

2019

PROXY PAPER™

# GUIDELINES

AN OVERVIEW OF THE GLASS LEWIS APPROACH TO PROXY ADVICE

# RUSSIA



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# Guidelines Introduction

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## CORPORATE GOVERNANCE BACKGROUND

Under Russian law, companies must establish a board of directors or supervisory board, which is elected by shareholders and is responsible for overseeing executives.<sup>1</sup> Executive functions may be carried out by a single person, acting as a CEO or managing director, and as group forming an executive board. A maximum of 25% of the board of directors or supervisory board may be composed of executive board members and the board chair may not also serve as the company's sole executive body.<sup>2</sup>

Throughout these guidelines, any and all rules applicable to a company governed by a board of directors apply to a company that is governed by a supervisory board. In effect, the Russian governance system is a hybrid of the one-tier and two-tier models, so that supervisory boards and boards of directors are vested with the same powers and oversight responsibilities.

The Russian Federal Law on Joint Stock Companies FZ-208 ("LJSC") provides the primary legislative framework for Russian listed companies. The LJSC is a legally-binding document introduced December 26, 1995 and most recently amended on July 19, 2018.

Best practices for corporate governance in Russia are primarily based on the Corporate Governance Code (the "Code") issued by the Federal Securities Commission for the Securities Market in 2002, but most recently updated by the Bank of Russia in March 2014. Compliance with the Code is voluntary. However, the listing requirements of the Moscow Exchange ("MOEX") requires companies to disclose the extent to which they comply with the listing requirements regarding corporate governance principles, which have been developed on the basis of the Code and international best practice. Listing requirements (including those regarding board independence, board committees and disclosure) vary by listing segment. Listing requirements are most stringent for List 1, and progressively lessen in stringency for Lists 2 and 3.<sup>3</sup> Though requirements vary among listing segments, our voting recommendations will generally follow best practices in the market, as set forth in the Code.

## SUMMARY OF CHANGES FOR THE 2019 RUSSIA POLICY GUIDELINES

Glass Lewis evaluates these guidelines on an ongoing basis and formally updates them on an annual basis. This year we've made noteworthy revisions in the following areas, which are summarized below but discussed in greater detail in the relevant sections of this document:

### INDEPENDENCE CLASSIFICATION

We have clarified that we will evaluate on a case-by-case basis the independence of directors or nominees when such board member/candidate is considered independent by the company in deviation from the Code's requirements.

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<sup>1</sup> Articles 64 and 66 of the LJSC, a legally-binding document introduced December 26, 1995.

<sup>2</sup> Article 66(2.2) of the LJSC.

<sup>3</sup> Pursuant to listing rules effective October 10, 2018. See English version: <https://www.moex.com/s575>.

## **BOARD SKILLS**

From 2019, our analysis of election proposals at companies listed on the blue chip index will include an explicit assessment of the board's skills and competencies.

## **ENVIRONMENTAL AND SOCIAL RISK OVERSIGHT**

We have codified our approach to reviewing how boards are overseeing environmental and social issues. For companies listed in the blue-chip index and in instances where we identify material oversight issues, Glass Lewis will review a company's overall governance practices to identify which directors or board-level committees have been charged with oversight of environmental and/or social issues. Glass Lewis will also note instances when such oversight has not been clearly defined by companies in their governance documents. Further, we have clarified that, in instances where it is clear a company has not properly managed or mitigated environmental or social risks to the detriment of shareholder value, or when such mismanagement has threatened shareholder value, Glass Lewis may consider recommending that shareholders withhold support from members of the board who are responsible for oversight of environmental and social risks. In making these determinations, Glass Lewis will carefully review the situation at hand, its effect on shareholder value, as well as any corrective action or other response made by the company.

## **AUDIT COMMISSION DISSOLUTION**

We have updated our guidelines in order to reflect recent changes to the LJSC, which provide companies with the option of abolishing the audit commission, subject to the removal of relevant provisions from a company's charter. Should a company propose such amendments to its charter, we will recommend voting against such proposal in the absence of a compelling rationale.

## **AUDITOR**

We have updated our guidelines to clarify that we will take auditor tenure into consideration when assessing any pattern of inaccurate audits and any ongoing litigation or significant controversies that call into question an auditor's effectiveness.

# A Board of Directors that Serves the Interests of Shareholders

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## ELECTION OF BOARD OF DIRECTORS

The purpose of Glass Lewis' proxy research and advice is to facilitate shareholder voting in favour of governance structures that will drive performance, create shareholder value and maintain a proper tone at the top. Glass Lewis looks for talented boards with a record of protecting shareholders and delivering value over the medium- and long-term. We believe that boards working to protect and enhance the best interests of shareholders are independent, have a record of positive performance, and have members with a breadth and depth of experience.

Under Russian law, directors are elected by cumulative vote.<sup>4</sup> Under this system, the number of voting shares of each shareholder is multiplied by the number of persons to be elected, and a shareholder has the right to cast all votes for one candidate or divide the votes among two or more candidates. It is important to note that ownership in Russia is quite concentrated - many Russian companies are controlled either publicly by the Russian government, or privately by a so-called "oligarch". For such companies, a board's composition will usually reflect the controlling shareholder's significant ownership stake.

## INDEPENDENCE

The independence of directors, or lack thereof, is ultimately demonstrated through the decisions they make. In assessing the independence of directors, we will take into consideration, when appropriate, whether a director has a track record indicative of making objective decisions. Likewise, when assessing the independence of directors we will also examine whether a director's track record on multiple boards indicates a lack of objective decision-making. Ultimately, the determination of whether a director is independent or not must take into consideration compliance with the applicable independence criteria as well as judgments made while serving on the board.

We look at each director nominee to examine the director's relationships with the company, the company's executives, and other directors. We do this to find personal, familial, or financial relationships (not including director remuneration) that may impact the director's decisions. We believe that such relationships make it difficult for a director to put shareholders' interests above personal or related party interests.

Thus, we put directors into three categories based on an examination of the type of relationship they have with the company:

- **Independent Director** — An independent director has no material,<sup>5</sup> financial, familial<sup>6</sup> or other current

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<sup>4</sup> Article 66(4) of the LJCSC.

