

ASSOCIATION OF EUROPEAN BUSINESSES IN THE RUSSIAN FEDERATION
POSITION PAPER SPRING 2007

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Dear AEB Members, Business Partners, Colleagues

The improvement of the Russian business environment demands open dialogue and unwavering support.

In the following pages, we highlight AEB expertise, which is the result of the tremendous knowledge and experience of more than five hundred and fifty member companies participating in twenty-six committees, task forces and working groups that bring together people so that they can learn from one another, share opinions and support one another. The value of this process is evident in this publication.

We are proud of the work of our committees which cover an unparalleled range of economic issues relevant to European industries operating in Russia.

We are sharing this knowledge and insight with you, our members and colleagues, and hope for your continued support of AEB initiatives and activities.

Best regards,

Reiner Hartmann
Chairman of the Executive Board
Association of European Businesses
in the Russian Federation

Dear Reader

Whether you work for Russian or European authorities, or Russian or Western Business, or simply have an interest in business in Russia, the following pages will make interesting reading.

This is the distilled experience of our members: 600 companies working on the Russian market, intimately aware of the hard end of doing business in this exciting and rewarding territory.

Our members meet in Industrial Committees, developing issues relevant to particular industries, and in Open Committees, which cover areas of interest to all members of the AEB (such as Tax, HR, Customs, etc).

Through these committees, they have gathered together their views on what major issues face them. They explain in which direction they would like to see the rules that govern their investments develop, and why.

The messages that reach you through these pages are completely independent. The AEB is neither funded nor influenced by any government: we answer to our members.

Yours sincerely,

Andreas Romanos
Chief Executive Officer

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ECONOMIC OVERVIEW: EUROPEAN BUSINESS IN RUSSIA

FINANCE AND INVESTMENT COMMITTEE

Chairman: Christian Ziegler, PricewaterhouseCoopers
Deputy Chairman: Vladimir Ismailov, Standard & Poor's
Committee Members: Deloitte & Touche CIS, Drum Risk Management, Ernst & Young, FBK, Ikea, KPMG, PricewaterhouseCoopers, Standard & Poor's, SGS Vostok Limited, ZAO

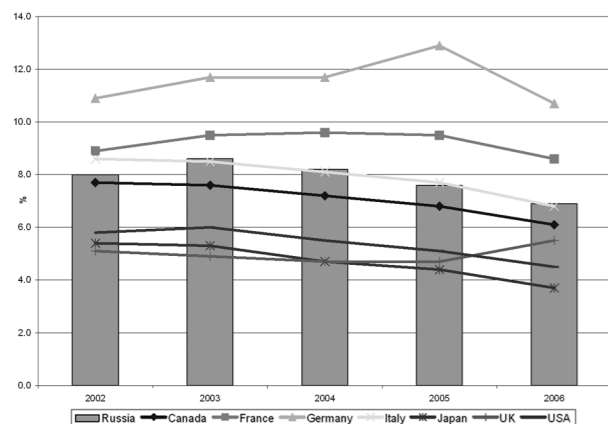
Since 1987, when the former USSR first adopted legislation allowing foreign companies to participate in business (initially only as minority shareholders), foreign business initiatives in the Russian Federation have come a long way. According to the State Statistics Bureau there was some US \$142.9 billion in foreign capital invested in Russia at the end of 2006. This is 27.8% more than 12 months ago. Most of the investments are in processing (30.4%), mineral extraction (20.7%), retail, wholesale and services (21.3%). Second tier target industries include real estate (9.3%), transport and communication (8.3%) and financial services (6.7%). In 2006, the main investors in the Russian economy were from Cyprus (22%), the Netherlands (16.4%), Luxemburg (16%), Germany (8.6%), the UK (8.2%) and the USA (5.4%).

Russian Capital Markets

Development of capital markets in Russia in 2006 was characterised by growth in all sectors. The Russian equity market is one of the fastest growing markets in the world. The RTS Index increased by over 70%, and that is in addition to the 80% growth that we saw in 2005. The fixed income market continues to grow at over 33% for the second year, reaching almost US \$200 billion at the end of 2006.

Russian companies have become active players in international capital markets. The volume of initial public offerings ("IPO") by Russian companies at home and abroad reached US \$22 billion in 2006 (compared to US \$4.6 billion in 2005). IPO of "Rosneft" in July of 2006 became the fifth largest in world history attracting US \$10.4 billion of capital.

Table 1 Unemployment in Russia compared to some EU and non-EU countries

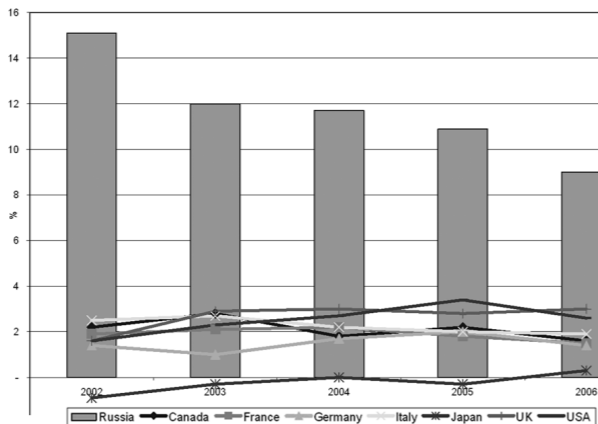


The Russian mergers and acquisitions market ("M&A") reached US \$63.6 billion in 2006, representing 57% growth over 2005. The share of Russian M&A deals is now 6.2% of the total value of M&A transactions in Europe. The nature of M&A transactions is continuing to change with a move towards diversification, a larger share of cross-border deals, global aggressiveness on the part of some national champions, and a significant role being played by government.

There are a significant number of European companies that see the Russian market as an opportunity to build business value through expansion into new sales markets. Reasons for this include Russia's population size (142.8 million as of December 31, 2006) with relatively low unemployment (see Table 1); the lower cost of the supply chain – for example prices for oil, electricity, and steel in Russia are still lower than in Europe and in North America; capitalisation on the highly qualified and less expensive labour force (the average monthly salary in January 2007 was US \$432, while the literacy level remains over 99%); and the advantageous geo-political location (Russia shares borders with the EU, the US, China, and Japan). Every foreign business that made the decision to come to Russia has seen the potential for real opportunity.

Russia is well known for its vast natural resources including natural gas, and is currently second in the world for oil production. Russia is also famous for its advanced technology in certain sectors, especially in the defence sector (air and space) and IT programming. It is no wonder that the government is trying to consolidate these industries in order to take advantage of this asset and gain an edge when competing with world markets.

Table 2 Inflation in Russia, some EU and some non-EU countries



Russia is successfully building partnership relations with other countries and business institutions. Government debt was down by US \$26.2 billion at the end of September 2006 compared to 12 months ago, while the external debt carried by banks and other sectors (excluding equity capital) grew by US \$68.3 billion. WTO negotiations are under way and are expected to be finalised by the end of 2007. The process of joining the WTO is indicative of the changes in Russian macro-economics and government management style. Unlike other countries such as China, the Russian government did not conceal its intention to join the WTO from the business community when negotiations began in 2001. Businesses in each industry are aware of the impact that WTO membership will bring to Russia. The economy will become more competitive due to the gradual lowering and elimination of barriers to foreign business. For Russian business this means less, if any, discrimination in foreign markets (WTO members). One may view Russia's WTO membership negotiation process as a very long one. By comparison, it took three years for Kyrgyzstan to join. However, Russia has not made a political case out of this and defends local business interests when signing individual membership agreements with other countries. Since not all negotiations have been finalised as of today, it is expected that the agricultural market in Russia will not change customs duties during the transition period, because the market is quite liberal at this point. However, some sectors will have to find their way around when the "greenhouse" effect kicks in. For example, the car manufacturing industry will have to face a further 10% rise in import duties (to 15%) and the majority of imported industrial goods will be levied at a further 25%.

Russia and the Russian Economy

Russia's GDP growth rate for the last five years has substantially exceeded those of some industrially developed countries (see Table 3).

Growth is driven by a booming domestic market. High prices for commodities in the past few years, such as oil, gold, nickel and many others that Russia has in plenty, have led to excess cash in the private sector and a positive trade balance. Russian currency and gold reserves reached historical highs of US \$315 billion in mid-March 2007, making them the third largest in the world. Due to

Table 3 Comparative GDP growth/decline, %

	2002	2003	2004	2005	Q3'06/Q3'05
Russia	4.7	7.3	7.2	6.4	6.5
EU					
France	1.0	1.1	2.3	1.2	1.8
Germany	0.1	-0.2	1.6	0.9	3.1
Italy	0.4	0.0	1.1	-0.1	1.7
UK	2.1	2.7	3.3	1.9	2.9
Non-EU					
Canada	3.3	1.7	3.1	2.7	2.5
Japan	0.1	2.1	2.7	3.1	1.5
USA	2.6	2.7	4.2	3.5	3.0

Source: RF Federal Government Statistical Services

the underdeveloped public sector and the unbalanced public finance system, the economy is struggling to channel this surplus in a way that would not spur inflation. The business infrastructure – energy generation, roads and utilities – require substantial investment in order to support the growing economy. The government is trying to boost public spending and effectively manage the tax system. Meanwhile, the strengthening of the rouble, which appreciates against the dollar, does not help local businesses to boost local manufacturing. This means that importing goods is more attractive for Russian business than manufacturing locally. Most likely this trend will continue in 2007. Inflation is scaling down (see Table 2) but is still high compared to countries with developed economies. High inflation keeps interest rates high (the Central Bank of Russia's re-financing rate is 10.5%). This precludes the debt market becoming a real driving force for the consumption that may become another driver for GDP growth in the country.

The Investment Climate in Russia

Russia is recognised as a country that has sufficient credit strength to meet its debt obligations. An Investment Grade credit rating was assigned to Russia by Moody's (October 2003), Fitch (November 2004) and Standard & Poor's (January 2005). Investment Grade helps Russian capital markets in attracting institutional investors who tend to have a more conservative approach to their portfolio but with larger funds under management.

The inflow of foreign direct investments (FDI) into Russia in 2006 was estimated at US \$28.4 billion, which represents a 94.6% growth rate on the previous year. Comparing the level of FDI in Russia with peer-countries of the BRIC Group (Brazil, Russia, India, and China), 2006 FDI in Russia exceeded that of Brazil (US \$14.8 billion) and India (US \$9.5 billion), and the growth rate exceeded that of China (even including Hong Kong - 2.9%). In general, the 2005 FDI growth rate in Russia exceeded the average world growth rate (34.3%), the average developed economy growth rate (47.7%), the average growth rate in the European Union (30.1%), developing economies (10%), and the average growth rate in South-East Europe and the CIS (56.2 %).

Attracting foreign direct investment (FDI) is a top priority for any government. International business strives to:

- Broaden its product line
- Increase its market share in a geographic region
- Strengthen the company's financial position
- Stabilise cyclical or seasonal business
- Provide key executive or technical talent

There is a clear willingness on the part of the government and the business community to develop a mutually beneficial relationship. However, they are still separate parties with their own interests and methods. On one hand, the government is trying to control key industries and is pushing for greater consolidation in areas such as natural resource extraction (oil and gas, diamond mining), the automobile industry (AutoVAZ, KamAZ), aircraft and ship building. On the other hand, the government is trying to attract more investment into the economy and improve the investment climate in general.

Thinking of Going to the Regions?

With Moscow markets reaching saturation point, foreign businesses are starting to look at the regions as a way to expand into new markets. Across Russia's vast territory, it is reasonable to expect that regions will be different in terms of investment climate – readiness and willingness to welcome outside investments. Indications of non-willingness by one set of local authorities should not be viewed as indicating the situation in the country as a whole. Such inability in most of the regions usually underlines more significant problems in finding skilled personnel and structural deficiencies in supporting the local development of any business. However, the number of regions that are making significant improvements in the development of local legislation, business infrastructure and success in attracting investments is growing. Saint-Petersburg, Krasnodar, Yekaterinburg, Nizhny Novgorod (to name but a few) attracted a lot of business, including from EU member-countries, by creating a favourable investment climate and focusing on servicing the needs of business.

Outlook for 2007

The current year is likely to see a continuation of the trends of the previous year. However, with commodity prices, especially oil, not expected to increase significantly, the growth trends will most likely to slow down. At the same time, the government plans to diversify the economy and make it more innovative. It is expected that the local market will continue to grow at a higher than average rate for the region and EU. Growth in real estate, financial services and trade sectors may accelerate. Growth of the mineral extraction industry will depend solely on world markets. The parliamentary elections in December 2007 and presidential elections in early 2008 will probably contribute to a slow down in growth. However, with no significant changes in Russian politics in the second half of 2007 and first half of 2008 slow down should give way to an optimistic return to the general market trends in the second half of 2008.

AGRIBUSINESS COMMITTEE

Chairman: Philippe Cohen, Bonduelle
Committee Members: Aarhus Oliefabrik A/S, BASF, Bayer CropScience, Bonduelle, Bord Bia Irish Food Board, Cargill Enterprises Inc, Danone Industria, Dow AgroSciences, DuPont, Drum Resources, Eckes Granini, Ehrmann, Heinz CIS, John M. Kopiski (Bogdarniya), Kambyk International B.V., Nestlé Food, Nutricia LLC, Paulig Export Ltd., Schaller-Moscow, Siratec, Syngenta



INTRODUCTION

After the decline of the Russian agro-industrial sector in the 1990s, development began anew in the wake of the 1998 financial crisis. Today, Russian agriculture represents a variegated picture. On one side there are big structures - 250 agro-holdings with some 20,000,000 hectares combined. These larger holdings can possess more than 100,000 hectares. On the other side, about half of all agricultural production comes from individual household plots, a historically developed survival practice (food complement) for the population. Individual plots represent more than 90% of the total Russian production of potatoes and more than 80% of the production of vegetables. Individual plots and small farms represent more than 50% of the total Russian production of milk and meat.

BACKGROUND

- The Russian agricultural sector differs from the traditional western way of farming in that development is largely driven by financial and industrial companies that see the potential of the Russian agriculture sector. According to some estimates, Russia can feed around 350,000,000 people and by 2015, Russia may be Europe's largest retail food market. Therefore, many large corporations, including those from the powerful energy sector with surplus funds to invest, set up subsidiaries that create giant plantations to diversify and tap into the development of this sector.
- Smaller trader companies lease plots amounting to tens of thousands of hectares to produce the most liquid agricultural products. In recent years, grain and oil crop production have gained the lead and Russia has become competitive in these two production areas. Moreover, significant success has been reached in sugar beet production and poultry farming, which have each grown by 20% annually for the last five years.
- In parallel, there are sectors where decline and disintegration are ongoing – such as cattle raising – and the government has thus far failed to reverse the trend. Russian government subsidies to agriculture equal US \$3 billion per year including hidden subsidies such as tax incentives, special prices for fuel, power and transport. In comparison, the European Union spends 60 billion per year on agricultural subsidies.

- The Ministry of Agriculture (MOA) is working on the implementation of a high priority national project called "Development of the Agro-Industrial Sector". A special budget has been approved for continuing the stimulation of:

Animal breeding/milk production - facilitating access to credit for investment, and subsidising interest rates; purchase of equipment based on new technologies; purchase of live animals (with the support of Rosagroleasing); changing customs duties on related imported equipment that does not have a local equivalent; and fixing quotas on meat products for the 2006-2009 period.

