THE EXECUTIVE REMUNERATION REVIEW

Sixth Edition

Editors
Arthur Kohn and Janet Cooper

THE LAWREVIEWS

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SIXTH EDITION

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This article was first published in November 2017
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Published in the United Kingdom
by Law Business Research Ltd, London
87 Lancaster Road, London, W11 1QQ, UK

www.TheLawReviews.co.uk

ISBN 978-1-910813-87-4

Printed in Great Britain by
Encompass Print Solutions, Derbyshire
Tel: 0844 2480 112

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THE MINING LAW REVIEW

THE EXECUTIVE REMUNERATION REVIEW

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THE TAX DISPUTES AND LITIGATION REVIEW

THE LIFE SCIENCES LAW REVIEW

THE INSURANCE AND REINSURANCE LAW REVIEW

THE GOVERNMENT PROCUREMENT REVIEW

THE DOMINANCE AND MONOPOLIES REVIEW

THE AVIATION LAW REVIEW

THE FOREIGN INVESTMENT REGULATION REVIEW

THE ASSET TRACING AND RECOVERY REVIEW

THE INSOLVENCY REVIEW

THE OIL AND GAS LAW REVIEW

THE FRANCHISE LAW REVIEW

THE PRODUCT REGULATION AND LIABILITY REVIEW

THE SHIPPING LAW REVIEW

THE ACQUISITION AND LEVERAGED FINANCE REVIEW

THE PRIVACY, DATA PROTECTION AND CYBERSECURITY LAW REVIEW

THE PUBLIC–PRIVATE PARTNERSHIP LAW REVIEW

THE TRANSPORT FINANCE LAW REVIEW

THE SECURITIES LITIGATION REVIEW

THE LENDING AND SECURED FINANCE REVIEW

THE INTERNATIONAL TRADE LAW REVIEW

THE SPORTS LAW REVIEW

THE INVESTMENT TREATY ARBITRATION REVIEW

THE GAMBLING LAW REVIEW

THE INTELLECTUAL PROPERTY AND ANTITRUST REVIEW

THE REAL ESTATE M&A AND PRIVATE EQUITY REVIEW

THE SHAREHOLDER RIGHTS AND ACTIVISM REVIEW

THE ISLAMIC FINANCE AND MARKETS LAW REVIEW

THE ENVIRONMENT AND CLIMATE CHANGE LAW REVIEW

THE CONSUMER FINANCE LAW REVIEW

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ACKNOWLEDGEMENTS

The publisher acknowledges and thanks the following law firms for their learned assistance throughout the preparation of this book:

ALLEN & OVERY

ALRUD LAW FIRM

BAKER MCKENZIE

BONN STEICHEN & PARTNERS

CLEARY GOTTLIEB STEEN & HAMILTON LLP

CREEL, GARCÍA-CUÉLLAR, AIZA Y ENRÍQUEZ SC

GORRISSEN FEDERSPIEL

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CONTENTS

Chapter 17

RUSSIA

Elena Novikova and Olga Pimanova[1]

I INTRODUCTION

Russian law does not provide for specific regulation of executive remuneration in the form of equity plans, and until recently, there were no special regulations related to cash remuneration. Recently, the legislator introduced special rules regulating the remuneration of executives in companies where the state has a stake (certain limits on payments in the case of termination of employment, etc.). The only non-state economic sectors for which some rules on remuneration have been introduced so far are the banking sector (on 1 January 2014 the Central Bank of Russia implemented regulations on remuneration in credit organisations that set certain requirements for the remuneration of risk takers in credit organisations) and financial industry (non-state pension funds, insurance companies, certain securities markets participants – since 14 July 2016); mainly they follow the principles of EU Capital Requirements Directive IV in this respect.

II TAXATION

i Income tax for employees

Generally, Russia taxes the worldwide income of its tax residents and Russian-sourced income of non-residents.

In accordance with the provisions of the Tax Code of Russia (the Tax Code), the Russian tax resident is an individual who spends at least 183 calendar days within 12 consecutive months on Russian territory. All days when an individual stays in Russia (including days of arrival and departure in case of travelling) are taken into account while calculating the number of days for tax residency purposes. It is important that days spent travelling outside Russia for short-term treatment or study (less than six months) are also counted as spent in Russia.

The final tax status of an individual is determined for the tax period (which is the calendar year from 1 January to 31 December).

Individuals considered as Russian tax residents are obliged to pay personal income tax on their worldwide income received (salaries or other remunerations, dividends, sale of property, capital gain, etc.). The general personal income tax rate is 13 per cent. However, the 35 per cent tax rate applies to the certain types of income received by the Russian tax

1 Elena Novikova is counsel and Olga Pimanova is senior associate at ALRUD Law Firm.

residents, such as interest on bank deposits exceeding certain limits; prizes and winnings received within promotional campaigns where the relevant income exceeds 4,000 roubles; and certain others.