<sup>5</sup> "Material" as used herein means a relationship in which the value exceeds: (i) RUB 1.5 million (or 50% of the total remuneration paid to a board member, or where no amount is disclosed) for board members who personally receive remuneration for a professional or other service they have agreed to perform for the company, outside of their service as a board member. This limit would also apply to cases in which a consulting firm that is owned by or appears to be owned by a board member receives fees directly; (ii) RUB 3.5 million, or where no amount is disclosed, for those board members employed by a professional services firm such as a law firm, investment bank or large consulting firm where the firm is paid for services but not the individual directly. This limit would also apply to charitable contributions to schools where a board member is a professor, or charities where a board member serves on the board or is an executive, or any other commercial dealings between the company and the director or the director's firm; (iii) 2% of the company's consolidated gross revenue for other business relationships (e.g., where the director is an executive officer of a company that provides services or products to or receives services or products from the company).

<sup>6</sup> Familial relationships include a person's spouse, parents, children, siblings, grandparents, uncles, aunts, cousins, nieces, nephews, in-laws, and anyone (other than domestic employees) who shares such person's home. A director is an affiliate if the director has a family member who is employed by the company.

relationships with the company,<sup>7</sup> its executives, or other directors, except for board service and standard fees paid for that service. An individual who has been employed by the company (or its managing company) within the past five years is not considered to be independent.<sup>8</sup> We use a three-year look-back for all other relationships. In accordance with the Code, in certain exceptional instances, the board of directors may consider a particular nominee or board member to be independent despite his/her formal affiliations with the company, its significant shareholders or any of its material trading partners or competitors, provided that such affiliation does not affect his/her ability to make independent, objective and bona fide judgments. In such cases, we will evaluate independence on a case by case basis, also taking into account the rationale provided by the company.<sup>9</sup>

- **Affiliated Director** — An affiliated director has a material financial, familial or other relationship with the company or its executives, but is not an employee of the company.<sup>10</sup> This includes, but is not limited to, any director:
  - who is a business partner of the company;<sup>11</sup>
  - who is a representative of the federal government or one of its municipal divisions;<sup>12</sup>
  - who has served on the board for seven years or longer;<sup>13</sup>
  - whose employer has a material financial relationship with the company or the company's competitors;<sup>14</sup>
  - who directly own 1% or more of the company's share capital or voting rights or owns shares with a market value of more than 20 times his annual fee;<sup>15</sup> or
  - who is affiliated with any entity directly or indirectly controlling more than 5% of a company's share capital or voting rights.<sup>16</sup>
- **Inside Director** — An inside director simultaneously serves as a director and as an executive or employee of the company (or its managing company). This category may include a board chair who acts as an employee of the company or is paid as an employee of the company.

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7 A company includes any parent or subsidiary in a group with the company or any entity that merged with, was acquired by, or acquired the company.

8 In our view, a five-year standard is appropriate because we believe that the unwinding of conflicting relationships between former management and board members is more likely to be complete and final after five (5) years. However, Glass Lewis does not apply the five-year look-back period to directors who have previously served as executives of the company on an interim basis for less than one year. We note that Part B, Article 2.4.1(103.1) of the Code recommends that the look-back period for employment relationships be three years.

9 Part B, Article 2.4.2(108) of the Code.

10 If a company classifies a non-executive director as non-independent, Glass Lewis will generally classify that director as an affiliate.

11 Pursuant to Part B, Article 2.4.1(102.3) of the Code, this includes transactions with an annual value exceeding 2% of the asset value of the company or 2% of the company's annual revenue on a consolidated basis. In accordance with Part B, Article 2.4.1(106.2) directors directly or indirectly owning more than 5% of the share capital of a related company pursuant to this definition cannot be considered as independent.

12 Part B, Article 2.4.1(102.4) of the Code. In accordance with Part B, Article 2.4.1(107) such a representative will be defined as anyone who was an employee of the federal or a municipal government within the past year, served as a representative on the board when the federal government was given the right to a golden share, has a duty to vote in line with the federal or a municipal government, or was employed by any non-scientific or educational organisation controlled by the federal or a municipal government where the government owns more than 20% of the share capital or voting rights of the company where the candidate has been nominated to the board.

13 Article 2.4.1(104) of the Code. Pursuant to the Code, a board member may not be considered independent after serving on the board for more than seven years (consecutive or non-consecutive).

14 Additionally, pursuant to Part B, Article 2.4.1(106.2) directors directly or indirectly owning more than 5% of the share capital of a competitor cannot be considered as independent.

15 Part B, Article 2.4.1(103.4) of the Code.

16 Part B, Article 2.4.1(102.2) of the Code. Further, board members who concurrently serve on the boards of two or more companies owned by a major shareholder cannot be considered independent.

## VOTING RECOMMENDATIONS ON THE BASIS OF BOARD INDEPENDENCE

Glass Lewis believes a board will be most effective in protecting shareholders' interests when at least one-third of the directors are independent of the company.<sup>17</sup> Given the cumulative voting structure in Russia, we only recommend that shareholders vote for certain candidates. As a result, we will generally recommend shareholders cumulate their votes equally among several of the independent nominees to ensure that minority shareholders are represented on the board. We will recommend abstaining from voting on the remaining nominees.

Where a company has one or more significant shareholders that control more than 30% of a company's voting rights, or when there are more candidates than available positions, we will recommend that shareholders only vote for independent candidates in order to ensure that the maximum number of independent directors is elected.

In the event that an incumbent board does not meet our independence criteria and there are more candidates than available positions, taking into consideration the company's shareholding structure, we will typically recommend shareholders to cumulate their votes among a slightly smaller number of independent nominees than otherwise,<sup>18</sup> in order to increase the probability that at least some independent directors are elected to the board.

## VOTING RECOMMENDATIONS ON THE BASIS OF COMMITTEE INDEPENDENCE

We believe that a company's audit and remuneration committees should be composed exclusively of independent directors.<sup>19</sup> We believe the nominating committee should be composed of a majority of independent members.<sup>20</sup> Though we generally advocate for the greatest possible independence of these key committees, we believe that it is acceptable for the composition of the nominating committee to reflect the company's share ownership structure.