Small entity development, namely, individual plots and small private farms, in the agro-industrial sector; facilitating access to credit and subsidising interest rates; stimulating the creation of structures of supply and distribution for cooperatives and processing units (to be supported by Rosselkhozbank); and creating a system of mortgages for agricultural land.

- MOA is opposed to foreign participation in the leasing of agricultural machinery for state initiatives, and is sceptical about the impact of WTO accession on Russian agriculture. While the support of local structures is surely a positive sign, the quality of equipment and technology is at times questionable, and protectionism does not follow WTO guidelines.

ISSUES

- Land ownership issues, despite the adoption of the new Land Code in 2001, remain a considerable problem for foreign investors. The underdeveloped credit and mortgage system, particularly outside Moscow region is a hindrance to investment and the development of agricultural land.
- Even with support at the federal level, land transactions are hampered by complex and sometimes controversial procedures at the local level. There are too many official bodies involved in land transactions, and the excessive administrative burden involves arbitrary fiscal administration. This includes obtaining sufficient energy supply, such as power and water, for facilities that are dependant on relations with key decision makers in local administrations and local supply companies.
- The law from July 1, 2003 on Technical Regulations, although implemented, continues to interfere with

the old GOST standards that continue to be relevant through the 7-year transition period, thus creating additional complexities.

- In spite of constant efforts by federal and local administrations, Russia's image abroad as an investment opportunity remains mixed and uninformed. Relations with domestic operators are often good for foreign operators but are too dependant on the attitude of local authorities and political circumstances.
- Many Russian partner companies in the distribution chain and logistic companies still operate in grey markets of illegal import and distribution.
- The positive political statements made in favour of direct investment are often contradicted by the actions of administrative bodies and regional stakeholders.

RECOMMENDATIONS

To further the development of high potential market segments for foreign businesses in the agricultural sector and investment opportunities for EU-based companies, the Agribusiness Committee suggests:

- The establishment of Agribusiness Committee panels, task forces and working groups that are focused on specific issues faced by industries and companies;
- Compliance with and adherence to agreements already concluded with the EU and those resulting from WTO pre-accession agreements;
- Maintaining a dialogue with Russian institutions and leading experts;
- Regular meetings within the framework of the AEB Agribusiness Committee;
- Permanent dialogue and consolidated actions on behalf of European operators involved in agribusiness in Russia (production, processing, equipment, service) for stronger integration of Russia into the CES and global economy;
- Better coordination between businesses, and national and EU institutions.

CROP PROTECTION SUB-COMMITTEE

Chairman: Egon Weinmueller, BASF

Co-Chairman: Pierre Cohadon, Syngenta

Committee Members: BASF, Bayer, Dow, DuPont, Syngenta



BACKGROUND

In 2006, the Crop-Protection sub-Committee won a considerable victory in the fight against counterfeit agricultural products. A landmark case was successfully brought against the owner of a company producing counterfeit goods, which resulted in a sentence. The immediate consequence of this first victory was the destruction of all confiscated stock. Consolidated action and close cooperation with the EC Delegation to Moscow and the European Commission in Brussels played a considerable role in bringing this case to a successful conclusion.

Over the past year, the sub-Committee has developed a closer relationship with law enforcement agencies and the Russian authorities. Meanwhile, within the sub-Committee itself we have seen member companies take concerted action on a wide range of key issues.

Ties with the European Crop Protection Association (ECPA) have also been strengthened. A good example of this close cooperation is the ongoing implementation of a Public Awareness Project aimed at blocking the flow of counterfeit chemicals onto Russian agricultural land. This project obtained strong support and funding from the ECPA. Russia has been chosen as one of the pilot countries for the implementation of this project.

An example of the positive outcome of the sub-Committee's collaboration with the European Commission Delegation is the inclusion of the issue of classification, registration and licensing procedures for crop-protection products on the agenda of technical regulation negotiations between the EU and the Russian Federation. Another important factor is that crop-protection chemicals in Russia are regulated by Minenergo, which has signed the framework agreement between the EU and the Russian Federation.

ISSUES

Since the summer of 2003, European interest groups have been working with the Russian Ministry of Agriculture (MOA) on amendments to the Russian Crop-Protection registration process, which has not been very effective for some time. In February 2004, a detailed proposal was sent to the MOA at their request. This was intended to improve the existing process for registering new active ingredients as well as re-registering existing products. The lack of adequate procedures had meant that new registrations had not been completed by the researching industry for several years.

There was no improvement in the situation until February 2005. After several months of lobbying by interested parties, Minister Gordeev (MOA) signed a special decree prolonging existing registrations until December 31, 2005. Thanks to the late spring in Russia in 2005, the effects of missing products were only felt by the crop-protection industry and Russian agriculture in the North Caucasus region.

After considerable efforts by stakeholders and their active participation in working with the MOA, the Crop-Protection sub-Committee, faced the re-registration problem all over again in 2006. This time the problem was with re-registration of fertilizer and crop protection products, despite the fact that in January 2006 an informal working group had been established in the MOA to deal with this issue.

Although the AEB Crop-Protection sub-Committee has been deeply involved in lobbying on these issues since June 2005, it has had a limited impact on the reorganisation of the registration process at the MOA. As of mid-February 2006, re-registrations were still taking place too slowly and around 300 agricultural products were still not re-registered.

From a legislative point of view, the appointed organ for registrations in the MOA was abolished by presidential decree at the end of 2005, and no successor has been defined so far. A great deal of confusion and delay exists as responsibilities between ministries and within the MOA have not yet been clearly defined. The situation is comparable to that facing pharmaceutical products, as it involves not only Minenergo, but also the Ministry of Agriculture, the Ministry of Health and the Ministry of Natural Resources.

RECOMMENDATIONS

The Crop-Protection sub-Committee would like to see internal reorganisation take place within the Ministry of Agriculture to ensure that more resources are allocated to the re-registration process and that the process is legally formalised. We also hope that registration for existing products will be extended for six months to one year to ensure a stable business environment for importers and agriculture and minimise any damage to Russian agriculture that a lack of plant protection products could cause.



AIRLINE COMMITTEE

Committee Chairman: Marek Pedersen, Scandinavian Airlines System (SAS)
Committee Members: Air France, Alitalia, Austrian Airlines, British Airways, Czech Airlines, Delta, Emirates, Finnair, Iberia, Japan Airlines, JAT Airways, KLM Royal Dutch Airlines, Korean Airways, LOT Polish Airlines, Lufthansa, Malev Hungarian Airlines, Olympic Airways, Qatar Airways, SAS, Swiss International Air Lines

ISSUES

• Russian Civil Aircraft Industry

International air transportation in Russia continued to grow in volume in 2006. This expanding market provides plenty of potential, both for foreign and Russian carriers. Nevertheless, the international air transportation segment remains very much closed with many restrictions. One of the problems encountered by Western airlines is that Russia persistently protects its nearly non-existent aircraft manufacturing industry. This leads to a situation where most Russian carriers cannot afford the high import duties on modern Western aircraft and thus, are banned from flying to Western destinations. At the same time, Western carriers find it hard to gain approval from the Russian side for additional flight frequency because of Russia's strict bilateral approach. All this stands in the way of greater access for investors, business people and tourists.

• Air Service Agreements, Taxation, Customs and VAT

Most of the existing Air Service Agreements were not designed for an open-market environment. Some agreements even date as far back as the 1950s. Meanwhile, the Russian authorities have not shown any evidence of their willingness to make progress on the most critical issues (as laid down in this document). Consequently, the Russian aviation market is likely to remain highly regulated and restricted with little adherence to the principles of a "market economy". Some points in the old agreements have been replaced by bilateral Taxation Treaties; others are no longer relevant due to legislative changes. This creates numerous legal hurdles for airlines operating in Russia. A further problem is that local authorities interpret and apply the laws differently across various Russian regions and cities.

• Royalties, Over-Flying Rights and Code-Share Agreements Across Russian Territory

These costly remnants of the past remain high on the Airline Committee's agenda and are being dealt with by the respective airline HQs with active support from the European Commission in Brussels.

• Traffic Rights and Commercial Agreements

The Russian side follows a strict bilateral or parity approach. "Commercial agreements" with local carriers

are often forced upon foreign carriers as a mandatory precondition of the Russian Authorities approving their schedule. AEB member airlines are against compulsory commercial agreements and would like to see greater liberalisation of the Russian market. There is a commitment to bring these issues up at every relevant inter-governmental and/or airline bilateral meeting.

• Handling Monopolies

With a few exceptions, Russian airports do not offer alternatives for airport services, such as ground handling, catering and fuel. The AEB Airline Committee is lobbying to have at least two ground service providers at all international airports in Russia.

• Air Navigation and Terminal Charges

The Russian authorities are still making considerable increases to "user charges". However, we have seen improvements in the consultation process and initial dialogues.

LOCAL ISSUES

• Taxation, Customs and Currency Legislation

The AEB Airline Committee monitors the legislative situation and takes action where appropriate in order to ensure compliance with the existing bilateral inter-governmental agreements and with international practice.

The Tax Police of the Russian Federation has been harassing some foreign carriers to pay an allegedly outstanding 'Turnover Tax' for the period 2000 – 2002. Acting in full accordance with their respective country's bilateral agreements with Russia, those foreign airlines have not collected the tax. The debate continues, but the fear is that after challenging one airline and being refused, the authorities will simply move on to challenge another airline.

The Central Bank of the Russian Federation constantly changes currency regulations, which often has a negative impact on international airline operation in Russia. As non-resident legal entities, international airlines are subjected to currency regulation restrictions that work in favour of Russian airlines. Russian customers (legal entities - residents) have to absorb extra costs and administration fees when paying airfares in Russia.

The Airline Committee's position is to adhere to valid bilateral agreements and follow internationally applied practice. We have conducted numerous meetings and consultations with the respective governmental bodies and institutions to make this position clear.

The Airline Committee's position is to adhere to valid bilateral agreements and follow internationally applied practice. We have conducted numerous meetings and consultations with the respective governmental bodies and institutions to make this position clear.

• BSP and E-Ticket Implementation in Russia

After more than a decade of wrangling, the BSP (Bank Settlement Plan) finally came to Russia on September 1st, 2006. This outcome is largely thanks to the persistent efforts of the IATA (International Air Transport Association) and participating airlines that lobbied for this long-overdue scheme. Despite the fact that BSP is a legitimate and modern way of structuring the business relationship between airlines and travel agents, the Russian Federal Civil Aviation Authority has so far failed to give it the support and recognition it deserves.

The Airline Committee actively supports full BSP implementation in Russia at the earliest date.

It is IATA's recommendation that all airlines operate in a ticket-less environment by the end of 2007, i.e. by issuing e-tickets – electronic tickets. The Airline Committee is determined to have this modern technology implemented as soon as possible, since it will save costs and simplify air travel, finally bringing the airline industry in Russia into line with international standards.

• Immigration Cards

The Airline Committee strongly opposed the introduction of Immigration Forms printed only in Russian. Last year the matter was finally brought to a satisfactory conclusion with the forms now being issued in both Russian and English.

• Transition From USD to Euro for all Fares Originating in Russia

Thanks to the lobbying activity of the Airlines Committee, airfares originating in Russia have been amended to Euro, effective from December 1st, 2006. This avoids the unreasonable exchange rate for international ticket sales that was previously used when converting dollars to roubles.

• VAT on Catering Equipment

Member airlines continue to experience problems when clearing their catering equipment. Our position is that catering equipment should neither need to be licensed nor subject to VAT and compulsory checks. The Airlines Committee is working to clarify this situation.

• VAT on De-icing Liquid

The local airport authority at Pulkovo Airport in St. Petersburg continues to impose VAT on de-icing liquid, which is contrary to bilateral treaties and international practice. Some carriers have decided to pay the fees "under protest", while others continue to refuse to pay, as is their right according to bilateral treaties and international practice.

• Dialogue with Moscow's Three Main Airports: Domodedovo, Sheremetyevo and Vnukovo

The Committee receives presentations from and maintains an ongoing dialogue with Moscow's three major airports: Domodedovo, Sheremetyevo and Vnukovo. Presentations from selected regional airports/airlines, e.g. from Kuban Airlines and a delegation from the southern airports, have also been well received by Committee members. The latter was particularly important in view of the fact that the southern city of Sochi has applied to host the 2014 Winter Olympics Games.

• Restructuring of the Civil Aviation Authorities in Russia

The new and overly complex structure of the Russian CAA put extra pressure on airlines, as carriers had to submit full documentation for registering with this newly created body. The new set-up has had a negative impact on air carriers and unnecessarily increased the already high level of bureaucracy in the Russian aviation industry.



ALCOHOLIC BEVERAGES COMMITTEE (ABC)

Chairman: Bill Mateo, Maxxium

Committee Members: Bacardi-Martini, Diageo, Maxxium and Pernod Ricard

Introduction of UFAIS

The Russian alcohol market, primarily import operators, experienced an exceptionally difficult time throughout 2006 while adjusting to numerous new requirements arising from new market regulations. Imports of alcohol products were hit especially hard due to very short notice periods, unrealistic implementation deadlines, as well as delays on the part of Russian official bodies in practical and legal implementation of the new regulatory requirements.

On many occasions, alcohol importers and their products were unjustly discriminated against by the Russian authorities not only in real-life operations, but also in the securing of Russian legislative documents. By mid-2006, such discrimination had become systematic and the ABC released and made public its Memorandum on Discrimination of Alcohol Importers, which was issued to high-ranking officials in the Administration of the RF President and the RF Government.

The ABC intensified lobbying activities to previously unprecedented levels, involving international allies, including European and US business and industry associations. The ABC worked hand in hand with the EC Delegation in Moscow, the Embassy of the United States of America in Moscow and a number of EU Member State Embassies in Moscow to improve the regulatory climate for importers and to minimise the negative impact of the regulatory/implementation chaos that reigned on the Russian alcohol market for much of 2006.

As a result of these efforts a number of positive changes to legislation and other regulatory acts were enacted by the RF Federal bodies: alcohol products intended for diplomatic missions and other missions with similar status, as well as products intended for exhibitions/fairs, and for certification purposes, were exempted from the ill-prepared and poorly implemented system of alcohol control – the so-called UFAIS. The same legislative amendment has exempted bonded warehouses (warehouses of temporary customs storage) from mandatory installation of UFAIS components and channeling of respective data to the UFAIS; products in international customs transit, as well as duty-free products were also exempted from turn-over registration in UFAIS.

Re-stamping of Imported Beverages

Among the major problems that the imported alcohol market confronted in 2006 was the “re-stamping” of imported beverages bearing “old” excise stamps. The regulatory requirements were inadequate and implemented ineffectively and belatedly by Russian officials. The issue was relaxed through an additional Resolution of the RF Government adopted at the very end of Dec 2006, which moved the re-stamping deadline from Dec 29, 2006, to March 30, 2007. Yet another amendment on the same issue was adopted by the RF Government on March 3, 2007, which is aimed at resolving the main difficulty in re-stamping – the admittance of importers to wholesalers’ warehouses. Nonetheless, a number of related “re-stamping” issues remain unresolved and the ABC continues its actions.

Long awaited amendments to labeling requirements under RF Resolution #80 that were lobbied for by the ABC (such as the removal of the requirement to place health hazard warnings on “face” labels) had also come into effect by the end of 2006. However, further action was undertaken by the industry in January 2007 to mitigate possible consequences of the Feb 1st deadline for implementation of these amendments.