Non-resident individuals pay personal income tax at the 30 per cent rate on all Russian-sourced income except for dividends from Russian companies, which are taxed at the 15 per cent rate. Income received from the sources located outside the territory of Russia is not taxable for non-residents. There are certain exceptional cases when a non-tax resident pays the personal income tax at the 13 per cent rate. Foreign nationals who have the status of highly qualified specialist pay 13 per cent personal tax on the employment remuneration irrespective of their actual tax status.

Tax legislation in Russia does not specifically regulate the taxation of the compensatory payments to executives. In the meantime, the Tax Code includes a list of specific compensatory payments that may be exempted from taxation, for example, dismissal payments, compensation for damage caused by injury or other impairment of health and some others.

Those compensatory payments that are not included into the above-mentioned list are taxed under general rules.

If an incentive programme assumes the establishment of a special structure, the employee may be subject to additional reporting obligations.

For example, if the executive, being a Russian tax resident, becomes a participant in a fund, trust or partnership, the individual may fall under the controlled foreign company regulation.

In such a case, the executive employee will have extra requirements on disclosure of information, regular reporting on the structure and tax payment on income received by the structure in an appropriate part that belongs to the individual. The legal qualification of such special arrangements may differ and should be specially analysed in each particular case.

As a rule, personal tax obligation arises once an employee receives cash or in-kind income. Thus, receipt of cash on a bank account or delivery of shares, which lead to the receipt of the actual benefit, may be taxable events from the Russian perspective. Generally, there are no personal income tax implications in connection with deferral of the remuneration.

In the case the shares are granted free of charge or purchased by an employee at a price below fair market value, the employee obtains a taxable benefit. The taxable income is the difference between the fair market value of the securities and their actual purchase price.

Owing to the specifics of the Russian law there is a risk that share options may be classified as non-traded financial instruments that, in turn, may lead to double taxation of an employee: (1) at the moment when the employee is granted a share option, and (2) when the option is exercised. Although there were no public negative cases and most incentive schemes are unlikely to be classified as non-traded financial instruments, which are subject to tax at grant, monitoring the practice and regularly assessing possible obligation to pay personal income tax at grant of an award is recommended. Eligible employees may also apply for official clarification from the Russian Ministry of Finance in order to check the position of the fiscal authorities.

ii Social taxes for employees

In Russia, social contributions are the sole obligation of employers and they should not be withheld from the remuneration of an employee. Obligatory social contributions are paid on

most remuneration and benefits paid to an employee except for certain types of payments, such as dismissal payments, compensation of business trips expenses, voluntarily insurance contributions (if the insurance contract term is more than one year) and some others.

Since 2017, an employer is obliged to pay social contributions in the following schemes:

a pension fund contribution of 22 per cent is payable on the annual income of an employee up to 876,000 roubles and 10 per cent above the threshold;

b social insurance fund contribution of 2.9 per cent is payable on the annual income of an employee up to 755,000 roubles. For foreigners and stateless persons (except for highly qualified specialists) this rate is 1.8 per cent within the threshold; and

c medical insurance fund contribution of 5.1 per cent is paid on all remuneration without any thresholds.

The thresholds are subject to annual revision taking into account the growth of the average remuneration in Russia.

Besides the obligatory social contributions, employers are also obliged to pay accident insurance contributions. The applicable rate varies from 0.2 per cent up to 8.5 per cent and depends on the degree of professional risk that the employer's activity entails.

iii Tax deductibility for employers

In accordance with the provisions of the Russian Tax Code, remuneration of employees (both monetary or in-kind) is tax deductible for the employer, regardless of whether the employee is an executive or rank-and-file worker.

The Tax Code requires that the expenses be documented in a proper way (including the condition that payment of a remuneration or benefit should be made on the basis of an employment or collective agreement) and incurred for business purposes of the company. As a rule, expenses on employees' remuneration and incentives are deductible on an accrual basis.

It might be important for the deduction purposes that incentives are paid in connection with the employee's professional results and achievements. Otherwise, if incentives are paid to an employee, for example, as a birthday present, expenses will not be deductible.

Obligatory social security and accident insurance contributions are also deductible for the profit tax purposes. Besides that, any employer can insure employees' health and life voluntarily.

In this case, there is no difference between executives and other employees. Payments for such insurance may be deducted for profit tax purposes if the voluntarily insurance contracts are concluded:

a for a period of not less than five years;

b with the Russian insurance companies having a licence for the relevant activity; and

c during these five years, such contracts do not provide for insurance benefits, including those in the form of rents and (or) annuities, with the exception of insurance payments in case of death and (or) harm to the health of the insured person.