## VOTING RECOMMENDATIONS ON BOARDS WITH NO INDEPENDENT DIRECTORS

In such cases where the board is composed entirely of affiliated directors or insiders, we find no reason to recommend voting for any nominees based on independence considerations. Rather, we believe shareholders should voice their concerns regarding the absence of any independent nominees, particularly on key board committees, by refraining from supporting any of the affiliated directors who currently serve on key board committees. Moreover, we believe shareholders should refrain from supporting the nominating committee chair<sup>21</sup> who we believe should be held accountable for failing to nominate any independent candidates. In these cases, or where a company's disclosure is not sufficient to determine which nominees may be considered independent, we will recommend abstaining from voting on all of the proposed candidates.

## OTHER CONSIDERATIONS FOR INDIVIDUAL DIRECTORS

The most crucial test of a board's commitment to the company and its shareholders lies in the actions of the board and its members. We examine the performance of these individuals as directors and executives of the company and of other companies where they have served. We also review a director's experience, analyse possible conflicts of interest and consider how directors voted while on the board.

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<sup>17</sup> Article 2.4.3 of the Code.

<sup>18</sup> We will generally recommend voting for the number of independent directors that we believe is proportionate to minority shareholders' stake in a company. Where minority shareholders account for a sizeable portion of a company's share capital, we will typically recommend voting for as many independent directors as possible without risking diluting minority shareholders' voting power.

<sup>19</sup> Article 2.8.1 of the Code. Article 2.8.2 of the Code recommends that the remuneration committee should be composed exclusively of independent board members and the committee chair should not act as board chair.

<sup>20</sup> Article 2.8.3 of the Code.

<sup>21</sup> In the absence of a nominating committee, we may recommend abstaining from voting on the board chair.

## PERFORMANCE

We disfavour directors who have a record of not fulfilling their responsibilities to shareholders at any company where they have held a board or executive position. We will typically recommend abstaining from voting on:

- A director who fails to attend a minimum of 75% of applicable board meetings and committee meetings.<sup>22</sup>
- A director who is also the CEO of a company where a serious and material restatement has occurred after the CEO had previously certified the pre-restatement financial statements.
- In the event a company's performance has been consistently lower than its peers and the board has not taken reasonable steps to address the poor performance, we will consider recommending abstaining from voting on the incumbent nominees.

## EXPERIENCE

We find that a director's past conduct is often indicative of future conduct and performance. We often find directors with a history of overpaying executives or of serving on boards where avoidable disasters have occurred appearing at companies that follow these same patterns. Glass Lewis has a proprietary database that tracks the performance of directors across companies worldwide.

We typically recommend that shareholders abstain from voting for directors who have served on boards or as executives of companies with records of poor performance, overcompensation, audit- or accounting-related issues, and/or other indicators of mismanagement or actions against the interests of shareholders.<sup>23</sup>

## EXTERNAL COMMITMENTS

We believe that directors should have the necessary time to fulfill their duties to shareholders. In our view, an overcommitted director can pose a material risk to a company's shareholders, particularly during periods of crisis. In addition, recent research indicates that the time commitment associated with being a director has been on a significant upward trend in the past decade. As a result, we will typically not recommend voting for a director who serves as an executive officer of any public company while serving on more than two (2) public company boards and any other director who serves on more than five (5) other public company boards.<sup>24</sup> We count board chairships as double.

Further, because we believe that executives will presumably devote their attention to executive duties, we may not recommend that shareholders abstain from voting on overcommitted directors at the companies where they serve an executive function. Similarly, we expect a chair of any public company to reduce his or her external commitments appropriately and we may not recommend that shareholders abstain from voting on overcommitted directors at companies where they serve as chair.

## CONFLICTS OF INTEREST

In addition to the three key characteristics — independence, performance, experience — that we use to evaluate directors, we also consider conflict-of-interest issues in making voting recommendations.

We believe that a board should be wholly free of individuals who have an identifiable and substantial conflict of interest, regardless of the overall presence of independent directors on the board. Accordingly, we generally recommend that shareholders abstain from voting on the following:

<sup>22</sup> This will generally not apply to a director who has served for less than one full year, or when the company discloses that the director missed the meetings due to serious illness or other extenuating circumstances. Rather, we will note the failure and express our concerns. We note that board meeting attendance is rarely disclosed in Russia.

<sup>23</sup> We typically apply a three-year look-back to such issues and also research to see whether the responsible directors have been up for election since the time of the failure.

<sup>24</sup> The Code does not provide any indication as to the maximum number of boards on which an individual should serve.

- When determining whether a director serves on an excessive number of boards, we may consider the size and location of the other companies where the director serves on the board, and the director's attendance record.
- Directors who provide, or directors whose immediate family members provide consulting or other material professional services to the company: These services may include legal, consulting, or financial services. We question the need for the company to have consulting relationships with its directors. We view such relationships as creating conflicts for directors, since they may be forced to weigh their own interests against shareholder interests when making board decisions. In addition, a company's decisions regarding where to turn for the best professional services may be compromised when doing business with the professional services firm of one of the company's directors. Where a director has a material business relationship with a company that falls under the normal course of business, we will generally refrain from recommending to abstain from voting on the director on that basis alone provided that the company has adequately disclosed the relationship and mitigated the potential for serious conflicts of interest and so long as the board and key committees are sufficiently independent. We will also hold the relevant senior director with oversight of related party transactions (whether a board committee, ad hoc committee, or the board as a whole, depending on the board's internal procedures) accountable for particularly egregious transactions concluded between the company and an executive director, which may pose a potential risk to shareholders' interest.
- A director or a director who has an immediate family member engaging in airplane, real estate or similar deals including perquisite-type grants from the company amounting to more than RUB three million. Directors who receive these sorts of payments from the company may have to make unnecessarily complicated decisions that pit their interests against shareholders.
- Directors who have interlocking directorships. CEOs or other top executives who serve on each other's boards create an interlock that poses conflicts that should be avoided to ensure the promotion of shareholder interests above all else.<sup>25</sup>

## BOARD EVALUATION AND REFRESHMENT

Glass Lewis strongly supports routine director evaluation, including independent external reviews, and periodic board refreshment to foster the sharing of diverse perspectives in the boardroom and the generation of new ideas and business strategies. Further, we believe the board should evaluate the need for changes to board composition based on an analysis of skills and experience necessary for the company, as well as the results of the director evaluations, as opposed to relying solely on age or tenure limits. When necessary, shareholders can address concerns regarding proper board composition through director elections.

