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PROXY SEASON REVIEW: RUSSIA

SPECIAL REPORT AUGUST 2011



Special Report: Russian Proxy Season Review

Ipreo is pleased to present the 2011 Proxy Season Review covering activity in the Russian and CIS market. The purpose of the study is to highlight key facts and takeaways from proxy solicitation activity in the region and provide investor relations and corporate finance professionals with an outlook for 2012.

General Overview

The 2011 Russian proxy season saw a rise in “say on Pay” and the “termination and election of independent Directors” as key areas requiring shareholder approval. Similarly approval of independent Auditors and internal Audit committees was sought in Russian shareholder meetings. Director independence was particularly important during this season and was aligned with Ipreo’s expectations due to the growing need for increased investor protection whilst reducing fears of internal corruption.

The independence of directors was the most contentious aspect of Russian shareholder meetings. Whilst Russian companies continue to enhance and improve their adherence to Corporate Governance policies, it will be some time before they are aligned with expectations of their international shareholders. A true reflection of what shareholders demand can be quantified by exercising their right to vote but shareholder requirements become unclear when complex or costly voting processes prevent votes being submitted.

An amendment to Federal Law on Securities that took effect on 2 April 2011 ensures that preliminary information regarding the convocation of a shareholder meeting be made publicly available on a company’s website no later than two calendar days after the decision to convene a meeting has been made. The level of disclosure of detail for individual Agenda items also improved for the 2011 proxy season. This was evident for all shareholder meetings that Ipreo reviewed.

However, Ipreo found that making meeting information available on the company website did not necessarily increase awareness of shareholder meetings unless investors monitored the site regularly. Despite the change in law a large number of shareholders still did not exercise their voting rights in 2011.

The main reasons included: being restricted to paper ballots, late receipt of meeting notification, Russian stocks being excluded from voting due to historical barriers to voting i.e. Power of Attorney and Russian stocks being held in index funds.

An Introduction to Corporate Governance in Russia

The Code of Corporate Conduct for Russian companies was introduced on 4th April 2002. It is a voluntary code but is comprehensive in its coverage.

The European Corporate Governance Institute states in relation to this:

“Corporate governance is a term that encompasses a variety of activities connected with the management of companies. Corporate governance affects the performance of economic entities and their ability to attract the capital required for economic growth. Improvement of corporate governance in the Russian Federation is vital for increasing investment in all sectors of the Russian economy from both domestic sources and foreign investors.”

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One means to foster such improvement is to introduce standards that are based on an analysis of best practices of corporate governance”

A large number of Russian companies have adopted several aspects of the code but it is not wholly implemented in the same manner that many Western companies have adopted their own country codes. This may relate to the lack of legal and operational frameworks to support this code and western-style governance watchdogs exerting relatively little influence in Russia.

This directly affects the level of protection offered to investors who are increasingly demanding long term value. A company’s corporate governance policy is a good indicator of how professionally a company is managed and will ultimately influence whether it is worthy of investment.

According to KPMG, international investors now rate Corporate Governance as the 2nd most important factor when investing in Russia. This subject was previously rated 4th but during austere times investors are demanding more transparency, disclosure and protection from the corporations they invest in. In Russia, good Corporate Governance increases investor confidence by demonstrating the company has measures in place to eliminate internal corruption whilst striving to increase their attractiveness to present and potential investors.

Standard & Poor's Governance Score

The Governance Alpha: Back testing the correlations of S&P’s Governance Scores with Corporate Performance (Russia & Kazakhstan, 2000-2009) report published on 1st June 2010 highlights:

- Poorly governed companies are prone to losing value to opaque transactions, investments motivated by external agendas of block holders or managers’ pet projects.
- Investors recognise the value of well governed companies and are willing to pay a premium on respective stocks.
- S&P’s measure of governance shows a positive relationship between governance and annual sales growth.
- Well governed companies were better positioned to take advantage of rapid economic growth between 2000-2008.
- There should be greater public awareness of the overall weakness of governance structures in these markets, their cost to investors and the ability of better governed companies to generate superior returns.

Voting Local Shares vs. American Depositary Receipts

Russian companies announce shareholder meetings on their websites, local press or local news reports. Paper ballots are still issued for Ordinary shares with various requirements for Powers of Attorney and a variety of deadlines apply to ensure all parties notified have sufficient time to review meeting documentation and cast their vote. This should allow sufficient time for Sub-custodians to pass meeting documentation to asset managers for review.

International investors increasingly use online voting platforms to administrate, process and submit votes. Platforms provided by Broadridge and ISS, offer a range of services that range from electronic meeting notification, manual, automatic or customised vote submission, and more bespoke services depending on individual investor requirements. This has proven to be the most efficient set up for voting ADR’s and GDR’s , mostly held by international investors, however local Russian shares can still only be voted by submitting paper ballots. This

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prevents many international investors that may also hold local shares from voting these, as it is a costly and often in-transparent process.

Non-domestic investors tend to rely on the recommendations of Proxy Advisors such as ISS & Glass Lewis when deciding how to vote for Russian Shareholder meetings. ISS often dominates with influence over international shareholder's voting behaviour, but Ipreo is observing more investors taking an active role in how they cast their vote at Russian Shareholder meetings, with the addition of in-house voting policies being derived specifically for Russian investments.