Otherwise, if any of these criteria is not met, the insurance costs cannot be deduced.

iv Other special rules

There are no special rules on taxation of the executives or other employees with respect to the change of control in the company or reincorporation in low-tax jurisdictions.

It should be noted that any in-kind benefit of an employee should not exceed 20 per cent of the gross monthly salary (including shares). Otherwise, the employer may be subject to an administrative liability in a form of fine. Moreover, this may result in difficulties in the deduction of relevant expenses.

Remuneration paid to the members of a board of directors is generally non-deductible and is not subject to social security contributions. Such remuneration should be paid upon a decision of the general shareholders' meeting.

If the company has an employment or civil contract with the member of board of directors (taking into consideration, that obligations under this contract are not the same as director's functions), the remuneration may be deductible. Moreover, social security contributions are to be paid.

The other important issue connected with the directors remuneration is that most double taxation treaties contain a clause on director's fees. This clause generally states that director's fees may be taxable in the country where the company paying the fee is registered and considered a tax resident, with no respect to the tax residency of the director.

III TAX PLANNING AND OTHER CONSIDERATIONS

Russian legislation does not provide for special favourable tax treatment for executives. However, there is a general possibility that may be used for the reduction of the employer's tax burden in respect of the employee, being the foreign national.

Thus, the Russian legislation provides special regime for highly qualified foreign specialists (HQS), working in Russia.

HQSs are foreign citizens with experience, skills or achievements in a particular field of activity, invited to work in Russia and whose remuneration is:

a not less than 83,500 roubles for one calendar month – for highly skilled professionals who are scientists or teachers, as well as for highly qualified professionals involved in the work by residents of industrial production, tourism and recreation, special economic zones and some others;

b not less than 58,500 roubles for one calendar month – for foreign nationals involved in the work by residents of technology-innovative special economic zone;

c at a rate of not less than 1 million roubles for one year (365 days) – for highly qualified specialists, that is, medical, teaching or research workers, in the case of an invitation to engage in the corresponding activity in the territory of the international medical cluster;

d without any requirements for the size of salary – for foreign nationals participating in the 'Skolkovo' project;

e at a rate of not less than 83,500 roubles for one calendar month – for foreign nationals involved employed within legal entities engaged in activities on the territory of the Republic of Crimea and Sevastopol; and

f not less than 167,000 roubles for one calendar month – for other foreign nationals.

Those employees who are treated as HQS shall be taxed at 13 per cent rate of the personal income tax regardless of the tax residency status. However, it should be noted that the 13 per cent rate applies only to employment remunerations; all other income (including, sale of personal property, etc.) shall be taxed based on the tax residency status.

The other issue that should be taken into account is that the Russian law on currency regulation and currency control sets a number of limitations. Such limitations apply to currency residents (Russian nationals or foreign nationals who reside in Russia on the basis of a residence permit).

Generally, currency transactions are forbidden between currency residents.

Moreover, currency limitations should be noted when an employer grants an employee shares. Frequently, this may lead to the necessity to open an account in a foreign bank for the purposes of holding shares and receipt of income (i.e., dividends and other proceeds).

Once the foreign bank account is opened, the currency resident is obliged to notify the Russian tax authorities of such bank account (particularly, on opening, closing, changes of any bank account details), to report annually on cash transactions via the account and to perform the transactions that are allowed by Russian legislation. For example, a currency resident may receive dividends on non-Russian shares, but credit proceeds from the sale of securities to a foreign bank account of the currency resident are prohibited. Violation of the prescribed rules may result in a fine of 75–100 per cent of the amount of the illegal currency transaction.

As of 2018, crediting funds obtained as a result of the disposal of foreign securities listed on the Russian or certain foreign exchanges (included in the list of the foreign exchanges mentioned in point 4 Article 27 of Federal Law No. 39-FZ 'On Securities Market') to the foreign bank accounts of the currency residents will be allowed.

IV EMPLOYMENT LAW

Non-competition covenants in employment relations are restricted. A ground for this lies in the provisions of the Russian Constitution and Labour Code, which declare freedom of labour, including freedom to choose work and profession as one of the fundamental principles of regulation of labour relations and other relations directly related to them. Therefore, a Russian court will most likely not enforce the non-competition covenants in employment relations. However, court practice in relation to non-competition covenants has not yet been developed.

It is not widespread practice to include non-solicitation provisions in employment contracts. However, some employers, especially subsidiaries of international companies, tend to include such provisions. We believe that such provisions can be enforceable depending on their actual contents and scope as well as circumstances of a particular case, at least partly. However, court practice on this issue has not yet developed, so it is difficult to predict whether the court will uphold its enforceability. Restrictions in the Russian labour law will significantly limit what a party will be able to claim in connection with a breach of the non-solicitation obligation.

Release of claims is not enforceable under Russian labour law. It will most likely be treated as a restriction of the legal capacity of a person granting a release of claims. Even if an employee voluntarily releases its employer from the claims, such release will not be enforceable.