In our view, a director's experience can be a valuable asset to shareholders because of the complex, critical issues that boards face. This said, we recognise that in rare circumstances, a lack of refreshment can contribute to a lack of board responsiveness to poor company performance.

On occasion, age or term limits can be used as a means to remove a director for boards that are unwilling to police their membership and enforce turnover. Some shareholders support term limits as a way to force change in such circumstances.

While we understand that age limits can aid board succession planning, the long-term impact of age limits restricts experienced and potentially valuable board members from service through an arbitrary means. We believe that shareholders are better off monitoring the board's overall composition, including its diversity of skill sets, the alignment of the board's areas of expertise with a company's strategy, the board's approach to corporate governance, and its stewardship of company performance, rather than imposing inflexible rules that don't necessarily correlate with returns or benefits for shareholders.

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<sup>25</sup> There is no look-back period for this situation. This only applies to public companies and we only footnote it for the non-insider.

As such, we generally recommend voting against proposals that seek to introduce age or term limits. Similarly, we generally recommend voting for proposals that seek to repeal or increase age limits.

## BOARD STRUCTURE AND COMPOSITION

In addition to the independence of directors, other aspects of the structure and composition of a board may affect the board's ability to protect and enhance shareholder value.

### SIZE OF THE BOARD OF DIRECTORS

While we do not believe there is a universally applicable optimum board size, we do believe boards should have at least five (5) directors to ensure sufficient diversity in decision-making and to enable the formation of key board committees with independent directors. Conversely, we believe that boards with more than 20 members will typically suffer under the weight of "too many cooks in the kitchen" and have difficulty reaching consensus and making timely decisions. Sometimes the presence of too many voices can make it difficult to draw on the wisdom and experience in the room by virtue of the need to limit the discussion so that each voice may be heard.

We note that under Russian law, companies are required to have boards with at least five (5) directors.<sup>26</sup> With boards consisting of more than 20 directors, we will typically recommend abstaining from voting on the nominating committee chair.<sup>27</sup>

### SEPARATION OF THE ROLES OF BOARD CHAIR AND CEO

Under Russian law, the board chair may not serve as the company's sole executive body (i.e., CEO).<sup>28</sup> Further, the Code recommends that companies either appoint an independent chair or appoint a lead independent director to oversee the work of the independent members of the board.<sup>29</sup> Glass Lewis strongly supports the appointment of an independent presiding or lead director with authority to set the meeting agendas and to lead sessions outside the insider chair's presence.

### BOARD SKILLS

We believe companies should disclose sufficient information to allow a meaningful assessment of a board's skills and competencies. From 2019, our analysis of election proposals at companies listed on the blue chip index will include an explicit assessment of skills disclosure.

### BOARD-LEVEL RISK MANAGEMENT OVERSIGHT

Glass Lewis evaluates the risk management function of a public company board on a strictly case-by-case basis. Sound risk management, while necessary at all companies, is particularly important at financial firms which inherently maintain significant exposure to financial risk. We believe such financial firms should have a chief risk officer and/or a risk committee that reports directly to the supervisory board or a committee of the supervisory board charged with risk oversight. Moreover, many non-financial firms maintain strategies which involve a high level of exposure to financial risk. As such, any non-financial firm that has a significant hedging strategy or trading strategy that includes financial and non-financial derivatives should also have a chief risk officer and/or a risk committee that reports directly to the board or a committee of the board.

When analysing the risk management practices of public companies, we take note of any significant losses or writedowns on financial assets and/or structured transactions. In cases where a company has disclosed a sizable loss or writedown, and where a reasonable analysis indicates that the company's supervisory board-

<sup>26</sup> Article 66(3) of the LJSC stipulates that the minimum board size for a company with 1,000 or fewer shareholders with voting rights is five (5) directors. For companies having between 1,000 and 10,000 shareholders with voting rights, the minimum board size is seven (7) directors. For companies with more than 10,000 shareholders with voting rights, the minimum board size is nine (9) directors.

<sup>27</sup> In the absence of a nominating committee, we may recommend abstaining from voting for the board chair.

<sup>28</sup> Article 66(2.2) of the LJSC.

<sup>29</sup> Part B, Article 2.5.1 of the Code.

level risk committee should be held accountable for poor oversight, we would recommend shareholders not to vote for such committee members on that basis. In addition, in cases where a company maintains a significant level of financial risk exposure but fails to disclose any explicit form of board-level risk oversight (committee or otherwise),<sup>30</sup> we may recommend abstaining from voting on the board chair on that basis.

## ENVIRONMENTAL AND SOCIAL RISK OVERSIGHT

Glass Lewis understands the importance of ensuring the sustainability of companies' operations. We believe that an inattention to material environmental and social issues can present direct legal, financial, regulatory and reputational risks that could serve to harm shareholder interests. Therefore, we believe that these issues should be carefully monitored and managed by companies, and that companies should have an appropriate oversight structure in place to ensure that they are mitigating attendant risks and capitalizing on related opportunities to the best extent possible.

Glass Lewis believes that companies should ensure appropriate board-level oversight of material risks to their operations, including those that are environmental and social in nature. Accordingly, for large cap companies and in instances where we identify material oversight issues, Glass Lewis will review a company's overall governance practices and identify which directors or board-level committees have been charged with oversight of environmental and/or social issues. Glass Lewis will also note instances where such oversight has not been clearly defined by companies in their governance documents.

Where it is clear that a company has not properly managed or mitigated environmental or social risks to the detriment of shareholder value, or when such mismanagement has threatened shareholder value, Glass Lewis may consider withholding support from members of the board who are responsible for oversight of environmental and social risks. In making these determinations, Glass Lewis will carefully review the situation at hand, its effect on shareholder value, as well as any corrective action or other response made by the company.

## BOARD COMMITTEES

While the Code recommends that companies establish an audit committee, a nominating committee and a remuneration committee, companies may also establish other committees as deemed necessary.<sup>31</sup> In our analysis, we devote special attention to the audit, remuneration and nominating committees. In the absence of these committees, we will recommend abstaining from voting on the board chair on this basis.

