senior Vice-President Strategy and Business Development, joined the speaker panel for this event to share her experience of corporate governance application. She noted the ever-increasing variety of regulations – from Russian Federal laws and obligations set by the domestic stock exchanges to international listing and disclosure rules – to which Russian issuers can be subject. In the effort to meet external governance expectations, internal stakeholders often miss out. Recognising employees as key stakeholders with which to communicate is a vital element of the corporate governance process, at the heart of which are processes and people. Sound corporate governance is as much reliant on internal commitment, healthy working relationships and a vibrant corporate culture, as it is on external marketplace legislation.

It was concluded that difficulties arise in striving to achieve a single, universal approach to implementing corporate governance principles. There are too many deep-rooted cultural and structural differences for a single approach to work well in all countries and for all companies regardless of their stage of development or business. However, the seminar identified the following criteria for the effective application of corporate governance principles generally:

- A high level of transparency, with coherent, focused and timely disclosures
- A way for shareholders to hold company Boards ultimately accountable for their decisions
- A real obligation to explain and justify decision-making, supported by adherence to listing standards, corporate law and rules set by regulators

Key Takeaways

- UK shareholders have historically played an active role in corporate governance.
- Barriers to shareholder engagement include ill-defined voting rights, practical difficulties in casting votes, lack of information and language difficulties.
- An effective Board of Directors balances professional experience, financial acumen and good judgement.
- Sound corporate governance is reliant on internal commitment, healthy working relationships and a vibrant corporate culture.
- There are too many deep-rooted cultural and structural differences for a single approach to corporate governance to work well in all countries and for all companies.

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