Future Lobbying

The discriminative requirement for importers to report on sequential excise stamp numbers, “double guarantee” at customs, excessive hygiene certification requirements, state monopoly on alcohol, clarification of alcohol advertising requirements and others emerge on the ABC agenda as a primary focus and lobbying issues. The ABC will also address the practice of setting unrealistic deadlines for implementation of legislative requirements by RF authorities as the problem that invariably remains the chief cause of many a crisis that shatters the alcohol market.

AUTOMOBILE MANUFACTURERS COMMITTEE (AMC)

Chairman: Mr. Henrik Nenzen, President, ZAO Ford Motor Company

Deputy Chairman: Mr. Oskar Akhmedov,

Managing Director, Volkswagen Group Rus OOO

Members: Automobiles Citroen Representative Office, BMW Russland Trading

OOO, DaimlerChrysler Automotive Russia SAO, Ford Motor Company ZAO

(Ford, Jaguar Land Rover Russia, Volvo Car Russia), General Motors CIS LLC,

Honda Motor RUS LLC, Mazda Motor Rus LLC, Mitsubishi/

Rolf Holding ZAO, Nissan Motor Rus OOO, Peugeot Rus Avto OOO,

Porsche Russland OOO, Renault/Avtoframos OAO, Toyota Motor OOO, Volkswagen Group Rus OOO

(Audi Russia, SkodaAuto Russia, Volkswagen) representing Audi, BMW, Cadillac, Chevrolet, Chrysler,

Citroen, Dodge, Ford, Honda, Hummer, Infiniti, Jaguar, Jeep, Land Rover, Lexus, Maybach, Mazda,

Mercedes-Benz, MINI, Mitsubishi, Nissan, Opel, Peugeot, Porsche,

Renault, Saab, Skoda, Toyota, Volkswagen, Volvo.



The Automobile Manufacturer’s Committee (AMC) was formed in 1998 to unite and represent the common interests of member companies. Members include major international car makers manufacturing in and/or official importers to Russia. The aim is to create and observe fair business rules for all companies officially operating on the Russian market and to leverage inter-company co-operation. Currently, the committee unites 18 member companies (automobile importers and representative offices of global automobile producers) representing 30 brands, which guide business activities in the Russian Federation. Participation in the committee is at the level of company CEOs and senior managers who meet regularly to discuss industry issues and work out a common position and solutions. The AMC concentrates on the most important and urgent issues faced by the automotive business and which affect its members, developing appropriate responses, lobbying committee interests, dealing with the Russian government authorities, public institutions, local automotive associations and the mass media.

To increase the efficiency of committee activities a decision was taken to focus on particular areas addressing acute automotive issues where member specialists work to find solutions together. The AMC consists of 8 working groups which integrate up to 150 people nominated by their company. Each working group deals with a distinct automotive issue that has been set as a priority by the committee: Statistics and Sales Data, Fuel Quality, Homologation and Automotive Regulation, Exhibitions, Customs, Consumer Legislation, Used Vehicles (Trade-In) and PR.

The committee operates under the AEB Committee Rules and Automobile Manufacturers Committee Charter.

For a number of years the AMC has cooperated with the Association of Russian Automakers (OAR). In February 2007, a Memorandum of Understanding was signed between the 2 organisations to intensify joint efforts, exchange information and strengthen lobbying activities in the automotive sector.

Marketing/Exhibitions

Since the foundation of the AMC, motor shows have been a priority issue. Together with the Association of Russian Automakers (OAR) and the International Association of Automakers, the AMC has intensively negotiated that the conditions at the Moscow International Automobile Salon be brought in line with those at other international events.

ISSUES

In 2006 the AMC succeeded in repositioning the Moscow International Automobile Salon regarding timing (with an extended term of 2 weeks/2 weekends and alternative dates so as not to coincide with other international motor shows fixed in the OICA official calendar), a location with modern facilities, a better test-drive area and parking capacity, and proper and fair conditions for all the exhibitors with competitive costs, terms and services. The 2006 Moscow International Automobile Salon was undoubtedly the best motor show arranged in Russia to date with all automakers having the opportunity to demonstrate their new cars and prototypes on professionally built stands. Consequently, the number of visitors exceeded all expectation and the event attracted extensive media coverage. The next passenger car motor show will take place in 2008 (according to international practice the event is arranged every 2nd year).

RECOMMENDATIONS

In 2007, the AMC would like to see changes to the organisation of national motor exhibitions. In particular, one large professionally arranged event rather than several smaller ones, as is currently envisaged.

BENEFITS

The expansion of the automotive market in Russia means that there is a strong demand for Moscow motor shows that meet the highest international standards. Holding a single, high-profile event would better satisfy this demand and attract more interest from the media.

Used Vehicles

ISSUES

The efforts of the AMC Used Vehicles WG are concentrated on the development of a transparent used vehicle (UV) sector in Russia. In spite of the fast developing market, UV trade in Russia is under-developed and is still considered "grey", since the majority of the transactions are performed by private individuals not official dealers and are almost tax free. When trading-in vehicles, consumers do not enjoy the benefit of having the support of an official dealer network (where the cost of the used vehicles is credited for the purchase of a new vehicle).

The main hindrance in the development of this market is legislative. Under the Tax Code, VAT is levied on all deals between legal entities and consequently UVs are subject to VAT on the full vehicle price. A legal entity (official dealer) is required to pay VAT on the sale of a car with mileage during trade-in, while this is not the case in transactions between private individuals. This leads to duplicate collection of VAT at vehicle resale by the dealer (VAT is first collected when the new vehicle is bought from the dealer, then again when the vehicle is resold) and artificially increases the UV price for the buyer. As a result, authorised dealers seldom trade-in vehicles from customers who have bought a new vehicle from them. Consequently, customers tend to buy used vehicles on commission from other private individuals and this pushes used-vehicle trade into the "shadow economy". In this scenario, consumer protection is minimal: no warranty is given to the buyer; retail finance cannot be obtained.

RECOMMENDATIONS

The Committee's main objective is to bring regulations in line with EU practice by getting rid of double taxation in UV trade; so that legal entities are allowed to sell UVs without being eligible for VAT, in accordance with European practice (Directive 94/5/EC).

The Committee has prepared a proposal based on a comprehensive study of European tax and trade-in practices with a financial estimate included. The initiative is supported by the Association of Russian Automakers (OAR) and the Russian Automobile Dealer Association (ROAD).

BENEFITS

The suggested amendments to the Tax Code would result in a more transparent and legal market for used vehicles and trade-ins. Consumers would gain a clearer and simplified system of trade-in and retail finance options and higher consumer protection due to vehicle safety checks carried out by dealers. Automotive companies would benefit from an increased demand for new vehicles and increased sales growth boosted by the trade-in option and higher levels of customer satisfaction. Benefits for the state would include: a transparent and legal UV trade sector; faster turnover of used vehicles; increased tax revenues to the state budget from the sale of new automobiles and funds emerging from trade operations with

legal entities; creation of new jobs in the automotive retail and maintenance sectors and a decrease in road traffic accidents due to official dealer involvement in technical inspection and pre-sale services.

Automotive Regulation (Homologation)

ISSUES

- The current vehicle certification system is not sufficiently transparent or efficient. The system was developed in June 1993 based on the Guidelines of the International Organisation for Standardisation Committee ISO/IEC. The second updated issue of the rules was published in 1998. The new Russian Law on "Technical Regulations" was enforced in July 2003 and in accordance with this law "the rules" of certification must be replaced by several technical regulations. These are timetabled for development, public discussion and approval by the State Duma in 2005-07.
- End Life Vehicles (EVL): More and more cars are being sold in Russia, but there is currently no system for recycling old cars (the issue is not yet on the agenda, although this is an acute problem considering the age and condition of the existing car fleet). This lack of an effective infrastructure could have consequences for the market, as well as being an environmental issue. Neither the government nor business representatives are involved in the process; there is no clear government policy and no unified utilisation system.

RECOMMENDATIONS

- The working group is committed to cooperation and dialogue with the Russian authorities to ensure the development of a transparent and efficient vehicle certification system in Russia and to promote European and international principles of homologation. In particular, the working group would like to see homologation requirements for second-hand vehicles and those imported by private persons brought in line with those for new vehicles and more equitable terms for importers.
- Car recycling is supported/subsidised by the state in most other countries. In Russia we would like to see an effective EVL infrastructure, system of exemptions and effective instruments put in place to encourage businesses to recycle vehicles. To kick-start discussion of the EVL utilisation issue, the working group plans to meet the relevant authorities (NAMI, State Parliament, Ministry of Industry, Association of Russian Automakers, Moscow Government, etc.) and business circles to treat the matter from legislative and business points of view, bearing in mind international practice (implementation of EU Directive in selected countries; ELV Responsibilities; a recycling quota and its impact on economic operators; material restrictions; technical requirements for treatment operators; ELV economics; the role of post shredder technology; monitoring and reporting, etc.).

BENEFITS

- If the suggested homologation requirements were put in place, there would be significant benefits for consumers and government. Customers would be assured of the safety of the vehicles they buy and use, while the government would benefit from the implementation of better environmental, ecological and road safety standards and the creation of barriers in the import of "grey" vehicles.
- The implementation of an effective EVL infrastructure would encourage consumers who presently find it easier to dispose of a car than to recycle it. The environmental and economic benefits would be significant.

Fuel Quality

The Fuel Quality Working Group is currently seeking practical solutions to poor gasoline quality and the resulting technical problems. The group aims to ensure the availability of quality fuel for modern cars all the way up to the filling station. To improve the existing situation the WG cooperates with local authorities, controlling organisations, major fuel producers on the Russian market and discusses conformity of current national fuel standards with existing European ones.

Statistics

Due to the absence of reliable information on the industry and statistics from official sources, the AMC began an exchange of car sales data between its members several years ago. At the moment, all international automakers that sell cars in Russia are involved in the project (45 brands). The objective of the existing system (exchange via an Internet web portal) is to draw an accurate picture of comparative statistics that all the sales offices of the automotive producers operating in Russia need for analysing the market, forecasting and planning. Currently, the system is the only up-to-date and reliable source for the Russian market. In 2006, the AMC began to distribute monthly press releases on foreign brand sales in Russia (new cars only) to the mass media. The system supplies the market with realistic figures (on both imported and locally produced non-Russian brands sold across the RF). The initiative has met with tremendous success, is widely quoted in the press and is actively used by automotive specialists and analysts.

Public Relations

The PR group was formed by the AMC at the end of 2005 to bring together public affairs specialists from automotive companies in order to: help the AEB AMC improve and strengthen press contacts; support a common position on test drive arrangements; service the needs of the Russian press in the automotive sector by coordinating press activities at national events; synchronise company press events; carry out media monitoring; exchange information on changes in the Russian press market; and provide information to the media in a proactive and efficient manner.

Customs

The working group is currently concerned with the issue of customs clearance procedures, in particular the "green channel" or "fast track" importation channel for official importers. The group is currently involved in negotiations with customs officials to share their experiences (both positive and negative) of customs processing and customs control that existed prior to the "green channel". The group exchanges information and collaborates with other organisations on customs issues that affect automakers; as well as raising these issues with the RF Federal Customs Service.

Consumer Legislation

The group is involved in the analysis and systemisation of the most frequent consumer complaints faced by companies. It works to create unified procedures for customer relations in conformity with current legislation and to strengthen ground and support dealers by exchanging legal case and quality test experience; identifying major areas of concern and lobbying for necessary changes in the current consumer protection legislation related to motor industry.



AUTOMOTIVE COMPONENTS COMMITTEE

Deputy Chairman: Ivan Bonchev, CIS Automotive Leader, Ernst & Young (CIS) LLC.
Committee Members: Air Liquide, Amtel-Vredestein, Atlas Copco, Continental Tires, BASF, Corning, DaimlerChrysler AG Research & Technology Office Moscow, Delphi, Dow Automotive, DSM, DuPont, Ernst & Young, GKN Driveline, JETRO, Johnson Matthey, KPMG, Michelin, OTEM (Eberspecher), Russian Automotive Components, Saint-Gobain, Sandvik, Sibur Russian Tyres, Tenneco Automotive, ThyssenKrupp, Umicore Automotive Catalysts, ZF Friedrichshafen

The Russian automotive industry has witnessed dramatic growth for the past couple of years. The clearest and foremost trend is the redistribution of the market share between Russian and foreign vehicle manufacturers in favour of the latter. 2006 was a turnkey year in the history of the Russian automotive industry: for the first time the total market for passenger cars reached the 2 million benchmark (new imports, second-hand imports and locally manufactured), whereby foreign brands considerably outnumbered local Russian makes.

ISSUES

As a result, the automotive component industry has also been developing, albeit at a slower pace and with some delay. Just a few of the factors hindering growth are:

- Lack of tiered divisions between component manufacturers due to the high level of integration with the major OEMs;
- Lack of competitive technologies among Russian manufacturers due to a legacy of highly integrated vehicle manufacture coupled with highly amortised equipment, which make most local component manufacturers less attractive;
- The relatively long-term process of adapting new technologies and applying know-how to local manufacturers;
- Economies of scale are a must for attracting major foreign component manufacturers (most require well over 200,000 units of car production in order to make an investment economically viable).

Government Reforms

In 2006, the Government contributed to attracting foreign investment to the automotive component industry by extending decree #166 to decree #566 in Q4 of last year. Like #166, this regulation lists over 130 components and sub-components that can be imported at reduced customs duties of 0-5% for 5-7 years, depending on the complexity of component manufacturing. Likewise, there are localisation requirements, mandatory processes and technological operations to be performed and minimum production volumes to be produced (for major components only).

Apparently, this is an attractive proposition for component manufacturers. However, Russia's accession to the WTO leaves a very short period of time for component manufacturers to obtain industrial assembly status. Furthermore, the government plans to develop, pass and promote other investment incentives which will provide customs and tax breaks to automotive component manufacturers even after Russia's accession to the WTO.

Future Strategy

By 2010, about 1,000,000 foreign brand cars will be manufactured locally in Russia. These numbers will already be sufficient to attract volume-critical component manufacturers like chassis, clutches, injection systems, etc.

Foreign component manufacturers are likely to follow their clients, who will encourage them to help meet localisation requirements. Other major international tier-1 players will establish themselves in Russia on their own to capture a fair amount of the market share of both foreign and local players. Russian players will continue working to improve the quality of their products and processes not only by implementing ISO standards, but also by engaging in continuous improvement initiatives and applying Toyota production system techniques. Russian OEMs will continue to restructure themselves internally to improve their competitiveness, market performance and capitalisation, and as part of this process new component companies will emerge through spin-offs, joint-ventures and strategic alliances. Special economic zones should further trigger supplier activity targeted at meeting the demand of local markets and serving as a basis for global sourcing. Suppliers' parks would then emerge and ultimately component clusters appear, backing up the efforts of the government, educational and training institutions and OEMs.

A major challenge remains obtaining sufficient government support to attract foreign investors; the localisation of car manufacture; and the application of competitive, efficient and environmentally friendly technologies and know-how. It is in addressing these issues that the Automotive Components Committee intends to play a crucial role in improving the investment climate in Russia by means of active lobbying to simplify investment conditions.