Employment relations can be terminated only on the grounds specifically set out by law. Russian labour law does not provide for such grounds of termination of employment as involuntary termination 'for good cause', 'constructive termination' or voluntary termination for 'good reason'.

An employment contract can be terminated at any time by agreement of the parties. Also, an employee may terminate the employment contract by his or her initiative by giving a respective notice. An employer may terminate an employment contract at its initiative on the following grounds set out by the Labour Code:

a liquidation of the company;

b staff redundancy (reduction of the number of employees);

c unsuitability of the employee for the position or work because of insufficient qualification (to be confirmed by the attestation);

d repeated breach of job duties;

e single gross breach of employment duties, namely, unjustified absence from work during the whole working day or shift or more than four hours during a working day, unauthorised disclosure of commercial, state secret or other secret protected by law including personal data of other employees, showing up to work intoxicated, commitment of theft, misappropriation of funds, intentional destruction or damage to the property confirmed by decision of a court or another competent state body, breach of health and safety rules if it led to major consequences (industrial accident, catastrophe);

f committing faulty actions by an employee responsible for dealing with monetary or commodity valuables, if this gives grounds for a loss of trust in such employee; and

g presentation of false documents to an employer when entering into the employment contract.

Apart from the above, the law sets special grounds for termination of employment, with the CEO and some other senior managers at the initiative of the employer, namely:

a change of the owner of the employer's assets. This termination ground applies only to CEOs, their deputies and chief accountant (this is a special ground different from the change in control which it usually does not cover; it applies, for example, in the case of privatisation of a state-owned enterprise);

b taking an ungrounded decision by the CEO, head of a branch or representative office, their deputies or chief accountant that resulted into making the employer's property unsafe, unauthorised use or other damage to the employer's property;

c a single gross breach of job duties by the CEO, head of a branch or representative office or their deputies;

d dismissal of the CEO of the company in accordance with insolvency laws;

e termination of employment with the CEO of the company on the ground of a decision of company's authorised body; and

f dismissal of the CEO, members of the collegial managing body (management board) on other grounds provided by their employment contracts.

The Labour Code provides for payment of severance in a limited number of cases, for example, in the case of liquidation of the company or staff redundancy, in the amount of a monthly of fortnightly average earnings. However, in addition, in the cases mentioned the employer is obliged to pay yet another monthly average earnings amount if an employee remains unemployed for two months after dismissal and in some cases one more monthly average salary.

If an employment contract with the CEO of the company is terminated by a decision of the authorised body (shareholders' meeting or board of directors) before expiry of its

term, the employer should pay to the CEO a compensation, which cannot be less than three average monthly earnings of the CEO. The employment contract with the CEO can provide for a higher compensation in case of such termination. Such compensation is payable in the absence of guilty acts or omissions of the CEO.

There are no specific rules in relation to severance upon a transfer of employment in connection with a corporate transaction. If such transfer of employment occurs, severance will be paid if applicable, according to the general rules.

V SECURITIES LAW

Russian securities law does not provide for special regulation of employee equity plans or any exemptions for such programmes from the general rules. Thus, where the law requires registration of securities and prospectus, this rule will apply to implementation of employee equity plans. Therefore, application of some programmes may require registration depending on the terms of the programmes. Generally, the following programmes can be used: offering of new securities of Russian companies in Russia, offering of existing securities of Russian companies and foreign securities distribution.

Registration with Central Bank of Russia (CBR) is required in case of issuance or offering of Russian company's new securities to employees.

There are two ways to offer new securities, namely to offer new shares by subscription or issuer's options. The second approach involves the conversion of options into shares at a certain later date. For both shares and issuer's options issuance and distribution procedures are similar. Since usually employee equity programmes imply an offer of shares to a limited predefined group of offerees, they would normally not require registration of a prospectus where the number of offerees falls within the prospectus exemption criteria.

An issuer's option is a book-entry serial registered security in accordance with the Federal Law on the Securities Market. In compliance with Russian rules governing placement of securities convertible into shares, placement of such securities require a special procedure of registration.

Securities laws set out certain specific rules for issuing options, out of them, the most important are that the number of shares of a certain category (type) that can be acquired through options may not exceed 5 per cent of the number of shares of such type placed as of the date of the filing of documents for the state registration of the options issue; and the decision on the issuance of options may provide for restrictions on their circulation.

The transfer of existing shares in connection with employee benefit programmes should be exempt from registration requirements. For this reason, use of existing shares may be chosen by the company to apply the programme. In order to implement this metho,d the company buys its own shares from shareholders or the market to distribute them. It is important that company may not hold these shares for more than a year; after expiry of the one -year period shares must be sold or redeemed. In certain cases, pre-emptive rights may arise (depending on the type of company, etc.).