We note that from July 1, 2020, Russian companies will be legally required to appoint an audit committee to the board for preliminary consideration of matters related to the control over the financial and economic activities of the company, including the assessment of the independence of the company's external auditor and the absence of a conflict of interest, as well as the assessment of the quality of the audit of financial statements.<sup>32</sup>

## AUDIT COMMITTEE PERFORMANCE

The audit committee promotes the active participation of the board of directors in the supervision of the company's financial and business operations, enabling it to ensure the efficiency of the company's internal control and risk management systems.<sup>33</sup>

When assessing an audit committee's performance, we are aware that an audit committee does not prepare financial statements, is not responsible for making the key judgments and assumptions that affect the financial statements, and does not audit the numbers or the disclosures provided to investors. Rather, an audit committee

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<sup>30</sup> A committee responsible for risk management could be a dedicated risk committee, or another board committee, (usually the audit committee or the finance committee), depending on a given company's board structure and method of disclosure. In some cases, the entire board is charged with risk management.

<sup>31</sup> Part B, Article 2.8.4(190) of the Code. Companies are also recommended to establish a corporate governance committee, an ethics committee, a risk management committee, a budget committee and/or a committee on health, security and environment on an ad hoc basis, and as deemed necessary.

<sup>32</sup> Article 64.3 of the LJSC.

<sup>33</sup> Part B, Article 2.8.2(171&172).

member monitors and oversees the processes and procedures performed by management, as well as internal and external auditors in ensuring accurate and timely financial reporting and disclosure.

## STANDARDS FOR ASSESSING THE AUDIT COMMITTEE

For an audit committee to function effectively on investors' behalf, it must include members with sufficient knowledge to diligently carry out their responsibilities. We prefer audit committees to be composed of members with both knowledge and experience in the fields of accounting and financial reporting.<sup>34</sup>

We are skeptical of audit committees containing members who do not possess expertise in finance and accounting or any other equivalent or similar areas of expertise. While we will not necessarily recommend not voting for members of an audit committee when such expertise is lacking, we are more likely to make such a recommendation when a problem such as a restatement occurs and such expertise is lacking.

Glass Lewis generally assesses audit committees against the decisions they make with respect to their oversight and monitoring role. The quality and integrity of the financial statements and earnings reports, the completeness of disclosures necessary for investors to make informed decisions, and the effectiveness of the internal controls should provide reasonable assurance that the financial statements are materially free from errors. The independence of the external auditors and the results of their work all provide useful information by which to assess the audit committee.

When assessing the decisions and actions of the audit committee, we typically defer to its judgment and vote in favor of its members. However, we may recommend abstaining from voting on the following members under the following circumstances:<sup>35</sup>

- The audit committee chair, if (i) audit and audit-related fees total one-half or less of the total fees billed by the auditor for two consecutive years; or (ii) the audit committee did not hold a sufficient number of meetings considering the company's financial situation and reporting requirements.<sup>36</sup>
- All members of an audit committee in office when: (i) material accounting fraud occurred at the company; (ii) financial statements had to be restated due to serious material fraud; (iii) the company repeatedly fails to file its financial reports in a timely fashion for two (2) or more years in a row; or (iv) the company has aggressive accounting policies and/or poor disclosure or lack of sufficient transparency in its financial statements.

## REMUNERATION COMMITTEE PERFORMANCE

Remuneration committees have the final say in determining the remuneration of executives. This includes deciding the basis on which remuneration is determined, as well as the amounts and types of remuneration to be paid. This process begins with the hiring and initial establishment of employment agreements, including the terms for such items as pay, pensions and severance arrangements. In establishing remuneration arrangements, it is important that remuneration be consistent with, and based on, the long-term economic performance of the business's long-term shareholders returns.

Remuneration committees are also responsible for the oversight of the transparency of remuneration. This oversight includes disclosure of remuneration arrangements, the matrix used in assessing pay for performance, and the use of remuneration consultants. It is important to investors to have clear and complete disclosure of all the significant terms of remuneration arrangements in order to make informed decisions with respect to the oversight and decisions of the remuneration committee.

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<sup>34</sup> We note that Part B, Article 2.8.1(174) of the Code recommends that at least one of the independent members of the audit committee should be qualified and experienced in the field of accounting and financial reporting.

<sup>35</sup> In the absence of an audit committee, we will consider recommending abstaining from voting on the board chair.

<sup>36</sup> We note that information regarding audit fees and audit committee meetings is not typically disclosed in Russia. We do not recommend that shareholders abstain from voting on any directors on this basis.

Finally, remuneration committees are responsible for oversight of internal controls over the executive remuneration process. This includes controls over gathering information used to determine remuneration, establishment of equity award plans, and granting of equity awards. Lax controls can and have contributed to conflicting information being obtained, for example through the use of nonobjective consultants. Lax controls can also contribute to improper awards of remuneration such as through granting of backdated or spring-loaded options, or granting of bonuses when triggers for bonus payments have not been met.

We evaluate remuneration committee members on the basis of their performance while serving on the remuneration committee in question, not for actions taken solely by prior committee members who are not currently serving on the committee.

When assessing the performance of remuneration committees, we may recommend abstaining from voting on the members of the remuneration committee if: (i) the company entered into excessive employment agreements and/or severance agreements; (ii) performance goals were changed (i.e., lowered) when employees failed or were unlikely to meet original goals, or performance-based remuneration was paid despite goals not being attained; or (iii) excessive employee perquisites and benefits were allowed.

## NOMINATING COMMITTEE PERFORMANCE

The nominating committee, as an agency for the shareholders, is responsible and accountable for selection of objective and competent directors.

Regarding the nominating committee, we may recommend abstaining from voting on the following members under the following circumstances:

- The nominating committee chair: (i) if the nominating committee did not meet during the year, but should have (i.e., because new directors were nominated); (ii) when the board is not sufficiently independent; or (iii) when there are less than three members on key board committees.
- All members of the nominating committee, when the committee nominated or renominated an individual who had a significant conflict of interest or whose past actions demonstrated a lack of integrity or inability to represent shareholder interests.

## ELECTION OF DIRECTORS AS A SLATE

In Russia, shareholders voting at the general meeting vote on nominees to the board individually by cumulative voting. However, in some rare circumstances, shareholders voting by proxy may only be given the choice of electing directors as a slate. In such cases, we will typically recommend that shareholders voting by proxy vote for the slate of nominees.