BANKING COMMITTEE



Chairman: Philippe Delpal, Cetelem Russia (BNP Paribas)
Committee Members: ABN AMRO A.O., Aizkraukles Banka, Bank Natexis ZAO, Bank WestLB Vostok AO, Banque Societe General Vostok, BNP Paribas, CA IB Corporate Finance, Calyon Rusbank, Cetelem Russia (BNP Paribas Company), Commerzbank (Eurasija), DeltaCredit Bank, Deutsche Bank Ltd., Dresdner Bank ZAO/Dresdner Kleinwort, European Bank of Reconstruction and Development, Federal Bank of the Middle East Ltd., Finansbank Ltd, Hansabank OAO, Hellenic Bank Ltd, HSBC, ING Bank (Eurasia) ZAO, International Moscow Bank, KMB-Bank ZAO, Liechtensteinische Landesbank Ltd., Northstar Corporate Finance (member of HSH Nordbank Group), Rabobank Nederland, Raiffeisenbank Austria, Bank Renaissance Capital, Rusfinance, San Paolo IMI SPA, Svenska Handelsbanken S.A., UBS Investment Bank, Ukrsibbank BNP Paribas Group, VP Bank LTD., YAPI Kredi Bank

Russia's Financial Sector

When assessing Russia's financial sector, one must take a broad look at each factor influencing the sector's operation and performance and try to assess the relative impact of each. Although a financial sector's quality is obviously determined by its players (i.e. banks and other financial institutions), equally important are the external influences and impulses. The most important external factors in Russia are the political and regulatory environments. For this position paper, we have identified a number of general issues, as well as the key issues that appertain solely to the legislative and political environment. Alongside these issues we have listed our recommendations.

While a number of the recommendations seem obvious whilst others may be more challenging to achieve, making small, concrete first steps in the right direction can help the Russian financial sector gain further confidence from foreign investors and boost the stable development of the Russian financial arena and long-term sustainable growth in the Russian economy.

ISSUES

1. Too many financial institutions are currently operating in Russia (banks alone number around 1300). The majority of these are small banks used as in-house treasury/financing vehicles for Russian corporations. The poor quality and non-transparent nature of some of these "pocket banks" harm the reputation of the Russian banking sector as a whole. At the same time, three major state-owned banks continue to dominate the market, including Sberbank's dominant position in retail deposits (more than 53% of the total).
2. The growth of the inter-bank market and the number of active players on the financial markets is still limited to the top 50-100 banks (both foreign and domestic), in part due to the unreliable financial data and lack of transparency of some of the smaller banks. Focus on enhancing the quality of reporting coincides with reform of financial reporting in general and migration to International Financial Reporting Standards (IFRS) for the banking sector.

3. The quality and level of internal procedures and risk management practices are too low and need further improvement across the sector.
4. Increasing levels of impaired loans (especially as more and more banks build up operations in the untested retail sector with limited credit history) could ultimately erode consumer and investor trust in the banking sector if credit quality worsens.
5. Separate regulations for the three types of companies that lend money have not yet been implemented: regulations are not only needed for banks that provide loans to legal entities, but also for banks that take deposits and grant ordinary credits and financial companies that provide personal loans and instalment credits.

RECOMMENDATIONS

1. Financial sector restructuring should be carried out by raising minimum requirements such as minimum capital levels, liquidity levels, asset concentration, and, importantly, by enforcing new regulations. The implementation of changes in regulations must be very cautious, with obligatory forecasting assessment of possible consequences and influences on the Russian banking system as a whole. Additionally, there is need for tighter monitoring of financial sector entities, including forced closure in case of non-compliance.
2. An increase in transparency and minimum reporting requirements, as well as encouraging second tier banks to work with international auditors to bring required levels of transparency to the bank; to recommend that the Central Bank of Russia (CBR) work out a detailed programme for further steps towards the full adaptation of IFRS to the practice of Russian banks in order to achieve transparency.
3. Improvements in the internal organisation and risk management procedures of financial institutions will require (most likely foreign) expertise and assistance to bring it up to par with its foreign peers. The goal is to set more rigorous control criteria for the internal policies and methods used by banks, while assessing their risks and the degree of adequacy of these methods to the character and purport of bank transactions.

4. More attention should be paid to Controlling Operational Risks (to paraphrase): simply requiring banks to have tested Disaster Recovery Plans in place will automatically reduce the number of banks. Gradual adoption of International Convergence of Capital Measurement and Capital Standards: a Revised Framework (Basel II) by the CBR should also lead to improved risk management by banks.
5. The banking sector regulator should consider tightening provisioning rules. Although only recently established, and in itself a positive development, the regulator should work towards limiting the number of credit bureaus for registration of client data. Moreover, there is need for a clearer and more sensible system of Credit History Bureaus.
6. A set of normative acts should be adopted that are related to the feasibility of rights of banks in relation to dishonest clients: personal bankruptcy (there is still no detailed concept for this in Russian law); streamlined and effective provisions on the sale of property at public auctions; levy of execution on the borrower's property (for example goods purchased on consumer finance credit); more effective execution and enforcement of court decisions; and a law on consumer finance, which should be simpler, more transparent for ordinary customers and should not limit the freedom of the agreement as a key principle of the Russian Civil Code.
 - Exclusion of connections between the consumer protection laws and consumer finance laws is a must; otherwise it implies that a consumer finance loan agreement is a public agreement, which entails certain legal consequences.
 - The issue of fees and commissions on consumer loans should also be addressed: recent court decisions have ruled that banks are not entitled to charge their customers certain fees and commissions, even though such fees and commissions were included in the loan agreements signed between the bank and their customers. In so far as valid contracts are disregarded, these court decisions generate legal instability and uncertainty: this is detrimental to the banking business and more generally jeopardises the principle of the rule of law in Russia. The courts of higher instance and/or the legislator should clarify the situation by confirming the validity of existing consumer loans contracts.

Russia's Regulatory Environment

ISSUES

1. ISDA agreements cannot be signed, derivatives cannot be traded and there is lack of clarity on the set-off of pledges. These are just a few of the factors that cause the Russian financial sector to lag behind many other countries in terms of legislation, ultimately hampering its competitiveness and attractiveness to foreign investors. There is inadequate liquidity (even in the home currency) as a result of a callable deposit base.

2. Through closer monitoring of financial institutions and stricter (and more effective) supervision (armed with sufficient legal powers), the quality and level of transparency of banks should improve. Improved monitoring will further restore confidence in the banking sector as witnessed by the increased amount of individual deposits in 2005-2006.
3. Increasing the minimum requirements for banks should cause a reduction in the number of banks in the Russian financial sector, since it will encourage banks to seek consolidation and tougher supervision in order to enhance their liquidity ratios.
4. The government was keen to use the deposit insurance scheme as a way to rid the banking system of small players but the introduction has not yet brought about any real reduction in the number of banks operating in the Russian financial sector. Credit bureaux should improve the asset quality of banks operating in the retail sector, although the sheer number of bureaux could dampen their effectiveness.

RECOMMENDATIONS

1. The Central Bank of Russia should work more closely with domestic banks and international organizations (such as ISDA organisations) to improve legislation and speed up the implementation process of new laws in order to remove the inadequacies described above.
2. Supervision of the CBR should be further improved to make it much more stringent (this should coincide with giving the Central Bank of Russia sufficient legal power to enforce and supervise problem banks efficiently).
3. The Central Bank of Russia should instigate tighter requirements for operating in the financial sector.
4. The CBR should continue to take steps to make the financial sector more transparent (stepping up reporting requirements) to enhance trust and confidence in the financial sector, for the long-term benefit and stability of Russia's economy and financial institutions.

Political Environment

ISSUES

1. Corruption and bureaucracy have represented serious barriers to reform, which have held back the development of financial sector.
2. As 2008 draws closer, uncertainty in terms of presidential succession could lead to a more conservative approach by foreign banks with regards to granting longer-term credits.
3. Rapidly and unpredictably changing political environments can result in additional costs in monitoring and incorporating new laws and guidelines, increasing the risk of being in breach of untested new laws.

4. Given the importance that international banks place on compliance and adherence to money laundering regulations, corruption can hamper the ability and willingness of foreign banks to grant credits. This can increase costs of compliance and work in getting deals awarded.
5. Increased state influence may lead to substitution of a proper credit decision process in banks with more political considerations, which could further undermine risk perception among international financial institutions. The question of whether a credit is quasi-sovereign as a result of state ownership can also distort lending margins.

RECOMMENDATIONS

1. Firm policies to reduce corruption would be welcomed by both international and domestic investors in Russia.
2. Government departments should be given incentives to make Russia an easier place to do business – a policy of reducing red-tape and implementing a commercial mind-set in governmental and civil service departments could be a major boost to Russia's economic growth.
3. We would welcome continued focus on credit analysis of borrowers and sector analysis to prevent potential future problems, such as over-investment in a certain sector in case of an economic downturn. The government should further stimulate private enterprise and investment in other sectors to reduce dependency on the natural resources sector.
4. Banking sector consolidation can be encouraged to allow improved capitalisation to match the size of Russia's corporate entity counterparts.
5. Strong growth and positive macro economic and political environments attract foreign investors. The presence of foreign investors is highlighted by some of the large M&A transactions in the Russian banking sector, the increased volume in internationally syndicated lending to Russian banks, and more local players tapping into Eurobonds markets. High growth may soon lead to heightened competition and increase the need for increased capitalisation and consolidation.



ENERGY COMMITTEE

Chairman: Reiner Hartmann, E.ON Ruhrgas
Committee Members: Areva, BP, Electricite de France, Eni S.p.A., E.ON Ruhrgas, Fortum, Gasunie, Gaz de France, Norsk Hydro ASA, The Lighthouse Group, PricewaterhouseCoopers, Repsol YPF, Schlumberger, Shell E&P, TNK-BP, Total E&P

INTRODUCTION

The AEB Energy Committee actively addresses issues of concern for European energy companies operating in the Russian Federation.

The growing interdependence between producer, consumer and transit countries requires strengthened partnership between all stakeholders to enhance global energy security. Cooperation in the energy field is one of the principal areas of interaction between the European Union (EU) and the Russian Federation. The EU is the main export market for Russian energy resources, while Russia is the main energy supplier to the EU. Russian companies as well as their European counterparts are interested in a non-discriminatory regime for international business, having financial markets and state-of-the-art energy technologies available to them. Energy dialogue between the EU and Russia requires the development of new forms of cooperation, with a commitment to attracting foreign investment on a rational scale and on mutually beneficial terms for the respective energy markets.

GENERAL ISSUES

1. Reciprocity

Status. The interdependence of energy supply (Russia) and demand (EU), particularly for gas supply, is an ongoing issue. Russia demands downstream assets in Europe but has set up restrictions blocking foreign access to upstream assets in Russia. EU initiatives aim at tackling Russia's increasing control over the EU market, and at minimising Europe's vulnerability regarding external energy suppliers.

Recommendations. Reciprocal penetration of energy markets by the EU and Russia should be set up: permitting Russia to gain access to EU markets, allowing direct sales to European end-users, and expanding participation of European companies in different sectors of the Russian energy market (in the various stages of upstream business, internal and external trading, transportation and storage, ancillary service provision, pipeline management, energy efficiency projects, equipment sales, non-discriminatory access to networks, etc.).

2. Regulatory Process

Status. The existing regulatory system in Russia is not sufficiently transparent, as well as being complicated, cumbersome, time-consuming and unpredictable to operate in. The approval procedures do not allow for paral-

lel processing of documentation and demonstrate poor coordination between the various agencies involved. Moreover, the division of responsibilities between different institutions is not clear enough and harmonisation of standards and technical norms is not yet in place. The transfer from GOSTs to "technical regulations" is currently suspended. Finally, multiple and excessive inspection/audit activities are common practice.

Recommendations. We support the introduction of a more transparent and clear regulatory system by shifting from a prescriptive to a goal-setting regulatory regime. We also recommend recognition of risk-based management systems together with a movement towards risk-based supervision and inspection. Other recommendations include: acknowledgment of foreign competence and easier certification procedures; as well as cooperation with governmental bodies and Russian business organisations on technical regulation, standardisation and conformity assessment.

3. Clarity and Stability of the Tax Regime

Status. The existing tax regime for oil and gas upstream business in Russia provides weak incentives for production from highly depleted brown oil and gas fields, small and remote green fields onshore and petroleum reserves at Russia's continental shelf. The regime is revenue-based and therefore insensitive to project costs; it does not recognise heavy up-front investment, long payback periods or the high risks of such projects.

Recommendations. The development of remote green fields for onshore and offshore petroleum reserves requires stable and predictable fiscal terms. A progressive profit-based regime is much more adaptive to increased development costs and the variability of petroleum prices. It is also important that the new tax regime ensures the stability of fiscal terms.

4. Amendments to the Existing Subsoil Law

Status. Recent draft amendments to the Subsoil Law set up three criteria for regarding fields and/or minerals as strategic. The proposed amendments say that foreigners and some Russian residents acting for foreigners will not be admitted on their own to auctions held by the MNR. They will need to establish a joint subsidiary, with Russian partners controlling more than a 50% interest in the entity.

Recommendations. Ideally, a new Subsoil Law aimed at reforming the subsoil management system should be introduced. While the amendments are acceptable as a temporary solution, the amended law does still require clarifications and supporting regulations.

5. Production Sharing Agreements

Status. In the past, projects based on the Production Sharing Agreement (PSA) have contributed to a vast amount of direct foreign investment and an inflow of state revenues into Russia. However, as a specific tax regime for subsoil users it is declared "politically unacceptable and economically unprofitable" in Russia today. Existing PSA-based projects are heavily attacked, and one of them has been forced to revise its shareholder structure. These facts are not in line with the constituting principles of PSAs, which are based on clarity, stability, flexibility and arbitrage.

Recommendations. PSA is a highly relevant scheme for challenging and risky projects with heavy investment, such as offshore field development projects in the Arctic areas of Russia. In cases where assets are transferred for development under PSAs, separate federal laws will regulate the terms of their operation. It is necessary to re-think the applicability of such a tax regime for the most challenging upstream projects in Russia. The current tax regime in Russia, even with significant tax exemptions, creates few incentives for significant foreign investment in such projects.

6. Environmental Issues and Global Climate Change

Status. The recent EU Energy Package includes challenging and ambitious environmental commitments. Meanwhile, Russia relies heavily upon conventional fossil fuels for its domestic market and exports. Despite signing the Kyoto Protocol in 2005, Russia has not yet introduced a regulatory framework for GHG emission inventory and trading.

Recommendations. We look to promote a better understanding of the high priority of environmental protection and global climate change issues as an important part of the contemporary EU Energy Policy. We hope for cooperation in the introduction of the carbon trade mechanisms of Kyoto protocol into Russia, as well as incorporation of the relevant provisions into the future EU-Russia Strategic Partnership Agreement.

ISSUES BY SECTOR

1. Oil Sector

- European petroleum companies investing in Russia come up against serious obstacles in bidding for exploration and production licences, awarding permits and the required approvals, making upstream projects profitable under the current tax regime (in particular, in remote areas and the Arctic offshore), and in crude off-take.
- Inconsistent and discriminatory ("strategic" reserves, information ban for foreigners) licensing conditions and enforcement
- Delays in bidding for the award of new licences
- Threat of revoked licenses

- Unfavourable conditions of cooperation offered by Russian Partners (exposure to main resource development risks, the role of financial carriers for projects, a long lead-time for return on investment)
- Unpredictable and drastic changes of these conditions, either initiated by the state or by partners
- Discriminatory access to trunk pipelines for green fields and certain routes
- Loss of profits because of a missing crude oil "quality bank"
- Non-transparent oil pricing and oil trading schemes
- Low incentives to improve petroleum product quality due to the absence of emission requirements for mobile power installations, etc.
- Current tax scheme reduces cash flow for investment by companies in:
- Green-field development
- Maintenance and replacement of equipment, e.g. Russian rigs
- Efficient oil exploration and enhanced oil recovery.