An employee stock ownership fund that is based on the use of the company's net profit can be established. This fund accumulates sold shares for their further distribution among employees. If employees pay for such shares all the money received should be used to replenish the fund.

Under Russian securities market legislation offering of foreign shares to the Russian employees and acquisition of such shares by them may be considered a type of placement or

circulation of foreign shares in Russia. Russian legislation permits circulation of such shares only in a limited number of situations, which may require registration of foreign securities with a Russian stock exchange or the Central Bank of the Russian Federation (CBR), admittance to circulation in a Russian market, qualification of foreign financial instruments as securities in accordance with the requirements of the Russian law, specific qualification of a buyer as a qualified investor, etc. Usually, employee equity programmes do not imply public circulation of foreign shares. However, even non-public circulation is subject to some requirements set by securities laws mentioned above. Regulations of the Federal Financial Markets Service (the former regulator of financial markets) introduced certain rules regulating acquisition of foreign financial instruments by Russian employees, but they do not exclude certain general requirements to private circulation of foreign shares. Therefore, employers should consider the possible negative consequences of offering foreign securities to Russian employees.

Generally, there are no specific rules governing company stock selling by executives. However, executives can be subject to insider trading rules if they qualify as insiders. The rules on insider trading may pose some restrictions, for example, to trade in a company's stock. In some cases, they will be able to trade if they comply with the notification or consent procedure. Liability for non-compliance with the rules on insider trading may differ from simple consequences such as void transaction, damages to injured persons to administrative or criminal liability. However, there are no anti-hedging or similar rules.

Furthermore, companies may set their own particular rules and procedures. The inner rules usually follow the legislation of relevant countries and practice of its application.

The other important requirements relate to reporting and apply to executives holding or trading in company stock. Generally, they are based on the rules of disclosure of information by the issuers of securities, public companies and their executives.

VI DISCLOSURE

The state requirements on disclosure of information apply to legal entities that publicly issue securities and are required to disclose the information on compensation of executives. Besides that, legal entities related to the state and receiving state support such as state corporations, federal state unitary enterprises and public joint-stock companies in which the state is the major shareholder are also required to disclose additional information on compensation of executives in the explanatory notes to their accounting statements.

Disclosure of information is carried out in the following forms:

a material fact statement;
b quarterly and annual report;
c securities prospectus; and
d annual and semi-annual consolidated financial statement.

Public joint-stock companies (i.e., ones that issue publicly shares and other securities convertible into shares) are obliged to disclose information on compensation of executives, including but not limited to their annual reports, securities prospectus and material fact statement.

Non-public joint-stock companies (i.e., ones that cannot issue shares and other securities convertible into shares publicly), if the number of their shareholders exceeded 50 shareholders, or non-public joint stock companies that publicly issue securities are also required to disclose information on compensation of executives (e.g., in annual reports)..

All the information that requires disclosure is disclosed in the forms prescribed for disclosure of such information. The form of disclosure of information also determines the timing.

i Material fact statements

Information to be disclosed in material fact statement

A material fact statement should outline information on changes in percentage of held shares in the charter capital of the issuer or its controlled entities (if such entities are material to the issuer) of the following persons:

a members of the board of directors;
b members of the collective executive body (the management board);
c the sole executive body (the CEO); or
d members of the board of directors, members of the collective executive body, the CEO of the management company (if applicable).

Material fact statement disclosure timing

The information disclosed in material fact statements should be published in a newswire service – not later than one day after; and on the company's website – not later than two days. The terms are calculated from the date of occurrence.

The text of the material fact statement should be available on the company's website for no less than 12 months from the date on which the term for its publication expired.

ii Quarterly reports and prospectuses

Information to be disclosed in quarterly reports and prospectuses

Quarterly reports and prospectuses should disclose information on:

a Persons serving in the management bodies of the company, and in particular their share (ordinary shares) in the charter capital of the issuer and the amount of shares that can be acquired by such person after the exercise of issuer options.
This rule also applies to the issuer's dependent companies and subsidiaries.

b Each governing body, including all types of remuneration (base salary, bonuses, commitment fees, benefits and compensation of expenditures); remuneration payments made separately for participation in the work of the relevant management body; and other types of remuneration already paid in the course of the respective period, including information on approved decisions and/or actual agreements with respect to such payments in the current financial year. Regulation related to CEOs may differ from the general. There is no requirement to provide information on the remuneration of the individual holding the office of CEO in a prospectus and quarterly report.

Confidentiality agreements cannot contain a clause preventing the above-mentioned information from disclosure. The only possible exception from this rule is information on the CEO's remuneration, which can be excluded from disclosure in a quarterly report or a prospectus.

Disclosure timing for quarterly report

The quarterly report shall be published by the issuer within 45 days of the end of the respective quarter.