In contrast, domestic investors are not familiar with online voting platforms or Proxy Advisory firms and therefore meeting notification and reaction can be delayed. Russian investors rely on regular website access, news announcements or confirmation from local sub-custodians to be notified of meetings. Local Sub-Custodians are not obligated to notify shareholders of meetings and often rely on investors submitting votes proactively. Accordingly domestic shareholders tend to make decisions how votes will be submitted internally and as long as they are informed of the Meeting within a reasonable timeframe.

When compared to Germany or France, where it is considered best corporate governance practice to vote local shares, Russian investors are less likely to vote than international investors. This relates to online voting platforms being more accessible to the international market whereas Russian investors are often bound to paper ballots being submitted by post or in person.

Why Don't all of our Shareholders Vote?

Shares can be held within different funds and different rules apply to the way each fund is managed. The structure of a fund determines whether holdings can or will be voted by an investor.

Some funds do not have voting rights or it may not be important to vote when evaluating investments. These include but are not restricted to Index, multi-manager, Hedge and Quant Funds.

Ipreo is able to identify and confirm if votes will be submitted based on the following factors:

- Size of holding - minimum thresholds for %holding and/or monetary value of holding may be applied.
- Geographical - investors will vote either – a) all global holdings, b) only in some countries, c) only in their domestic region or d) not vote at all. This relates to the cost of administering votes, the level of understanding of the voting process in different countries and fund structure.
- Voting decision makers – larger investors tend to have a Proxy department dedicated to all proxy voting related queries. However the decision to vote may still be at the discretion of the Fund Manager or Beneficial Owner of the fund invested. The voting decision maker can be the Proxy Department, back office, Portfolio Manager, Fund Manager, Sub-Advisor, Proxy Advisor (ISS Glass Lewis) or Beneficial Owners.
- Voting process; For Ordinary shares paper ballots can be submitted in person or by post. Electronically: votes for ADR's and GDR's can submitted automatically by the Proxy Advisor or manually via voting platforms including that of Broadridge.

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Corporate Governance Highlights of the 2011 Proxy Season

ENRC

Events in the past year that heightened Russian Corporate Governance expectations included the dismissal of senior independent director Sir Richards Sykes – former CEO of GlaxoSmithKline and Dr Ken Olisa from ENRC - Eurasian Natural Resources Corporation. The company was listed on the London Stock Exchange despite failing to meet the 25% free float requirement. A Corporate Governance review by the Institute of Chartered Secretaries and Administrators called for "urgent actions" and said ENRC gained the worst rating the assessors had encountered. Although minority shareholders benefitted from share price increases since the company's listing in 2007, the share price and level of trades soon plummeted after the dismissal of the Sykes and Olisa, the only truly independent directors, on 8 June 2010.

This demonstrates the selection and independence of board members can affect investor confidence and ultimately the value of a company. Listing on an international exchange is not enough to establish consumer confidence; ironically it is likely a basis for investors to assume the company meets international best practice in its corporate governance policy implementation.

Norilsk Nickel

In 2010 a proxy fight between the largest shareholders, UC Rusal and Interros, saw Rusal's board representation unelected and led to UC Rusal filing a number of lawsuits against Norilsk Nickel and Interros.

Mismanagement and poor corporate governance were cited yet, once investigated, the financial regulator's response to the allegations confirmed that no actions by the company or Interros had been illegal or unethical.

Allegations made by Rusal included the changing of quorum, shares being voted by companies that related to Interros and Norilsk Nickel voting shares that were not known to have voting rights.

Interros' board presence was once again re-elected in the 2011 AGM but quorum was not reached for director remuneration. This was associated with the Chairman being remunerated almost 10 times more than any other director. Shareholders were not supportive and the board will have difficult task in finding an acceptable resolution.

Ipreo's Outlook for 2012 Season – Russia

Best practice of Corporate Governance differs in every country depending on the legal framework in place to support and enforce acts of wrong doing. By adopting the voluntary Corporate Governance code Russian companies can demonstrate their commitment to fulfilling their ethical obligations to investors.



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With new GDR programs being offered to the international market place it would be ethically pertinent for Russian companies to adapt their internal corporate governance practices to meet the standards their international investors commonly expect.

Employing the services of a proxy solicitation firm would increase awareness of shareholder meetings and give all investors the equal opportunity to submit votes. As GDR programs are limited to 25% of issued capital, local shares being voted still play an important part in approving Shareholder meeting resolutions.

Ipreo is able to assist Russian companies in understanding and implementing international Corporate Governance practices that are considered to be of great importance to their current and potential investors both locally and internationally.

Our extensive research and understanding of complex investor voting policies combined with our bespoke voting behaviour software enables us to provide clear indications of shareholder meeting outcomes before meetings take place and allow us to effectively manage client expectations.

Our offering of Agenda Analysis and Resolution Reviews prior to a shareholder meeting being announced can eliminate the negative effects of resolutions not being passed. We continually strive to improve investor access to meeting information whilst assisting Russian companies improve their Corporate Governance practices.