2. Gas Sector (Pipeline Gas & LNG)

- The upstream gas business in Russia today is complicated and risky for European investors due to the Gazprom monopoly, poor prospects for establishing equity-based commercial models of partnership and uncertainties with gas off-take.
- Gazprom monopoly on gas production, transportation and export limits space for independent producers and puts potential partners in a straitened position
- Development of gas resources in new areas requires heavy investment under high risk conditions
- Limited access to gas pipelines
- Blocked project developments due to external factors, threat of revoked licenses
- Squeezing out of independent gas companies as possible business partners
- Disincentives for oil companies to invest in gas production and to engage in related business with European companies
- Absence of experience on LNG technologies (liquefaction, transportation and re-gasification)
- The Russian gas industry requires long-term natural gas export sale contracts (which do not contradict the idea of gas market liberalisation) in order to secure investments for further business development.

3. Electric Power Sector

- Potential risks in the long-term sustainability of this strongly regulated sector increases price risk

- Risk of domination by state-affiliated companies in all parts of the value chain will jeopardise the basis of the reform process
- Lack of clarity on how to gain an operational position in generating companies limits the options for strategic investors to engage
- Significant risk of shortages in gas available to existing and new generating assets; complicated system of access to gas pipelines
- Potential bottleneck in the development of new capacities in the area of energy machinery manufacture
- Absence of a long-term and approved forecast of the fuel-energy balance for the country
- Current power and heat prices do not support the entry cost for new capacities.

4. Nuclear Power Sector

Even though Russia has never openly stated its policy and expectations regarding the involvement of European firms in the nuclear power sector, Russian and foreign companies share numerous common interests that could be considered both in Russia and abroad:

- Uranium extraction
- Production and enrichment of nuclear fuel
- Joint construction of nuclear power plants (NPP) in third countries
- Joint development for a new generation of reactors
- Joint ventures for major components manufacturing
- Joint research on speciality steels
- Joint programmes on improving NPP safety, life extension and availability
- Such collaborative projects would open new markets for both the Russian and European nuclear power industries. However, in order to be implemented, the Russian civil nuclear industry must first be established on a "business-like basis".

5. Energy Efficiency, Renewables and the Environment

The latest EU "Energy Package" establishes an extremely ambitious target: to reduce the amount of carbon dioxide emissions from energy use by at least 20% by 2020. To achieve this objective it is necessary to focus on such energy-related strategic goals as: improving energy efficiency by 20%, increasing the share of renewables in the primary energy mix-up to 20% and raising the proportion of bio-fuels in motor fuel to 10% by 2020.

However, Russia's priorities seem to be very far removed from these objectives. The general lack of political interest results in:

- Low incentives to invest in energy conservation because of low regulation of energy prices, cross-subsidisation
- Absence of a law on renewable energy
- No guaranteed connection to the electricity grid for producers
- Lack of progress on implementation of the Kyoto Protocol's flexibility mechanisms, in particular of the project guidelines for Joint Implementation (i.e. revenues from emissions trading not available for projects in Russia)
- Over-centralised decision-making on projects of local and regional impact
- Next to no public support for efforts to encourage the management of energy demand (to make energy efficiency projects feasible)
- Lack of municipal housing reform, an inefficient ownership structure and resulting lack of predictable revenues
- Lack of Russian financing for energy efficiency and renewable energy projects
- Vague understanding of specific benefits for companies and regional authorities regarding the introduction of energy saving programmes
- Lastly, we should note that many EU member countries have broad experience in implementing energy-saving projects (both at an industry and consumer level). European businesses and organizations are ready and willing to work with Russian partners and share their experience.

HEALTHCARE AND PHARMACEUTICALS COMMITTEE

Chairman: Serge Scotto, AstraZeneca UK Ltd.

Committee Members: AstraZeneca UK Ltd., Bayer Schering Pharma, Biomerieux, Boehringer Ingelheim, Chiesi, Egis, Gedeon Richter, FIC MEDICAL, Hexal, Herbs Trading / Richard Bittner, Ipsen, Novo Nordisk, Polpharma, Sanofi-Aventis, Servier, UCB (Union Chimique Belge), Zentiva



ISSUES

The European Community has rich experience in the field of healthcare management. This experience has enabled European nations to significantly increase the life expectancy and quality of life of its citizens. European pharmaceutical companies produce a substantial portion of foreign medicines sold in Russia, as well as making significant investments in industry and research. Furthermore, the European Community is taking part in negotiations to decide the conditions for the accession of the Russian Federation to the World Trade Organization (WTO).

The Health and Pharmaceuticals Committee aims to contribute to this process by:

- Encouraging the set-up of an effective reimbursement program for the those with low incomes;
- Lobbying for greater protection of intellectual property rights (IPR) and more effective action against counterfeit medicines;
- Building an adequate legal environment to facilitate wider public access to quality and innovative medicines.

RECOMMENDATIONS

To achieve these aims, the Health and Pharmaceuticals Committee intends to:

- Maintain and develop its existing working partnerships with the Ministry of Health and other Russian institutions;
- Maintain a constructive dialogue with foreign and Russian professional pharmaceutical associations on issues of common concern;
- Capitalise on the potential of the Committee for close cooperation with EU and national institutions in lobbying, promoting member interests in the RF and integrating them into the EU framework;
- Exploit the opportunities available through the AEB for B2B partnerships between Russian and foreign companies;
- Achieve maximum involvement in AEB activity of European pharmaceutical companies represented on the local market.

Update On 2006

The AEB Pharmaceuticals Committee played an important role in securing Russia's admission to the European Pharmacopoeia (EDQM), an organisation which has guaranteed the quality of medicines in Europe since 1964.

Last autumn, the AEB Pharmaceuticals Committee worked with EDQM and several Russian federal institutions to organise a national conference on the theme of combating counterfeit medicines. The conference was attended by hundreds of healthcare professionals and led to some highly fruitful debate.

Throughout the year, the Committee continued its dialogue with the Russian authorities on the implementation of the DLO program. The Committee's leadership met regularly with top officials from the Russian government and committee representatives were present at all meetings held by the Ministry of Health and Roszdravnadzor (Federal Inspectorate for Health and Social Development) on the DLO program.

Despite the difficulties faced by the program, the Committee remains committed to making it a success. Moreover, at a recent meeting with the newly appointed head of Roszdravnadzor, we were assured of the commitment of the Russian authorities to the partnership and to close cooperation with foreign producers.

Over the past year, the Committee has been involved, both at the executive and legislative level, in formulating a new law on medicines. The Committee has also worked hard to establish strong working relationships with Russian and foreign pharmaceutical organisations. A number of collaborative initiatives were undertaken. For instance, the Committee coordinated a high profile press conference at the RIA Novosty Press Agency with the RF President's statement on the DLO issue. This conference generated wide coverage in the Russian media and greatly influenced further developments in the resolution of the issue.

CURRENT ISSUES

Reimbursement Program

Since life expectancy in the Russian Federation remains significantly lower than in the rest of Europe, increasing access to high-quality and affordable medicines for those on low incomes should be a priority. The current implementation of the DLO program is considered as a

positive step. The Health and Pharmaceuticals Committee is ready to support any initiative aimed at facilitating the program's implementation and guaranteeing the stable supply of medicines.

Protection of Intellectual Property Rights

Counterfeiting remains a serious problem on the Russian pharmaceutical market, despite the sustained efforts of the Ministry of Health. This issue has implications for both the Russian and foreign pharmaceutical industries, since it hinders innovation. More worryingly, it restrains efforts to improve the health of the Russian population. The Health and Pharmaceuticals Committee supports initiatives that aim at combating the production and distribution of counterfeit medicines, such as those aimed at better collection of evidence, law enforcement measures and sanctions. However, the main priority for the nearest future is to ensure that government systems for combating counterfeit goods are based on solid foundations and firm guiding principles.

Access to High-Quality and Innovative Medicines

Ensuring wide access to quality and innovative medicines is key to improving public health. These medicines can only be introduced and developed in Russia if there is a supportive legal environment. Indeed, the World Trade Organization requires that member countries have this kind of supportive legal framework in place. The Health and Pharmaceuticals Committee is prepared to encourage and support any initiatives that further Russia's accession to the WTO, especially in the fields of:

- Protection of intellectual property rights (especially trademark protection)
- Transparency of choice for customers
- Free access to a liberalised market

HUMAN RESOURCES COMMITTEE

Chairman: Tim Carty, Ernst & Young

Deputy Chairman: Olga Bantsekina, Coleman Services

Committee Members:

Antal International, BAT, Brunel CR, CBSD, Coleman Services, Danone, Deloitte, Deutsche Bank, Dirol Cadbury, Ecopsy, Emborg, Ernst & Young, Hay Group, IN2, Kelly Services, KPMG, Manpower, Marriott Hotel, Nestle, Nissan, Philips, Porsche, PricewaterhouseCoopers, Shell, SHL, TNK-BP, TNT



As a representative of professionals working in the development of the people-related aspects of European business in Russia, the HR Committee would like to see improvements in a number of fields. Committee activity is divided among three sub-Committees specialising in Training, Development & Assessment, Compensation & Benefits and Recruitment. A separate programme of activities is dedicated to issues affecting foreign workers in Russia and Russian nationals working abroad.

TRAINING, DEVELOPMENT & ASSESSMENT SUB-COMMITTEE

Education & Graduate Career Opportunities

The sub-Committee is pleased to see that interaction between Russian educational bodies and business organisations has continued to intensify. In particular, we value the opportunities for AEB Members to interact with educational establishments and their students at organised events, including career days, business training meetings and so on.

While the sub-Committee appreciates the need for basic funding of such events, it opposes any policy of designing events to generate profit for educational establishments, or for participating individuals and enterprises.

The sub-Committee also welcomes the increased focus within the academic establishment on developing skills among students that are more directly relevant to their future careers. Furthermore, the sub-Committee encourages greater commitment from the authorities to promoting internship programs for students.

Professional Development

A greater variety of professional HR qualifications are now available in Russia. In the mid-term, we would like to see the development of home-grown professional qualifications in the HR field to supplement international qualifications.

COMPENSATION & BENEFITS SUB-COMMITTEE

Executive Remuneration and Governance

Increased transparency in the process of executive remuneration in Russia is necessary. Within the wider frame-

work of improved corporate governance, the development of greater clarity in the delivery of remuneration is particularly important. Whilst allowing for confidentiality, competitive concerns, and the labour protection afforded to all employees, the remuneration of senior management should be delivered as payroll costs to the employer, or recharged to the employer in as transparent a manner as possible, to minimise any suggestion of tax evasion and ensure that the economic cost of an organisation's personnel is accurately reflected in its statutory financial accounts. Parallel minimisation of technical risk and penalties in the fields of taxation, labour and currency law, and accounting is also recommended.

Deferred Compensation

The use of deferred compensation is a tried and trusted method that can help broaden the outlook of executives in decision-making; assist in retention; and motivate executives to manage their businesses in the mid- to long-term interests of their shareholders and stakeholders, avoiding the potentially damaging effects of short-term decision making.

Official recognition of deferred compensation as a valid remuneration tool, and clarification of labour law, taxation and accounting rules to reflect this is necessary.

Equity Remuneration

Equity remuneration is a specialised sub-category of deferred compensation, and adds significant levels of technical complexity to an area that is already unclear in Russian legislation.

Recent advancement in the RF laws on currency control, which facilitate the participation of Russian executives in international equity programs within their organisations are welcome developments.

The sub-Committee welcomes clarification of personal taxation, social security and corporate profits tax implications of participation in equity plans. Particular attention should be paid to the fact that such programs are often run outside the geographical confines of the Russian Federation and that the linkage between an executive's Russian employment and his ability to benefit from his wider employer group is not set out with clarity.

Introducing clearer definitions of how such international programs should be treated in the areas of labour law,

tax law and accounting would bring a number of benefits. Firstly, it would enable the development of this type of remuneration program within the wider domestic market in Russia, since it would lessen the risk of companies inadvertently committing technical infringements in these areas. It would also encourage compliance with tax and other obligations arising out of participation.

Recruitment Sub-Committee

Loan Staff

With the dynamism of the Russian economy, and consequently high staff turnover, many organisations seek to utilise loan staff as a legitimate means of bridging shortfalls in staffing levels. The decision to work on a loan staff basis can be a desirable and useful opportunity in the career of an employee.

However, the government should look carefully at Russian labour laws and other types of legislation that deal with the employment of loan staff to clarify areas of concern and ensure that proper protection is put in place for both the individuals and organisations concerned.

Foreign Nationals

A number of positive developments have been identified in this area over the last twelve months. In its statements, the Russian government has recognised the importance of investment by foreign companies as well as the skills and talents of foreign nationals to the Russian economy. Recent moves by the immigration authorities to simplify procedures for foreign nationals seeking to work lawfully in Russia were welcomed by the Committee. However, issues remain about the implementation of these changes, and there are still areas of concern that have yet to be addressed.

Defining Business Trips

At present, the difference between a foreign national entering Russia on a business trip and a foreign national entering Russia to begin work is not clearly defined in legislation. We would like to see the implementation of clearer definitions and regulations.

Secondments

The sub-committee fully recognises the potential problems in the use of secondments as a means of bringing expatriate personnel into Russia. In particular, there is the risk that a foreign national could work for a Russian business in Russia, but be effectively employed and paid by a foreign entity that has no presence in the country. Since the employer is absent (and hence outside the scope of Russian jurisdiction) it would be difficult to assign responsibility and seek redress for violations of the employee's rights under Russian law. Likewise, the absence of the employer may mean that parties present in Russia are unable to seek redress for the actions of the expatriate employee. There are also potential security risks to be taken into consideration.

However, circumstances exist where a foreign executive is requested to move to Russia in order to assist in the development of his organisation's business. In this scenario, it is unlikely that the employee would wish to formally quit his existing employment, and become an employee of the entity through which his employing organisation conducts its business in Russia for the duration of his assignment. This entails the employee losing access to social security, pension and other types of benefit schemes as well as employment rights in his/her home country.

To solve these difficulties, a scheme whereby an executive can be seconded from his usual employer to work under the control and management of the entity through which his employing organisation conducts its business in Russia could be set up.

Consideration is given to such a work arrangement in the chapter on corporate profits tax in the Tax Code of the Russian Federation. However, this type of secondment is not recognised under Russian migration law, and the Russian migration authorities do not currently view secondment as a permissible basis for issuing a work permit to a foreign national. This interpretation of work permit regulations is not consistent with that applied by the migration authorities from November 2002 to Spring of 2004 – an inconsistency that cannot be explained by any legislative changes since that period. The Committee regards current interpretation as a disincentive to the assignment of executive level talent that could ultimately be of benefit to the Russian economy. It also facilitates poor compliance, tax avoidance and obscure accounting.

The concept of secondment, as formally articulated in the Tax Code, should be introduced into all other areas of Russian law where it is relevant, so that executives and organisations can use it without risk. We are committed to a continued dialogue with the Russian government to ensure that genuine concerns about abuses that could arise from inconsistencies in the current legislation are addressed.

Taxation of Foreign Nationals

The current approach to personal taxation and the government's continued commitment to a low tax regime, whereby active compliance and payment of taxes is a financial burden that all individuals are expected to accept should be applauded. Nevertheless, there are a number of ongoing problems with the taxation system as it affects foreign nationals, which work as a disincentive to compliance.