The quarterly report should be available on the issuer's website for no less than five years from the date when the term for its publication expired, and in the event that it was not published within 45 days of the end of the respective quarter, from the date of its publication.

Disclosure timing for prospectus

A statement on the registration of a prospectus should be made by way of its publication in a newswire service – not later than one day, and on the company's website – not later than two days from the date of publication of information on the registration of the prospectus on the website of the CBR, or the date of receipt of the CBR written notification on the registration of the prospectus, whichever date is the earlier.

iii Consolidated financial statement

Information to be disclosed in the consolidated financial statement

International Financial Reporting Standards (IFRS) regulate the content of the consolidated financial statement.

Consolidated financial statements disclosure timing

The issuer shall publish its semi-annual consolidated financial statement within 60 days of the end of the second quarter, and an annual consolidated financial statement within 120 days of the end of the relevant year.

iv Annual report

Information to be disclosed in the annual report

An annual report should contain information on the CEO, members of the management board and members of the board of directors, including, but not limited to the amount of their participatory shares in the charter capital of the issuer. In the event that transactions on the acquisition or disposal of shares belonging to said persons within the reporting year have been concluded, the annual report should also contain information on such transactions (date, contents, category and the amount of shares transferred).

The annual report should also include criteria of determination of the amount of remuneration and/or compensation of expenditures and information on each governing body, including all types of remuneration (base salary, bonuses, commitment fees, benefits and compensation of expenditures); remuneration payments made separately for participation in the work of the relevant management body; and other types of remuneration already paid in the course of the respective period. Regulation related to CEOs may differ from the general. There is no requirement to provide information on the remuneration of the individual holding the office of CEO in an annual report.

Disclosure timing for the annual report

Annual report shall be published within two days after drawing up minutes of the annual general meeting of shareholders or meeting of the board of directors on approval of the annual report.

Information in the form of an annual report, a prospectus, a quarterly report or a material fact statement should be disclosed on a group basis with respect to each governing body. This obligation applies to the board of directors, the management board and the CEO (the sole governing body).

Regulations on disclosure do not set a materiality threshold for executive compensations or require specific disclosure of perquisites at the moment.

Quarterly reports and prospectuses should contain information on members of the governing bodies of the company, and in particular the amount of their participatory share in the charter capital of the issuer and the amount of shares that can be acquired by such persons after the exercise of issuer options.

Quarterly reports and prospectuses should disclose information on actual agreements with respect to payments made during the current financial year. However, the CBR has issued no clarification as to how and in what form this information is to be disclosed, and as a matter of practice, companies disclose only the fact of the existence or absence of such agreements, and not the agreements themselves.

VII CORPORATE GOVERNANCE

In Russia only certain public companies are subject to some corporate governance requirements to remuneration.

Such rules are set by the Central Bank of Russia for companies whose securities are traded or intend to be traded at the stock exchange.

One of such documents is the Code of Corporate Governance approved by the Central Bank of Russia in 2014 (the Code), which sets out some recommendations in this respect. The Code is not mandatory for Russian companies, and has recommendation nature for joint stock companies admitted to trading at the stock exchange. In particular, the Code recommends forming a remuneration committee consisting of independent directors that develops remuneration policy of the company subject to approval by its board of directors. It further recommends implementing a remuneration policy that sets forth transparent mechanisms of setting remuneration for the executives, board members and other key employees and sets out types of payments. The Code also recommends limiting compensation payments to executives and other key employees in case the company terminates their employment at its initiative (the 'golden parachute') with twice the annual fixed remuneration of the respective employee.

Russian law does not set specific rules allowing clawback or recoupment of remuneration previously paid in the event of a financial restatement, misconduct, adverse change in business or other circumstances, save for special regulations for certain officials or employees of credit and some other organisations (see Section VIII for more details). The excess salary paid to an employee can be recovered only if this was caused by a calculation fault or a court confirmed an employee's fault in his or her failure to perform work normatives or an excessive amount was paid due to the illegal actions of an employee (and this has been confirmed by a court).

The Federal Law on Joint Stock Companies and Federal Law on Limited Liability Companies require approval of payments to members of the board of directors, interested-party transactions, major transactions.

The law does not require the payment of any remuneration to members of the boards of directors. A general meeting of shareholders or participants may decide on setting and paying any remuneration to members of the board of directors.

In the Information Letter of the Central Bank of Russia No. IN-015-28/41 on sources of remuneration payment to the members of the board of directors (supervisory council) of a joint-stock company, the Central Bank of Russia clarifies that the Federal Law on Joint Stock Companies and the Code do not link the payment of remuneration to members of

the board of directors (supervisory board) of the company with a company's profit for the reporting year, allowing the general meeting of shareholders to decide on the payment of the said remuneration and in the absence of the company profit for the reporting year.