# Election of Corporate Bodies

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## ELECTION OF AUDIT COMMISSION

With the adoption of law 209-FZ of July 19, 2018, introducing changes to the LJSC, the establishment of an audit commission for public companies is no longer obligatory. Public companies may choose to abolish this corporate body provided that relevant changes have been made to their articles of association. Should a company propose the abolition of the audit commission we will recommend voting against such proposal in the absence of a compelling rationale.

Prior to the introduction of law 209-FZ, Russian companies were required to elect the audit commission at every annual general meeting. The audit commission is the corporate body in charge of controlling the operations and financial activities of the company. Commission members are elected by shareholders at general meetings for one-year terms.

Glass Lewis considers independent candidates as better able to discharge the duties of this corporate body.<sup>37</sup> However, it is customary for Russian companies to appoint employees of subsidiaries or candidates affiliated with the company or its major shareholders as members of the commission. We note that, under Russian law, members of the audit commission cannot be members of the supervisory board or hold offices in the management of the company.<sup>38</sup> We believe that this requirement protects the interests of shareholders by requiring nominees to meet a minimum level of independence.

Therefore, absent the showing of illegal or egregious conduct on the part of the corporate bodies, we will typically recommend voting for the election of the audit commission nominees. In cases where there are more candidates than available positions, Glass Lewis typically recommends that shareholder cumulate their votes equally for the independent nominees. However, in the absence of independent nominees, a common occurrence for the audit commission, we will review the nominees on a case-by-case basis and base our analysis and vote recommendation on the background and performance of each nominee.

## ELECTION AND REMOVAL OF EXECUTIVES

A Russian company's charter may provide that shareholders, rather than the board of directors, retain the right to remove and elect the company's executives (i.e., CEO and management board members).<sup>39</sup> Further, the powers of the sole executive may be transferred to an external management company with the consent of shareholders.<sup>40</sup> The responsibilities of the sole executive may be bestowed on several persons (individuals and/or legal entities), who may be permitted to act either jointly or independently.<sup>41</sup> Absent any evidence of egregious conduct, we will typically recommend that shareholders defer to the board's judgment on these matters.

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<sup>37</sup> Article 5.2.1 of the Code provides that the independence of the audit commission may be achieved by separating its functional and administrative reporting to the board of directors and the company's sole executive body, respectively.

<sup>38</sup> Article 85(6) of the LJSC.

<sup>39</sup> Article 69(3) of the LJSC.

<sup>40</sup> Article 69(1.3) of the LJSC.

<sup>41</sup> Civil Code, Article 65.3.

# Transparency and Integrity in Financial Reporting

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## ACCOUNTS AND REPORTS/CONSOLIDATED ACCOUNTS AND REPORTS

As a routine matter, Russian company law requires that shareholders approve a company's annual financial statements and annual report in order for them to be valid.<sup>42</sup> Prior to being submitted for shareholder review, a company's annual report must be approved by the supervisory board.<sup>43</sup> Consolidated financial statements, which must be prepared according to International Financial Reporting Standards (IFRS), are not, at this time, subject to shareholder approval.<sup>44</sup>

A company's consolidated financial statements combine the activities of the company with the activities of its subsidiaries.

Unless there are concerns about the integrity of the statements/reports, we will recommend voting for these proposals. However, in the event that the audited financial statements have not been made available, we do not believe shareholders have sufficient information to make an informed judgment regarding this matter. As such, we will recommend that shareholders abstain from voting on this agenda item.

## ALLOCATION OF PROFITS/DIVIDENDS

In Russia, companies must submit the allocation of income for shareholder approval.<sup>45</sup> We will generally recommend voting for such a proposal.

With respect to dividends, we generally support the board's proposed dividend (or the absence thereof). However, we may recommend that shareholders vote against a proposed dividend in cases where a company's dividend payout ratio, based on consolidated earnings, has decreased from a more reasonable payout ratio and for which no rationale or corresponding change in dividend policy has been provided by the company. In cases where a company has eliminated dividend payments altogether without explanation, we may recommend shareholders vote against the proposal. We will also scrutinise dividend payout ratios that are consistently excessively high (e.g., over 100%) relative to the company's peers, its own financial position or its level of maturity without satisfactory explanation. In most cases, we believe the board is in the best position to determine whether a company has sufficient resources to distribute a dividend to shareholders. As such, we will only recommend that shareholders refrain from supporting dividend proposals in exceptional cases.

## APPOINTMENT OF AUDITOR

Russian companies must submit their choice of external auditor for shareholder approval annually.<sup>46</sup>

The auditor's role as gatekeeper is crucial in ensuring the integrity and transparency of the financial information necessary for protecting shareholder value. Shareholders rely on the auditor to ask tough questions and to

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<sup>42</sup> Article 54(2) of the LJC.

<sup>43</sup> Article 88(4) of the LJC.

<sup>44</sup> Law on Consolidated Financial Statements.

<sup>45</sup> Article 54(2) of the LJC.

<sup>46</sup> Article 86(2) of the LJC.

do a thorough analysis of a company's books to ensure that the information provided to shareholders is complete, accurate, fair, and that it is a reasonable representation of a company financial position. The only way shareholders can make rational investment decisions is if the market is equipped with accurate information about a company's fiscal health.

Shareholders should demand an objective, competent and diligent auditor who performs at or above professional standards at every company in which the investors hold an interest. Like directors, auditors should be free from conflicts of interest and should avoid situations requiring a choice between the auditor's interests and the public's interests. Almost without exception, shareholders should be able to annually review an auditor's performance and to annually ratify a board's auditor selection.

## VOTING RECOMMENDATIONS ON AUDITOR APPOINTMENT

We generally support management's choice of auditor except when we believe the auditor's independence or audit integrity has been compromised. When there have been material restatements of annual financial statements or material weakness in internal controls, we usually recommend voting against the auditor. We will also take auditor tenure into consideration when assessing any pattern of inaccurate audits and any ongoing litigation or significant controversies which call into question an auditor's effectiveness when making this determination. In the event that the audited financial statements have not yet been disclosed, we recommend that shareholders abstain from voting on this agenda item. We do not hold a company's auditor responsible for, what we believe, may be the company's failure to comply with reporting obligations or a lack thereof, depending on the jurisdiction.