There should be a clear policy by the tax administration to lean most heavily on those individuals who do not comply with their tax obligations, rather than those who attempt to do so. In particular it should be noted that, under law, Russia has had a self assessed personal taxation system since 2001, and yet the tax administration continues to require, with no technical basis, a vast level of documentation to support every figure appearing on a personal tax return. This is an administrative and structural issue that requires urgent review.

A more effective way of ensuring that tax returns are accurate would be to conduct checks on a limited number of individuals, selected at random and using a measure of analysis, both to inspect the selected individuals and encourage all taxpayers to be accurate and diligent in their returns. Attempts to check data on all tax returns is misguided, an inefficient allocation of resources, and inconsistent with the law.

The current legal provision, whereby only a taxpayer may pay his/her taxes, should be amended to state that a taxpayer may not transfer ultimate responsibility for his liability to another party. This would allow companies to settle their expatriate employees' taxes on their behalf, which would materially simplify the administration of foreign nationals' tax affairs, improving compliance and increasing tax revenue.

Furthermore, revisions to the section of the Tax Code dealing with the application of double tax treaties to bring it into line with the provisions of double tax treaties is necessary.

Finally, the tax return form should be revised to allow non-residents to report more clearly for compensation paid in foreign currency for duties performed in Russia.

Social Security

Preliminary discussions surrounding the establishment of a Totalisation Agreement between Russia and France on social security taxes and benefits is a welcome development, as would be further efforts made in this direction for a wider number of foreign jurisdictions.

Russians Working Abroad

Many Russian companies are working actively to increase and develop their foreign investments and overseas assets, which has a beneficial effect on the Russian economy. At the same time, there is an increasing tendency for international organisations to send their Russian personnel on temporary placements abroad to widen their experience. International companies are also making increasing use of Russian managers in strategic international roles.

Unfortunately, there is some confusion in the rules related to personal income tax for Russian nationals working abroad. We would like to see amendments introduced to the Tax Code to ensure that Russian nationals who either cease Russian tax residency or who are subject to taxation in their host jurisdiction, are explicitly exempted from the withholding tax on personal income paid in Russia in relation to duties performed in a foreign jurisdiction.



VISA TASK FORCE

Chairman: Sergey Melnikov, Your Lawyer
Committee Members: Alinga Consulting Group, LLC; Consulting and Visa Service; Deloitte; Ernst & Young (CIS) Limited; Norman DL Associates; Smithbridge Advisory Services Ltd.; Visa Delight; Your Lawyer

INVITATIONS

ISSUES

1. Registration in order to invite foreign visitors duplicates registration for the purposes of work permit execution.
2. The registration term is limited to one year, a company's file is then terminated and the company must re-submit the whole set of documents once more.

RECOMMENDATIONS

1. Combine the procedures implementing the so called "one-stop" system
2. Ensure tacit registration renewal once a company confirms that all the data related to registration remains unchanged.
3. To develop a simplified renewal procedure in the event that some information submitted for registration has changed.
4. Not to limit the registration term to the term of the lease contract for the company's premises or the work permit/visa of its General Director (in case the position is occupied by an expatriate).

BENEFITS

1. Decrease of the burden on hosting entities related to repeated submission of the set of documents.
2. It is not necessary to submit the same documents several times in order to register the company during the same year.

Work Permits

ISSUES

1. In case a foreign citizen appointed as a General Director of a Russian legal entity enters the Russian Federation with a business visa in order to establish such legal entity he is denied a work permit until the company is registered. While registration is possible only after a General Director has gained a work permit.
2. Decree of the government of Moscow of December 27, 2006 No. 477 adopted the List of Healthcare Facilities Authorised to Survey and Examine Foreign Citizens, which does not include some major inter-

national healthcare centres represented in Moscow. Though all of them have the necessary licenses to provide the required health certificates.

3. Furthermore, medical certificates issued abroad are not accepted. Foreign citizens who have medical insurance in their respective home countries and want to receive the said analysis and certificates there may be disadvantaged because of this regulation.

RECOMMENDATIONS

1. Formalise a clear procedure for company registration where the General Director is a foreign citizen.
2. To provide for initial registration of such companies without the General Director having a work permit.
3. Extend the List of Healthcare Facilities Authorised to Survey and Examine Foreign Citizens, to include major international healthcare centres represented in Moscow.
4. Provide for the acceptance of medical certificates issued by foreign healthcare facilities. Without their legalisation in Russian Consulates abroad many Russian Consulates (e.g. London) deny certification of such documents.

BENEFITS

1. A simplified company registration procedure, where it would not be necessary to appoint a Russian citizen acting as a General Director in the interim period.
2. Foreign citizens would not be subject to repeated medical survey in Russia as in most cases they already have certificates confirming the absence of HIV issued abroad and the documentation required by Russian Consulates to receive entry visas to the Russian Federation.

Accreditation

ISSUE

It is currently not possible to combine work in a representative office with any employment in some other company. Therefore, if a person appointed General Director of a Russian legal entity enters the Russian Federation with an invitation visa from SRC, he/she is denied the work permit for employment in the company he/she should head.

RECOMMENDATIONS

1. To formalise the right of employees of foreign representative offices to combine their activities in this capacity with employment in other companies.
2. To elaborate in detail all issues related to the activities of foreign companies' representative offices and branches in the territory of the Russian Federation in a separate statute.

BENEFITS

Foreigners would thus be given the opportunity to work part-time in more than one company.

Registration

ISSUES

1. Migration registration procedures effective from January 15, 2007 provide for repeated migration registration and submission of a tear-off slip of the respective migration form each time a foreigner leaves the territory of the Russian Federation or moves to any other city (constituent) of the Russian Federation for a period exceeding 3 business days (10 business days for persons having residence certificates). This provision presupposes much work to be done by the hosting party, especially in case the foreigner frequently travels abroad or goes on business trips within the Russian Federation.
2. Recently there have been also some faults in the activities of post offices that accept notifications but refuse to accept tear-off slips.

RECOMMENDATIONS

1. Simplify the procedure for migration registration for heads of companies and top executives (for foreigners entering the country with multiple annual work permits (visas) as well as for some other categories of foreigners (categories to be defined) permitting a single notification valid for one year upon first entry and a tear-off slip return on final departure from the Russian Federation upon expiry of the visa. Consider alternative migration registration procedures, such as the possibility to fill in electronic notification forms for companies with a large number of expatriate employees entering the territory of the Russian Federation, departing thereof and travelling within Russia, on a daily basis. Consider automatic notification of a foreigner's entry/departure upon crossing the border of the Russian Federation to migration authorities sent by border guard service employees.
2. To arrange for post offices to accept not only notifications but also tear-off slips. To discharge post offices from the responsibility of checking whether notifications and tear-off slips have been properly filled in.

BENEFITS

1. Decrease companies' expenses arising from the necessity to employ extra staff to fulfil the responsibilities related to migration registration, as well as the increased burden on the migration authorities.
2. Decrease the burden on post offices arising from responsibility to check whether notifications and tear-off slips have been properly filled in. The hosting company should receive confirmation of the migration notification return in the form of a post stamp, while in fact migration authorities provide no confirmation that migration notification slips have been returned.

Secondments

ISSUES

1. Currently, a significant number of companies hiring expatriates to work in Russia follow international practice and do so under secondment, or "provision of personnel" agreements. These agreements are concluded between a foreign entity (the actual employer of the individual/ the home entity) on one side, and the Russian legal entity or a representative office/branch of the foreign legal entity in Russia (the host entity) on the other.

Secondment agreements are not new to Russian legislation (i.e. they are directly referred to in the profit tax section of the Tax Code and used to be the only method by which a private foreign organisation could lease employees from the State), however, immigration legislation currently ignores this concept entirely.

Many companies use secondment agreements to bring expatriates to Russia to enable their more senior executive and technical individuals to maintain their home country employment agreements with their employers abroad, which, in turn, allows them to remain in their home country social security system and keep an on-going work record with the company that normally employs them. Such experts will often be unwilling to move to Russia without such an arrangement.

2. Under current law, a work permit may only be applied for by the employer of the individual. In theory there is no reason why a foreign employer with no presence in Russia could not make such an application, but the practical requirements effectively exclude such an approach. Therefore in practice, many expatriates enter into a sham relationship with the host Russian business to whom they are assigned, usually for minimal compensation, solely for the purposes of obtaining a work permit. This generates a number of corporate tax risks, is dubious in ethical terms, and reduces the level of control exercised by Russia over foreign nationals working in the country.

RECOMMENDATIONS

1. To introduce the idea of secondment into legislation, allowing for application of Russian work permits on the basis of secondment agreements. The AEB recommends that corporate applications are done through the medium of the entity to which the expatriates are seconded, which are present in Russia, and that this entity should take responsibility for the seconded expatriates during their Russian assignment.
2. As an alternative, the AEB suggests that the current system of corporate level applications, followed by individual applications be replaced for suitable qualifying executives or technical experts, by a direct application for a work permit on an individual basis, with specific allowance in the procedures for this to apply to seconded personnel. For manual workers and foreign nationals with a low level of management experience or technical skills, we recommend the continuation of the current approach whereby corporate permission is first required, and a direct employment relationship with the host entity is also necessary.

BENEFITS

1. Introducing the concept of secondment into immigration legislation and its practical application will finally recognise and regulate a practice that already exists, and will bring immigration law into conformity with other areas of legislation, such as the tax law.
2. By making secondment structures a proper and unequivocal basis for work permit applications for executive level foreign nationals and technical experts, Russia is more likely to be able to attract these valuable resources to work in the country where needed.
3. By avoiding the need for dual employment structures, foreign businesses operating in Russia will avoid concerns over corporate tax, and the mis-statement of information to the Russian Authorities.
4. Russia will be presented with better levels of compliance in the immigration area. This is important from a security perspective. It is also important in increasing the understanding of skill shortages within the Russian labour force, which should help redirect investment in training and similar skill development programs for Russian nationals more readily.
5. Restricting the application to senior executives and technical specialists should help avoid abuse of such structures for tax reasons, whilst ensuring that foreign staff with less sophisticated skills continue to be employed locally, and hence may easily be availed of the protections of the Russian Labour Law and social benefits.

INSURANCE AND PENSIONS COMMITTEE

Chairman: Alex Bertolotti, PricewaterhouseCoopers
Deputy Chairman: Wil Osthorn, ING Non-State Pension Fund
Committee Members: ACE Insurance Company, ACE Life Insurance Company, AIG Insurance and Reinsurance Company, AIG Life Insurance Company, Allianz Insurance JSC, Aviva Insurance Company, CMS Cameron McKenna, Cologne Re, Ergo Insurance Group, Euler Hermes Kreditversicherungs-AG, IF Russian Operations, Ingosstrakh, ING Non-State Pension Fund, In2 Consulting (CIS) Ltd., Munich Life Reinsurance Company Eastern Europe/Central Asia, PricewaterhouseCoopers, Raiffeisen Non-State Pension Fund, Renaissance Life Insurance Company, Roland Berger Strategy Consultants GmbH, Rosgosstrakh, Russia Consulting, Russian Standard Insurance, SCOR, Sogaz- Zhizn, Sogecap Life Insurance LLC, Swiss Reinsurance Company



GENERAL ISSUES

1. Market access for EU insurance players

A Federal law came into force on January 17, 2005 that removed barriers and limitations for EC companies seeking to establish daughter companies in the life and non-life insurance sector. The fact that limitations are still in force on non-EU insurers will be a discussion point at the Russia-WTO negotiations. The AEB Insurance and Pensions Committee supports the position that foreign investors should be permitted to own 100% of a Life or Non-Life Insurance Company as part of Russia's accession to the WTO.

Within the framework of WTO negotiations, some countries are insisting on Russia's acceptance of the obligation to allow foreign companies to open branches. Under Russian corporate legislation, the legal definition of a branch is far different from that in European or other countries, and so it is difficult to fully support this request. Nevertheless, this is an issue for further clarification and discussion with the Russian authorities. Further steps are envisaged in the development of a transition plan for the types of services that foreign companies will be allowed to sell through their branch offices in Russia. Realistically, progress in this field can be reached only after the implementation of changes and amendments to the Russian civil and/or insurance law on the legal status of foreign branches in Russia that are authorised for insurance activity. The same problem exists in the banking and other financial services' sectors. Experts from all sectors should combine their efforts to help the Russian authorities develop proper legal definitions of a branch.

Russia still imposes a limit on the percentage of foreign capital allowed in the insurance industry (25% of the total market capital). The cap was substantially increased in 2003 from the 15% that had been in force since 1997. At the present time, the ratio of foreign capital to total Russian insurance sector capital is well below that limit. Nevertheless, in view of the decreasing number of players, increased capital requirements and inflow of foreign capital likely after WTO accession, this existing limitation could create practical problems even for existing companies, which might limit expansion in Russia. This limita-

tion could also provide a negative example for other CIS countries to follow in their negotiations to join the WTO. All the comments above show the need to launch broad discussions with the Russian authorities on developing a step-by-step increase in the foreign capital share of the Russian insurance sector and/or fully remove it from regulatory measures within the next 3-5 years.

2. Movement towards international accounting standards in the insurance & pensions industry

Over the last year, the committee has become increasingly convinced that it is important for the Russian insurance market to move towards the use of international accounting standards. The committee is aware that the Ministry of Finance is drawing up plans and a timetable under which insurance companies and pension fund managers will be required to introduce international standards alongside Russian standards. The committee fully supports the Ministry of Finance in its efforts to introduce international accounting standards and is ready to offer assistance and advice if requested to do so.

3. The development of the actuarial profession.

The role of professional actuaries is important in all areas of the insurance and pensions industry. The committee is aware that the current law on insurance requires regulations to be brought forward by the Ministry of Finance to establish a system for attesting actuaries and for defining their role within insurance companies.

The committee is strongly in favour of the establishment of clear rules for the attestation of actuaries and for stipulating what work they should carry out in Russia. It is ready to offer assistance and advice if required to do so.

4. Market capitalisation and solvency requirements

The Russian insurance sector continues to be challenged by low capitalisation. According to a report of the Federal Insurance Supervision Agency ("FISA"), the owner's capital in the 1,074 officially registered Russian insurance companies amounted to RUR 143 billion in 2005. Only 26 companies had owned capital that exceeded RUR 1 billion in 2005.

The FISA has taken some steps towards increasing the minimum capital requirements for insurance companies, but the situation is not improving as quickly as we would like. We believe that further market capitalisation and consolidation will improve the situation, allowing Russian insurance companies to increase the amount of business they retain and fund the development/growth of their business and investments in new projects. It will also provide companies with a buffer should trading result in a loss.

It is possible that as the market grows, a number of companies will face financial shortcomings. This will also hasten consolidation. We expect that the process of consolidation will continue, especially if the FISA continues to strengthen solvency controls.

The FISA established solvency requirements for authorised companies based on the EU "Solvency 1" criteria, to help create a stable market and protect consumers. However, recent developments in the European market demonstrate that the Solvency 1 approach is now out of date and the EU is in the process of developing new, more relevant, rules for solvency. We consider that solvency requirements for Russian non-life and life insurance companies need to be improved as well.

A strong impact on industry consolidation can be foreseen as a result of the implementation of a new requirement (on 1st July 2007) that quality of assets cover the solvency margin.

5. Taxation legislation on the insurance and pensions market

Tax Law is generally developing in a favourable direction. However, there are a number of issues regarding the taxation of insurance-related operations. Problems in this area include: the non-deductibility of certain types of insurance premiums (e.g. voluntary third-party liability insurance), lack of clarity in tax law provisions for insurance companies; and the lack of sufficient tax incentives for development of pension insurance/long-term life insurance. On the positive side is the expected transition from taxation of pensions to taxation of pension insurance contributions, albeit there are discrepancies between the insurance law and tax law. Furthermore, there is currently no clear transition mechanism – which could lead to practical difficulties in the implementation of the new law.