Existing court practice treats employment contracts with CEOs or relevant provisions of employment contracts setting their remuneration, including bonuses, other compensations, remuneration under incentive programmes as interested-party transactions and, where applicable, major transactions. Such transactions currently require prior corporate approval, as set out by law.

Starting from 1 January 2017, rules on approval of major transactions have been modified. Currently major transactions include (1) transactions that provide for acquisition or disposal, or possibility of disposal of the property which value makes 25 per cent or more of the assets value of the company as per its latest balance sheet, and (2) transactions providing for the company's obligation to grant temporary use of its property or grant a licence to use its IP objects, whose value makes 25 per cent or more the assets value of the company as per its latest balance sheet. Major transactions are subject to approval by general meetings of shareholders or participants if the value exceeds 50 per cent of the assets value of the company as per its latest balance sheet. Such transactions should be approved by three-quarters of the votes of shareholders holding voting shares who attend the general meeting. Major transactions subject to approval by the board of directors are major transactions whose value is more than 25 per cent and up to 50 per cent of the assets value of the company as per its latest balance sheet. Such transactions should be approved unanimously by all members of the board of directors. Transactions entered into in the course of the usual business of a company, transactions on placement (sale) of ordinary shares or issuable securities convertible into ordinary shares, as well as transactions mandatory for a company by law, are not subject to approval as major transactions. Starting from 1 January 2017, the requirement to approval of interested-party transactions have also been changed. According to the introduced amendments, interested-party transactions are transactions in which the CEO, member of a collegial managing body (management board), member of the board of directors (supervisory board), a controlling person or any person who is entitled to give binding instructions to the company, if such person (or such persons' spouse parents, children, foster parents or children, siblings or controlled persons) is:

- a party to, beneficiary of, intermediary or representative in the transaction with the company;
- a controlling person in a company who is a party to, beneficiary of, intermediary or representative in the transaction with the company; and
- holds a position in management bodies of the company that is a party to, beneficiary of, intermediary or representative in the transaction with the company.

Persons indicated above should notify the company about the facts that qualify them as interested persons and about potential interested-party transactions.

The law no longer requires mandatory preliminary approval of interested-party transactions. Instead, companies are obliged to notify boards of directors or management boards of interested-party transactions before entering into them. Where all members of the board of directors are interested in a transaction or there is no board of directors in the company, such notification should be made to the shareholders or participants of the company. CEOs, members of the board of directors or management board, or shareholders or participants holding at least 1 per cent of voting shares are entitled to request prior approval

of an interested-party transaction. In a non-public joint-stock company, such consent shall be granted by a majority of votes of non-interested members of the board of directors; if such directors do not make a quorum set by the company's charter, the transaction shall be subject to approval by the general meeting of shareholders. In a public joint-stock company, such transaction shall be approved by the majority of non-interested directors who are not (and were not during one year preceding the decision):

a a CEO or a managing company of a company, member of its management board, a member of managing bodies of the managing company;

b a person whose spouse, parents, children, sisters, brothers, siblings are members of managing bodies of the management company or a manager of the company; or

c a person controlling the company or its managing company who performs a CEO's functions or is entitled to give mandatory instructions to the company.

In a limited liability company the interested-party transaction shall be approved by a majority of votes of non-interested members of the board of directors or a majority of general meeting of shareholders.

In a joint-stock company an interested-party transaction is subject to approval by the majority of votes of non-interested shareholders in the following cases:

a if the cost of the property which is a subject of a transaction or series of related transactions is 10 per cent or more of the balance sheet assets value of the company on the last reporting date, except for transactions described in the following two paragraphs;

b if a transaction or series of related transactions are the placement by subscription or sale of shares that are more than 2 per cent of ordinary shares previously placed by the company and ordinary shares into which can be converted previously issued securities convertible into shares; and

c if a transaction or series of related transactions are the placement by subscription of issuance securities convertible into shares that can be converted into ordinary shares, that amount to more than 2 per cent of ordinary shares previously placed by the company and ordinary shares into which can be converted earlier placed issuance securities convertible into shares.

In a limited liability company interested-party transaction is subject to approval by the majority of votes of non-interested shareholders if the transaction price or value of assets which are subject matter of the transaction is 10 per cent or more of the balance sheet assets value of the company on the last reporting date.

The charter (articles of association) of a limited liability company or a non-public joint-stock company may establish different procedure of approval of interested-party transactions or totally exclude a requirement for the approval of interested-party transactions.

Where an equity remuneration plan involves the issue of shares, such issue is subject to the requirements and procedures set out by the Federal Law on Securities Markets. Such procedures include, *inter alia*, a general meeting of shareholders (or board of directors, if the charter of the company provides so) taking a decision on the placement of securities and approval of the decision on the issue of securities by the board of directors. The issue of securities is subject to registration with the market regulator (currently – the Central Bank of Russia).