Reasons why we may not recommend ratification of an auditor include:

- When audit fees plus audit-related fees total less than one-half or less of the total fees billed by the auditor, unless a specific justification is provided;
- Recent material restatements of annual financial statements, including those resulting in the reporting of material weaknesses in internal controls and including late filings by the company where the auditor bears some responsibility for the restatement or late filing;<sup>47</sup>
- When the company has aggressive accounting policies evidenced by restatements or other financial reporting problems;
- When the company has poor disclosure or lack of transparency in its financial statements;
- Other relationships or concerns exist with the auditor that might suggest a conflict between the auditor's interests and shareholder interests.

In cases where the company does not disclose sufficient information regarding the appointment or ratification of the auditor (e.g., the name of the auditor), we will recommend an abstain vote. Although recommended by the Code,<sup>48</sup> it is neither required by law nor common for Russian companies to disclose information regarding the past or proposed auditor's fees. Thus, based on market practice, we will recommend that shareholders support the auditor's appointment as long as the proposed auditor has been identified and we have found no evidence that the auditor's integrity has been compromised.

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<sup>47</sup> An auditor does not audit a company's interim financial statements. Thus, we generally do not believe that an auditor should be opposed due to a restatement of interim financial statements unless the nature of the misstatement is clear from a reading of the incorrect financial statements.

<sup>48</sup> Article 6.2.3(294§3) of the Code.

# The Link Between Pay and Performance

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Shareholders of Russian companies are typically asked to vote on the policies or regulations for setting directors' fees. Other than this proposal, shareholders are not entitled to any votes on remuneration-related issues.

## **DIRECTORS' FEES AND REGULATIONS FOR DIRECTOR REMUNERATION**

The remuneration paid to the members of the board of directors for performing their duties is determined by shareholders at the annual meeting.<sup>49</sup> Such approval may take the form of approval of regulations governing director remuneration.

Glass Lewis believes that non-employee directors should receive remuneration for the time and effort they spend serving on the board and its committees. Directors' fees should be competitive in order to retain and attract qualified individuals. However, excessive fees can represent a financial cost to the company and can threaten to compromise the objectivity and independence of non-employee directors. Therefore, a balance is required. We will typically recommend voting for the directors' fixed fees, except where a company has proposed a large increase in fees without sufficient justification.

When a company proposes to pay directors additional fees other than fixed fees, we will typically recommend voting against the fees absent a clear, reasonable cap and sufficient rationale from the Company. Such fees could include bonuses or profit-sharing schemes, which are not uncommon in Russia. In our view, such payments threaten the independence and objectivity of directors by aligning their interests with management. Moreover, where a company proposes to introduce or increase such fees, we will recommend voting against the proposal.

## **EXECUTIVE REMUNERATION AND EQUITY INCENTIVE PLANS**

Under Russian law, shareholders are not entitled to vote on executive remuneration or equity remuneration. Moreover, the Code does not currently contain any recommendation regarding a shareholder vote on executive remuneration.

We view the election of directors, and specifically those who sit on the remuneration committee, as the appropriate mechanism for shareholders to express their disapproval or support of board policy on this issue. Further, we believe that companies whose pay-for-performance is in line with their peers should be granted the flexibility to compensate their executives in a manner that drives growth and profit. However, Glass Lewis favours performance-based remuneration as an effective means of motivating executives to act in the best interests of shareholders.

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<sup>49</sup> Article 64(2) of the LJC.

# Governance Structure and the Shareholder Franchise

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## AMENDMENTS TO THE CHARTER AND INTERNAL REGULATIONS

In Russia, companies often have internal regulations governing the rules of procedure for the board of directors or executives, the directors' and/or audit commissions' fees, and the general meeting, in addition to the charter. Companies may present amended and restated versions of the charter or internal regulations for approval.

We will evaluate proposed amendments to a company's charter and internal regulations on a case-by-case basis. We are opposed to the practice of bundling several amendments under a single proposal because it might force shareholders to vote in favour of amendments that they might otherwise reject had they been submitted as separate proposals. In such cases, we will analyse each change individually. We will recommend voting for the proposal only when, on balance, we believe all the amendments are in the best interests of shareholders.

Regardless of whether a company seeks approval of new versions of the charter or internal regulations or only of specific amendments, we will generally recommend that shareholders abstain from voting on such proposals where the company has not provided documentation detailing each of the proposed changes. In addition, we expect companies to provide a specific, detailed rationale for any changes that may affect shareholders' interests.

## RELATED PARTY TRANSACTIONS

In Russia, shareholders are requested to approve certain related party transactions. Russian law defines the related party transactions as agreements to be entered into, directly or indirectly, between the company and its directors, members of the executive board, a shareholder owning at least 50% of the company's voting rights or a person empowered to give the company mandatory instructions.<sup>50</sup>

In particular, such transactions must be approved by the majority of disinterested shareholders if (i) the value of the transaction is equal to or exceeds 10% of the book value of the company's assets; (ii) the transaction involves the issuance of common or preferred shares or convertible debt instruments in an amount exceeding 2% of the company's issued voting stock.<sup>51</sup>

We will evaluate related party transactions on a case-by-case basis. Most of such transactions fall within the company's regular course of business. As such, we will generally approve such transactions absent a showing of egregious or illegal conduct that might threaten shareholder value. Further, we believe that directors can be held accountable on these issues when they face re-election. It is our opinion that management and the board are in the best position to determine what operational decisions are the best in the context of the business.

However, details regarding the proposed related party transactions are not always disclosed by companies. In cases where insufficient information is provided by the company, we will recommend that shareholders abstain from voting on the proposal.

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<sup>50</sup> Article 81(1) of the LJSC.

<sup>51</sup> Article 83(4) of the LJSC.

## ANTI-TAKEOVER DEVICES

Glass Lewis believes that authorities that are intended to prevent or thwart a potential takeover of a company are not conducive to good corporate governance and can reduce management accountability by substantially limiting opportunities for shareholders.