6. Market Transparency

There are currently few commercial sources of information available for insurance policy holders who want to find out more about the market and its players. The lack of essential information on the insurance market, including CMTPL, may lead to policyholders making poor decisions in their choice of insurance company

Critical information on the penalties the FISA can impose on insurance companies is also unavailable for policyholders. The situation has to be improved to avoid further disappointment and to create a competitive environment in the market.

Although Russian accounting standards continue to develop in the direction of IFRS, they fall far short of full IFRS requirements. Generally speaking, form dominates over substance, both when insurers prepare their financial statements and when the regulator assesses them. Therefore, market statistics are inherently distorted by schemes, for both life and non-life.

Moreover, there is a lack of general understanding in the market about IFRS. Few Russian companies produce audited IFRS accounts, and mandatory publication of financial information in accordance with the IFRS, audited by competent auditing firms is a necessary step forward to increased transparency.

7. Supporting the growth of Bankassurance

In many areas of Europe, banks play a key role in distributing insurance and pension products. There are many variations of bankassurance and each country has developed legislation and sales practices that fit the specific legal and regulatory features of that country.

Whilst the committee supports the protection of confidential banking information, discouraging cross-selling of financial services could hamper the development of this important potential sales channel and could slow down the development of important social protection mechanisms as provided by the insurance and pensions industry.

ISSUES AFFECTING SPECIFIC AREAS OF THE MARKET

Life insurance

Life insurance is poorly developed in Russia. However, in the last couple of years, the Russian authorities have taken steps to combat the use of tax-optimisation schemes by Russian entrepreneurs seeking to minimise social taxes. The AEB has always stressed the importance of transparency in understanding life insurance products and their regulation by the state.

In the long term, we would like to see amendments made to the Russian Civil Code and Insurance laws to bring definitions for life insurance products into line with western practice and ensure greater protection for consumers. There is an urgent need for the establishment of technical provisions rules for the life insurance sector. Substantial efforts are required to develop life actuarial standards and practice, and provide special safeguards for investments made by life insurance companies. Finally, clear definitions on unit-linked products are required in regulations. The committee has provided detailed information to the Ministry of Finance and remains ready to assist if so requested.

Non-life insurance

The non-life sector of the insurance industry is by far the largest segment of the market in terms of premium income. As a result, it would benefit greatly from the general recommendations noted above, especially:

- The introduction of international accounting and reporting standards
- The development of the actuarial profession and the increasing use of actuarial methods in reserving claims
- Improvements to overall market reporting and statistics
- An increase in the overall financial strength of insurance companies
- Making voluntary liability insurance tax-deductible
- Assisting the development of Bankassurance

At the present time, Russia is still in the process of joining the international 'Green Card' system which simplifies the process of providing third-party motor liability insurance for vehicles crossing international borders. This system facilitates cross border travel and trade within Europe and as such would be of substantial benefit to both Russia and to other countries in Europe. The committee therefore supports the efforts of the Russian insurance industry to join the 'Green Card' system.

Reinsurance

Removal of restrictions on the activities of foreign reinsurers

Recently-introduced regulations on the placement of insurance assets create unfavourable market conditions for foreign players in the reinsurance sector. In general, the new investment regulations support the international trend towards developed IAIS standards for qualified assets, based on their credit ratings. Efforts made by the Russian authorities in this field have been very effective. Nevertheless, the existing limits on the share foreign reinsurers can hold in technical reserves for non-life operations are in effect discrimination against foreign reinsurers. The share of resident reinsurers is capped at 60%, whereas the share of foreign reinsurers taken together cannot exceed 30%. The same approach is in force for life reinsurance. The total life-reinsurer share of insurance reserves is limited to 20% of the reserve, while the maximum share of a foreign reinsurer cannot exceed 10%. The established maximum share per reinsurance company is 10% of the reserve, regardless of whether it is a foreign or Russian life reinsurance company.

Changes to the legislation, as currently envisaged, would further limit the access of foreign reinsurers to the market. The draft changes to the Russian insurance law also introduces limitations on foreign reinsurance in life insurance. The AEB Insurance and Pensions Committee does not support the proposed amendments to paragraph 2.2 of Article 13 of the Law, since the proposal clearly discriminates against non-resident reinsurance companies.

Furthermore, there is a concern among Committee members that the terms and conditions of the potential WTO agreement for Russia could erode the existing rights of EC insurance companies. We would like to see grandfather clauses adopted to protect existing market access; in particular, structures and licenses in place at the time

of Russia's accession to the WTO should be protected, and this protection should be interpreted in broad not limited terms.

Legal limitations are still in force on the access of foreign subsidiaries to certain classes of compulsory insurance. So far, these limitations are correlated with the 49% foreign share capital rule, (which does not apply to EU companies). Quite often, while lobbying for new compulsory classes, domestic companies appear to be attempting to block operations in this field for foreign subsidiaries. This creates the potential for a hidden monopoly by selected Russian companies in certain market segments, which violates freedom of competition in accordance with Russian law.

Development of market reinsurance systems for terrorism and major natural catastrophes

Since the terrorist attack on the World Trade Center in New York, the potential for huge loss resulting from terrorist attacks has become apparent. In a number of countries, the risk of substantial financial losses to the insurance industry has led to the development of state-supported reinsurance systems to cover terrorist losses. At the same time, the level of insurance losses from natural catastrophes has been increasing rapidly and in this area too, market wide schemes have been developed.

The committee believes that it would be beneficial to Russia to develop similar systems of protection against major risks and is ready to provide information on how different countries have approached the problem of providing reinsurance for the insurance market as a whole.

Pensions

Voluntary Pensions & Pension Reform

It is our view that in its current state the Russian pension system does not allow the working public to accumulate sufficient savings to fund decent pensions upon retirement. The mandatory pension insurance (2nd pillar) has so far not reached critical mass outside of the State Pension Fund and the voluntary savings pillar (3rd pillar) remains under-developed and little known to the general public.

2nd Pillar Reform

Although the Russian government should be commended for introducing wide-ranging reform of the mandatory pension system in 2002/3, it is unfortunate that some 4 years after the actual reforms the system has failed to take off. The amounts that are effectively outsourced from the State Pension Fund to private Asset Managers / Non-State Pension Funds are relatively small. There is also a clear lack of interest by Russian and foreign operators in investing in the reforms. This is unfortunate, since the success of the reforms very much depends on significant advertising and distribution budgets being invested. As a result, little progress has been made in terms of educating the market and the general public, and the reforms have failed to have the intended effect on the market. Instead of creating a savings culture through the promotion of the

concept of individual accounts managed by private operators, most assets under the new second pillar system remain with the state due to the “monopoly role” of the state-owned asset manager VneshEconombank (VEB).

In particular, we see the following structural problems, when it comes to the second pillar of the pension system:

- Fee structure: almost 60 Asset Managers and more than 110 Non-State Pension Funds are licensed for the second pillar. These numbers look impressive at first sight, but upon closer inspection it is evident that these are mostly “captive” organisations, which have used their “administrative resources” and a minimum of investment to enrol their staff. The reforms have failed to motivate private pension operators to make any large investments in this sector, particularly in the areas of advertising and distribution. The fees that the Asset Managers or Non-State Pension Funds are allowed to charge by law are too low to make their respective businesses sustainable in the longer term. For comparison, in Bulgaria and Poland pension operators are charging up to 5% on pension contributions made under the second pillar, as well as fees on Assets under Management. Meanwhile, under Russian law operators are not allowed to charge anything at all when funds are contributed. Only if investment income is positive can operators claim any fees: a Russian Non-State Pension Fund for example can only charge 15% on annual investment income plus revaluation of securities.
- The current fee structure in Russia does give providers a fair deal. The NSPF has to bear regular maintenance expenses, but there could be situations where these expenses are not reimbursed, because of unfavourable market fluctuations at the end of the year, which are out of the NSPF’s control. A fairer approach, which would make the 2nd pillar more attractive to investors, is to allow the NSPF to charge (1) a percentage of average assets under management of for instance 1% of AuM, as in the case of Asset Management Companies in Russia, as well as (2) a fee of 3% on pension contributions received, to cover part of their upfront distribution and administration costs. This latter charge would be of a similar level to charges levied by 3rd pillar NSPFs.
- In brief, the lack of proper incentives in terms of fees and sustainability has led to both potential Russian and foreign investors showing little interest in making any meaningful investments, preferring to wait for further government reforms.
- Investment risk: Non-State Pension Funds operate in a very vague legal environment concerning investment risk placement. While the Law on Non-State Pension Funds indicates that investment risk is borne by consumers, regulations issued after the law assume that this risk is borne by providers. It leads to unfair treatment of Non-State Pension Funds compared to Asset Managers and the State Pension Fund. International experience suggests that to

make the 2nd pillar savings efficient, the investment risk has to be placed on consumers to encourage investments in long-term bonds and equities. This issue, along with the issue about fee structure, is the main obstacle to investments in the 2nd pillar.

- Awareness: The general public is under-informed about the reforms and its entitlement to outsource its savings from the State Pension Fund to private operators. Apart from an annual mailing exercise (which does not reach many recipients and is difficult to understand) very little is done in terms of educating the general public (using, for example, the press, TV, government announcements, social advertising, etc.).
- Furthermore, recent initiatives undertaken by the Ministry of Social Affairs and Health to abandon the 2nd pillar reform have seriously damaged public confidence in the reform.
- Operational issues: There are some significant operational difficulties when it comes to transferring 2nd pillar assets from the State Pension Fund to Non-State Pension Funds once an individual has opted to have assets managed by a private operator. Based on practical experience, the average period of time between the client signing the relevant documentation and the actual receipt of funds by the Non-State Pension Fund amounts to 18 months. The assets in question do earn interest, which is then allocated by the State Pension Fund based on certain computations, which are not disclosed to market participants or the end client. This process should be streamlined to reduce the time it takes to transfer assets, and the process/computation of interest allocation should be made fully transparent to all parties involved.
- Cap on contributions: The laws regulating the 2nd pillar provide for caps on total contributions to individual accounts for each employee. Currently, the cap amounts to RUR 16,320 (US\$ 624) per annum and will be increased in 2008 to RUR 24,480 (US\$ 936). This creates a big obstacle for pension providers, as this relatively low annual contribution makes it very difficult to convince consumers, and high income earners in particular, to outsource their funds from the State Pension Fund to a private operator, not least as the process remains relatively cumbersome and paper-intensive.
- Replacement ratio: As a result of the above point, participants will be faced with a low income replacement ratio after retirement. In particular, not allowing higher earners to increase their annual contribution to the 2nd pillar, will lead to a very low replacement ratio for them.

Voluntary Pensions / 3rd Pillar

- Apart from overhauling or further reforming the 2nd pillar, a lot could be done to improve and support the 3rd pillar of the pension system, i.e. voluntary Non-State Pension in Russia. Voluntary pension savings in Russia stand a real chance of being accepted as a long-term savings product provided that the public feels that this market is properly regulated and its

interests are protected. This can be done by further improving the regulatory environment and by educational efforts (particularly amongst Russian employers), as well as by attracting more foreign investment into the sector. Both employers and employees should be properly incentivised through the tax system to accumulate additional savings for retirement in voluntary pension plans. While the ongoing tax reform continues to reduce non-transparent relations between employers and employees (e.g. tax avoidance through life insurance), it is important to promote new forms of relationships between these parties. Voluntary pension plans are part of such new arrangements.

- Non-State Pension Funds currently face a number of practical problems that should be immediately addressed. These are as follows:
- A lack of tax incentives for voluntary pension plans, both on the level of employers and also employees/individuals. There are also some current tax provisions that are detrimental, such as the requirement for employers to pay Unified Social Tax on pension contributions.
- The restricted use of the insurance reserve, which NSPFs are required to form, creates an unreasonable burden on pension funds and their clients. This makes the products offered by NSPFs relatively unattractive and hinders their promotion to the general public. If the insurance reserve could be used not only to cover longevity risk, but also investment losses, the product would be of a lot more interest to both the clients and providers.
- The current interpretation of the Law on Non-State Pension Funds, and the applicable accounting rules, requires NSPFs to give a “0%-guarantee” on pension contributions received, and investment return allocated, on an annual basis. This again puts a heavy burden on pension funds and discourages them from implementing a more flexible (and thereby higher yielding) investment strategy. If the “0%-guarantee” were to be applicable at maturity only, overall investment returns would stand to improve.

Although a number of welcome changes have recently been made to asset management regulations for non-state pensions funds (basically expanding the classes of asset that NSPFs can invest in), no clear regulatory instructions or guidelines have been issued to explain how NSPFs should operate under these new regulations. For example, while diversification into foreign assets (e.g. OECD state paper) is now in principle allowed, operators have been left in the dark on how exactly such investments can be made. Furthermore, the new regulations currently prohibit investments in real estate and it is not clear whether this is only a temporary restriction. NSPFs are therefore currently employing a “wait and see” policy in terms of their asset management strategies until these issues have been clarified by the local financial market regulator (note: deadlines set in the regulations require additional guidelines to be issued by August 2007).

Finally, a change in the fee structure for 3rd pillar pension funds, similar to the one proposed under the first bullet of the 2nd pillar section of this Paper, would be most welcome.

Charter capital / Minimum capital requirements (both 2nd and 3rd pillars)

Another barrier to entry for both 2nd and 3rd pillar pension funds is the level of charter capital that is required to set up a new Asset Management company or Non-State Pension Fund. Minimum capital requirements should be linked to the volume of liabilities undertaken by the provider. If it is simply a fixed amount, then it essentially an entry charge rather than the capital required to meet liabilities in the future. Similarly, for insurance companies the minimum capital requirements should be a percentage of pension reserves and/or pension contributions but not less than a specified amount.

This is where another important consideration comes into play. If there are capital requirements for a pension fund, then there should be stakeholders who are willing to pay it. It is not sensible to ask participants to pay the capital, because they already pay the insurance reserve. The most appropriate way to solve the problem would be to allocate commercial status to a pension fund (as opposed to their current non-profit status) and ask shareholders to pay the increase in capital. Otherwise only captive funds will be able to pay such increases, which would lead to an uneven playing field vis-a-vis non-captive funds.



IT & TELECOM COMMITTEE

Chairman: Christian Von Wistinghausen, BEITEN BURKHARDT
Committee Members: Alcatel, Antor Business Solutions, Bearing Point, BEITEN BURKHARDT, Bruck Technologies, BSGV, Calyon, Control Risks Group, Deloitte, Deutsche Bank, Ernst & Young, IT Excellence, i2 CIS, Honda, Luxoft, Raiffeisenbank, SAP, Siemens, Soft-Tronic, Sheremetyevo International Airport, Svenska Handelsbanken, Telenor

MISSION

To promote the interests of AEB member companies in Telecom and Information Technology (IT) through government liaison and information exchange. To Educate and assist AEB member companies on changes, best practices, legal and regulatory issues and other matters of importance in the areas of information technology and telecommunications.

VISION

- Be a reliable source of information for AEB member companies
- Accurately represent the needs of our members to governmental organisations
- Act as a reliable network to members seeking advice on IT and Telecom issues

ISSUES

Business in Russia continues to expand at an increasing rate and organisations are morphing from local, domestic companies into multi-national players and global conglomerates. European businesses operating in Russia are also developing from smaller organisational units into major, strategic assets of the corporate portfolio. The role of the Chief Information Officer (CIO) and IT organisation to support changes in a large multi-national company differs significantly from the role of a CIO and IT organisation supporting a small branch office or a domestically focused Russian company.