Governmental approvals are not required in respect of the executive remunerations of executives of companies where the state does not hold a stake. Certain restrictions are set for amounts of remuneration of executives of state-owned companies.

VIII SPECIALISED REGULATORY REGIMES

Generally, there are not many special regulations for the specific industries in terms of remuneration regulations (we do not discuss the rules and limitations applicable to executives of companies or enterprises with state ownership).

Special regulations are set for banks by the Instruction of the Central Bank on the evaluation of the labour remuneration system in a credit organisation (Instruction). The Instruction came into force on 1 January 2015.

The Instruction sets forth the criteria of evaluation of labour remuneration systems in credit organisations by the Central Bank of Russia (its Department of Surveillance of key system credit organisations).

In particular, the Instruction provides that remuneration of employees of credit organisations should be set depending on the risk level to which a credit organisation may be (or has been) exposed (as a result of employees' actions), *inter alia*:

a for departments of a credit organisation that conducts transactions with risks calculation of the variable remuneration component is based on:
- quantity figures characterising these risks and planned profit for these transactions;
- amount of its own funds which are sufficient to cover the risks taken; and
- volume and price of loaned and other attracted funds sufficient to cover the risks taken;

b at least 40 per cent of the total target remuneration (before adjustment) of the risk-takers should be variable. Risk-takers are the members of the executive body and other employees taking the risks;

c internal policies of a credit organisation provide (and these policies are applied) in respect of the risk-takers:
- deferral and further adjustment of not less than 40 per cent of the variable component of a remuneration based on terms of receiving of financial results of a credit organisation activity (the deferral must be not less than three years). Internal policies of a credit organisation must provide also a possibility to reduce or to eliminate a variable part of a remuneration if the financial result of a credit organisation is negative in a general or in particular activity;
- combination of monetary and non-monetary form of labour payment that is sensitive to financial results of a credit organisation and to risks taken by a credit organisation (in case of absence of a non-monetary form of remuneration the employment contracts with risk-takers must provide for adjustment of a deferred part of remuneration based on the price of shares of a credit organisation); and
- the preceding paragraph is not applicable to a credit organisation established in the form of a limited liability company or a fair market price for shares of a credit organisation cannot be determined based on listed share prices).

Further, the Instruction requires that operations of compliance departments and risk management department be organised in accordance with the Instruction and in particular, that fixed remuneration makes at least 50 per cent of the total remuneration of employees of compliance departments and risk management departments.

The Instruction establishes a board of directors (supervisory board) of a credit organisation as the corporate governance body responsible for the organisation, monitoring and control over labour remuneration system.

Also the Instruction sets forth the obligation of a credit organisation to disclose information on the labour remuneration system on a regular basis but at least once per calendar year.

Special regulations are set for non-state pension fund, securities market participants, management companies and insurance organisations by The Information Letter of the Central Bank of Russia No. IN-06-54/53 of 14 July 2016 on recommendations on remuneration system organisation and disclosure of information of the labour remuneration system in above-mentioned organisations (Information Letter).

The Information Letter recommends establishing remuneration system in such organisations taking into account their risk management policies.

It is recommended establishing fixed remuneration and variable remuneration for the sole executive body, members of the collective executive body and other employees taking risks. In accordance with the Information Letter, a significant part (40–60 per cent) of risk-takers employees' remuneration shall be variable. However, for employees undertaking activities on internal control, risk management, report preparation or valuation of assets or liabilities establishing a significant part (40–60 per cent) of remuneration as fixed remuneration is recommended.

The Information Letter also recommends determining the list of risk-takers.

The Information Letter provides that a board of directors (supervisory board) of the organisation or its general meeting of shareholders (or participants) shall:

- create special committee (remuneration committee). The main duties of this committee shall be preparation the management body's decisions on remuneration system organisation;
- considering questions on organisation, monitoring and control over labour remuneration system;
- confirm (approve) and review the organisation's policy on remuneration, but at least once per calendar year;
- organise work on conformity assessment of remuneration system of the organisation's business model, its strategy; and
- confirm the amount of the organisation's wage funds. It is important that payment of variable remuneration does not lead to the loss of financial sustainability.

The Information Letter also sets forth the obligation of the organisations to disclose information on the labour remuneration system on a regular basis, but at least once per calendar year.

The Information Letter is of a recommendatory nature and shall not be binding, because Central Bank's information letters are not normative legal acts. However, it is strongly recommended following the provisions of the Information Letter for all relevant organisations.

Appendix 1

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Olga advises domestic and international clients on corporate and M&A projects. Olga has vast experience in developing and advising on employee remuneration and incentive programmes, including employee share plans, both share-settled and cash-settled, advising on specifics of implementation of global share plans in Russia.

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ISBN 978-1-910813-87-4