## SUPERMAJORITY VOTE REQUIREMENTS

Glass Lewis believes that supermajority vote requirements act as impediments to shareholder action on ballot items that are critical to shareholder interests. One key example is in the takeover context where supermajority vote requirements can strongly limit the voice of shareholders in making decisions on such crucial matters as selling the business. Russian law requires a supermajority of voting capital be present at a shareholder meeting in order for certain voting decisions to be valid.<sup>52</sup> While we recognise that supermajority voting requirements are imposed by national law for approval of certain proposals, we will recommend voting against any proposal seeking to extend supermajority voting requirements to decisions where a supermajority requirement is not stipulated by law and such provisions are not clearly designed to protect the interests of minority shareholders. In cases where a company seeks to abolish supermajority voting requirements we will evaluate such proposals on a case-by-case basis. In many instances, amendments to voting requirements may have a deleterious effect on shareholders rights where a company has a large or controlling shareholder. Therefore, in analysing such proposals Glass Lewis will take into account additional factors including: shareholder structure; quorum requirements; impending transactions – involving the company or a major shareholder – and any internal conflicts within the company.

## OWNERSHIP REPORTING REQUIREMENTS

Russian law requires that companies disclose relevant information to shareholders in the event that any shareholder's percentage ownership of outstanding shares with voting rights in a company rises above or falls below the thresholds of 5%, 10%, 15%, 20%, 25%, 30%, 50%, 75% or 95%.<sup>53</sup>

## MANDATORY TENDER OFFER PROVISIONS

Russian law requires a shareholder to make a mandatory tender offer for all of the company's outstanding shares if it acquires control over 30% or more of the total outstanding voting share capital.<sup>54</sup>

In the event that control of a company changes hands, we believe that minority shareholders should be granted the right to tender their shares under the same conditions as those granted to the majority shareholder. However, a balance should be maintained between the need for minority protection and the promotion of takeover activities. Therefore, we will typically oppose provisions that allow the ownership threshold be set at a lower percentage than what is mandated by law, as they may function as a defensive mechanism that discourages investors from purchasing shares in a company.

## SHAREHOLDER RIGHTS

Glass Lewis strongly supports the right of shareholders to call special meetings. We note that, pursuant to Russian law, only shareholders holding at least 10% of a company's share capital are entitled to call a special meeting.<sup>55</sup>

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<sup>52</sup> Article 49(4) of the LJC. Such proposals may include amendments to the company's articles of association, company reorganisation, liquidation, delisting of company shares, share repurchase and determination of the amount, par value, type and rights of shares, and major transactions.

<sup>53</sup> Article 30 (14.25) of the Federal Law on Securities Market.

<sup>54</sup> Article 84(2.1) of the LJC.

<sup>55</sup> Article 55(1) of the LJC.

# Capital Management

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## INCREASES IN CAPITAL

Glass Lewis believes that adequate capital stock is important to a company's operation. Russian companies are authorised to increase share capital through several methods, which may or may not involve the issuance of shares.

## ISSUANCE OF SHARES AND/OR CONVERTIBLE SECURITIES

Under Russian law, increasing a company's capital through the issuance of additional shares is subject to shareholder approval only in cases where (i) this matter is specifically entrusted to shareholders by the company's articles of association;<sup>56</sup> (ii) additional shares are offered by private placement;<sup>57</sup> and (iii) the issuance of shares and/or convertible securities exceeds 25% of the company's total share capital.<sup>58</sup>

In general, issuing an excessive amount of additional shares and/or convertible securities can dilute existing holders. Further, the availability of additional shares, where the board has discretion to implement a poison pill, can often serve as a deterrent to interested suitors. Accordingly, where we find that the company has not detailed a plan for use of the proposed shares, or where the number of shares far exceeds those needed to accomplish a detailed plan, we typically recommend against the authorisation of additional shares.

While we think that having adequate shares to allow management to make quick decisions and effectively operate the business is critical, we prefer that, for significant transactions, management come to shareholders to justify their use of additional shares rather than providing a blank check in the form of a large pool of unallocated shares available for any purpose. We will consider the discount price at which the new shares may be issued where disclosed. Where a company seeks to issue shares at a significantly discounted price without a comprehensive explanation, we may recommend that shareholders do not support the authorisation in question.

## WITH OR WITHOUT PREEMPTIVE RIGHTS

In our view, any authorisation to issue shares and/or convertible securities with preemptive rights should not exceed 100% of the company's total share capital and any authorization to issue shares and/or convertible securities without preemptive rights should not exceed 25% of the company's total share capital.

## AUTHORISED CAPITAL

By law, increases in authorised capital require shareholder approval.<sup>59</sup> Shares issued pursuant to these authorities may be used for a broad range of corporate purposes, including raising funds for expansion plans, refinancing existing loans, or carrying out mergers and acquisitions. Because such shares are subject to shareholder approval under the aforementioned conditions, we generally do not view authorities to increase authorised capital as a contentious issue.

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<sup>56</sup> Article 48.1(6) of the LJSC.

<sup>57</sup> Article 39(3) of the LJSC. Such proposals require 75% supermajority approval.

<sup>58</sup> Article 39(4) of the LJSC. Such proposals require 75% supermajority approval.

<sup>59</sup> Article 27(2) of the LJSC.

## AUTHORITY TO REPURCHASE SHARES

Though not common in Russia, shareholders may be asked to vote on the authority to repurchase shares, if determined in the company's articles of association.<sup>60</sup> A company may want to repurchase or trade in its own shares for a variety of reasons. A repurchase plan is often used to increase the company's stock price, to distribute excess cash to shareholders or to provide shares for equity-based incentive plans for employees. In addition, a company might repurchase shares in order to offset dilution of earnings caused by the exercise of stock options.

We will recommend voting in favor of a proposal to repurchase and trade in company stock when the following conditions are met: (i) a maximum of 10% of the company's total shares may be repurchased; (ii) a maximum price which may be paid for each share (as a percentage of the market price); and (iii) the share buyback may not be used as a takeover defense.

We note that Russian law limits the number of shares which may be repurchased to no more than 10% of the company's capital.<sup>61</sup>

## AUTHORITY TO CANCEL SHARES AND REDUCE CAPITAL

In conjunction with a share repurchase program, companies often proceed to subsequently cancel the repurchased shares. As a general rule, we believe that buyback programs and associated share cancellation programs are in shareholders' best interest, so long as the company is left a sufficiently strong balance sheet in light of its capital requirements.

Repurchased shares must be reissued at a price no lower than their market value within one year of their repurchase. Otherwise, shareholders may decide to cancel such shares and decrease the share capital.<sup>62</sup>

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<sup>60</sup> Article 72(1) of the LJSC.

<sup>61</sup> Article 72(2) of the LJSC.

<sup>62</sup> Article 72(3) of the LJSC.

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