The IT & Telecom Committee has identified the following issues:

- Dramatic growth and merger & acquisition activities can drastically change the landscape of an IT organisation overnight;
- The lack of experienced local resources for hire constrains the ability of an IT department;
- High costs in major markets (Moscow and St. Petersburg) are forcing a reduction in pro-rata IT costs even while business is expanding;
- Global or Russian expansion requires significant upgrades to technology platforms to serve decision-making, supply chain management, and other advanced organisational needs.

RECOMMENDATIONS

- Establish long-term partnerships with key technology and service suppliers based on value, quality, and ability to serve rather than focus on cost;
- Evaluate existing IT strategies and ensure alignment with business goals;
- Consider options to reduce long-term IT costs such as rationalisation and outsourcing;
- Consider opportunities to migrate IT and other business support functions to lower cost regions in Russia;
- Standardise, where appropriate, on packaged solutions to support business activities;
- Set up working committees to investigate new technology and organisational models that can deliver high business value – e.g. Process Governance and Process Centres of Excellence, Business Process Management, IT Service Management Automation, Maintenance Systems, etc.
- Invest in a Business Intelligence Strategy and infrastructure to support current and future management decisions.

BENEFITS

- Long-term, value based partnerships will drive more value into an organisation and advance the competitive capabilities of operational units;
- Effectively aligned IT strategies help business and IT leaders to take advantage of the right technologies to support and increase operational efficiency;
- Standardisation, rationalisation and outsourcing can significantly lower IT costs to allow for greater reinvestment and business returns;
- New technologies can help Russian organisations to “leap frog” competition.

ISSUES

Administrative barriers for import of IT products shall be lowered

In the 2006 position paper, the IT-Telecom Committee highlighted legal and administrative barriers encountered by IT suppliers when importing IT products containing encryption functions into Russia. According to information

obtained by committee members in ongoing working relationships with Russian industry partners, such barriers will soon be lowered significantly.

The expected changes are reflected in a letter from Ms. Susan C. Schwab (Unites States Trade Representative) to the Russian Ministry of Trade and Economic Development, pursuant to which the Government of the Russian Federation and the Government of the United States reached an understanding on the principles to be applied in the establishment of import licensing procedures for import of goods containing encryption technology. The agreement was reached in recognition of obligations under the WTO/GATT rules.

We cannot provide a date for when the legislative changes will occur, but we are clear that such changes in legislation will provide new opportunities for European IT suppliers to access the Russian market, reduce import costs and increase sales for European companies already selling to Russian customers. Also, it will allow multinational companies to better implement worldwide IT standards in their Russian operations.

Telecom Trends & Issues

Telecom Media & Technology (TMT) has become an increasingly dynamic industry. More than other industries it requires high initial capital investment. Large investments have been made in the CIS TMT market recently, with more to be spent on deploying new technology and offering new services in the near future.

Successful telecommunication companies tend to generate large cash flows with revenues exceeding operating costs by a wide margin. The winners will be those companies that can consistently increase value for the customer and for the company simultaneously.

As the market matures and becomes more competitive, a key success factor will be a management style focused on overall operational efficiency. Pressure from the external environment creates the need for more constructive management information and more sophisticated decision support capabilities.

- After recent significant growth and massive investment there is a trend towards rationalisation represented by post-merger consolidation and business strategy transformation;
- Regulatory changes and new requirements affecting current market players resulting in regulatory & antimonopoly compliance and a transparent, tested model for calculating tariffs;
- Overall pressure on both cost and revenue driving improvement in operational efficiency, processes and structural changes within organisations.

RECOMMENDATIONS

- The introduction of regulatory and antimonopoly compliance programs; a proofed and transparent costing model which enables tariff cost calculation according to international standards;
- Re-engineering of business and infrastructure processes based on market changes and new requirements;
- Focus on more accurate and effective finance management; introduction of new costing, planning, budgeting and reporting systems to change and develop relevant processes and procedures;
- Create and implement a Customer Relation Management (CRM) strategy driven by customer segmentation and customer care differentiation;
- Transform the IT/Information System (IS) strategy and deploy new Enterprise Resource Planning (ERP)/Operation Support System (OSS)/Business Support System (BSS) to support the decision-making process.

BENEFITS

Higher quality, more transparent, accurate and constructive information within the decision making process will be the key competitive advantage on the telecommunications market. This will drive improvements and benefits in the following areas:

- Compliance with regulatory requirements for both wireline and wireless market players;
- Network optimisation and new generation network Return of Investment (ROI) calculation;
- Quality and complexity improvements to the telecom product portfolio and services provided;
- Improvements in sales channel management, tariff pricing and promotion strategies;
- Better measurement and management of client satisfaction by way of meeting and exceeding their expectations.

LEASING VAT WORKING GROUP

Member Companies: Allen & Overy Legal Services, Deloitte, Ernst & Young (CIS) Limited, Ford Motor Company, Hansa Leasing, ING Lease (Eurasia) Llc., Noerr Stiefenhofer Lutz, Pepelyaev, Goltsblat & Partners, PricewaterhouseCoopers, Scania Leasing Ltd., Svenska Handelsbanken, Volkswagen Group Finance

BACKGROUND

The enactment of the Act On Leasing allowed for the creation of basic rules and resulted in economic growth not only for investors (leasing companies), but also for suppliers (manufacturing plants) and clients (lessees). By renewing capital assets leasing companies create competitive domestic production of commodities and contribute to performance of works and services. Capital assets corresponding to the state-of-the-industry do not pay off in one or two years, they require stability in the tax and tariff policy of the state as well as the availability of long-term credit resources.

During recent years, Russian and foreign leasing companies have attracted monetary assets exceeding US \$10 billion to the Russian Federation.

In his address to the federal assembly dated May 10, 2006, President Putin commented that the state must assist in the acquisition of state-of-the-art foreign technology, in part by means of leased equipment.

Leasing companies attract long-term credit resources, whereas lessees may lease for medium or long-term capital assets. Both lessors and lessees require a stable tax environment and the observation by the taxation authorities of the following principles established in the

Tax Code

acknowledgement of VAT paid by suppliers to customs authorities as tax deductions in accordance with Art. 171 and 172 of Tax Code of the RF (leasing companies have accumulated significant amounts of VAT not returned from the budget due to the nature of their activities - constant acquisition of capital assets); accelerated depreciation of capital assets and attribution of leasing payments to costs (present norms of depreciation were transmitted from the decree of the Council of Ministers of the USSR dated October 22, 1990 Nr. 1072 and on many occasions do not reflect the actual requirements of renewal of equipment).

At the same time, Art. 258 and 259 of the RF Tax Code allow for the use of an acceleration ratio of the norm of depreciation up to 3, which provides lessors and lessees with flexibility in scheduling leasing payments and the possibility of renewing equipment faster, i.e. to remain competitive under constantly changing conditions).

In practice, especially during recent years, all leasing companies have encountered the following issues.

Buy-Out Value of the Leased Asset by the Lessee

ISSUE

Financial lease contracts normally feature either a buy-out value of an asset at the end of the lease (or earlier, in case of termination) giving the lessee the right to receive ownership of the asset, or right to obtain this title subject to the fulfilment of all its obligations under the lease contract, including repayment of all lease obligations.

RECOMMENDATIONS

It would be a legitimate approach for the tax authorities to compare the buy-out value of the asset (or lack thereof) to the market price of this asset at the time of transferring the title to the lessee, taking into account that under the financial lease contract the lessor receives the entire amount of its original investment back and the buy-out value by definition cannot be compared to the market price of this asset (the buy-out value is established at the beginning of the lease).

Sale and Lease Backs

ISSUE

According to the Law on Financial Leasing (Article 4), the lessee and the seller can be one party within one leasing transaction. In practice, the tax authorities deny VAT recovery on the basis that a financial lease transaction represents a sale and lease back and as such does not have any economic purpose. Whereas, sale and lease back represent a financing tool for lessees allowing companies to attract medium and long-term financing, while providing the lessor with better security than provided by the pledge law.

RECOMMENDATIONS

We request that the Ministry of Finance state its position as to the criteria that should be applied when assessing the economic purpose of sale and lease backs.

Bad Faith Suppliers

ISSUE

At present, it is not clear whether the lessor is to be held liable for the failure of the seller to pay VAT to the budget in cases where there is no affiliation (in the Russian law) between the lessor and the seller of the lease object and payment is made in cash to the seller by the lessor

(including VAT thereon). Shifting responsibility for supplier tax obligations to lessors introduces uncertainty into the business activities of the lessors who have no control over suppliers.

RECOMMENDATIONS

We request that the Ministry of Finance states its position on this issue and defines clear criteria to be applied by the lessor when choosing a supplier for a financial lease transaction.

Using borrowed funds or failing to repay loan facilities due to the failure of lessees to meet their payment obligations to the lessor

ISSUE

Lease companies actively use borrowed funds to support business activities. As with other financing companies, the ability of the lessor to meet its payment obligations under the loan facilities depends on the repayments by the lessees of their obligations under the lease contracts. This represents a regular business risk for the lease company.

RECOMMENDATIONS

Non-repayment by the lease company of its obligations under loan agreements due to business risks encountered by the lease company in its regular activities cannot be used by the tax authorities as grounds for denying VAT recovery. The Ministry of Finance should confirm this position.

Non-Profitability of Activities

ISSUE

At present, lack of profitability is used as an argument for denying VAT recovery. Profitability is, however, a result of the relationship between revenues and costs.

RECOMMENDATIONS

We request that the Ministry of Finance express its opinion on this issue and define clear criteria when lack of profitability may be used as an argument for denying VAT recovery.

FX Revaluation Differences

ISSUE

Lease contracts are often denominated in foreign exchange (FX), which requires lease companies to attract matching funding in FX. According to Russian accounting rules, the entire amount of liabilities of lease companies is revalued using the prevailing Central Bank of Russia (CBR) rate, while the assets are not revalued (save for the current portion of lease payments) even if the contract stipulates the obligation of the lessee to pay lease payments in RUR equivalent of a hard currency amount. This leads to positive or negative FX differences for lease companies that are economically unjustified.

RECOMMENDATIONS

Introduce amendments to accounting rules allowing revaluation of FX assets in correspondence with revaluation of FX liabilities.



LEGAL COMMITTEE

Chairman: Sergey Stefanishin, Ernst & Young

Deputy Chairmen: Konstantin Potapov, Deloitte; Dmitry Kurdyukov, Porsche Russland

Committee Members: Allen & Overy Legal Services; Baker & McKenzie CIS Ltd.; Baker Botts L.L.P.; Bech-Bruun International A/S; BEITEN BURKHARDT; CMS Bureau Francis Lefebvre; CMS Cameron McKenna; CMS Hasche Sigle gmbH; De Berti Jacchia Franchini Forlani; Delegation of the European Commission; Deloitte; Denton Wilde Sapte; DLA Piper Rudnick Gray Cary; Ernst & Young;

Gide Loyrette Nouel; Grant Thornton Trid ZAO; Impex Consult OOO; International Road Transport Union (IRU); KPMG; LeBoeuf, Lamb, Greene & Macrae, L.L.P.; Macleod Dixon LLP; Magnusson; Marks & Sokolov, LLC; Mazars; Noerr Stiefenhofer Lutz; Pepelyaev, Goltsblat & Partners; Porsche Russland; PricewaterhouseCoopers; Roedl & Partner; Salans; Secretan Troyanov; Smithbridge Advisory Services Ltd.; Standard & Poor's; Total; Vinson & Elkins L.L.P.; Your Lawyer

Corporate Law

ISSUES

- Although delayed, the project for making important changes to the Law on OOO is still underway; work on a far-reaching overhaul of corporate law is still pending.
- A general trend is for very low minimum share capital to give way to so-called "one day companies", which are often used for criminal matters (Tax evasion).
- Protection of minority shareholders in legal entities, mainly in Stock companies, is sometimes underdeveloped.
- Squeeze-out is still in force, but very few cases have been brought to court so far, due to the fact that the procedure for evaluation of shares is not clear.
- A project for the protection of strategic companies is underway. However, there is a relatively wide understanding of what constitutes a strategic company.
- There are still many problems regarding the registration of legal entities (and representative offices): the legal time schedule is often not respected and a very formalistic and bureaucratic approach is applied. The tax authorities are looking at prolonging the registration procedure.
- More (and better) jurisdiction in the field of corporate law, as well as further development of scientific literature.

RECOMMENDATIONS

- Continuance and enlargement of different legal projects currently underway.
- The planned changes to the Law on OOO are mostly welcome, in particular the abolition of the unlimited exit right for shareholders of an OOO (Art. 26 Law on OOO).

- The minimum share capital of legal entities should be increased to at least 100,000 Roubles (app. 3,000 EUR) for OOO and ZAO companies. This would be a very effective means of tackling "one-day companies".
- The grandfather rule (that a 100% company cannot be the sole founder of a company) should be dropped.
- The project on prolonging registration procedures will not likely hinder "one-day companies", and instead create obstacles for investors. This project should be abandoned without delay. Instead, the implementation of a faster system of registration (including a real "one-window-principle", no second registration with all kinds of funds, statistics etc.) is recommended.
- A more comprehensive commercial register should be introduced containing all relevant information on a legal entity (some important improvements are already foreseen in the planned changes to the Law on OOO). The notion of good faith regarding the information third persons receive from this register should also be introduced.
- Development of a mechanism to evaluate compensation to minority shareholders of a squeeze-out procedure. The squeeze-out should also apply to companies, where 95% of shares were held by one shareholder before the recent legal changes came into force.
- The proposed criteria for strategic companies should be more precise.
- Further development of Corporate Governance in Russian companies.
- Shareholder agreements should be accepted and enforced with respect to some legal questions, even if foreign law regulates the agreement.
- Work permits for foreign employees of a representative office (especially for heads of rep-offices) should be dropped, since representative offices are already accredited.

BENEFITS

- More transparent legal structures would increase foreign investments into Russian companies, thus bringing more foreign investors and know-how to Russia.
- More transparency would also help Russian legal entities to expand abroad, acquiring foreign companies or raising funds at foreign Stock markets (such as New York, London, Frankfurt).
- A clear and rapid registration procedure would make investments (foreign as well as domestic) in Russia easier. The bureaucratic attitude of the registration authorities is one of the main factors for the relatively low image of Russia abroad. Everyone knows at least one unbelievable story about unsuccessful registration.
- A reliable commercial register will make all transactions easier as the amount of documents to be checked decreases. This holds true for foreign as well as local transactions.

Labour Law

ISSUES

- There is uncertainty in the difference between a place of work and workplace. It results in uncertainty regarding how the term should be formulated in the labor contract.
- There is insufficient legal regulation of business trips at the level of the Labour Code. There is a time restriction on business trips made by foreign employees.
- There is a lack of special legal regulation of relations connected with the employment of foreign nationals (personnel leasing, outsourcing, outstaffing, etc.).
- There is a lack of regulation on representation of employees in individual labour relations (on concluding labour contracts, making changes to labour contract, dismissal, etc.).
- There is a lack of regulation on invalidity of labour contracts.
- Uncertainty surrounds many of the essential terms of a labour contract.
- There is a lack of legal restriction in establishing additional grounds for terminating a labour contract for some categories of employees.

RECOMMENDATIONS

- An unambiguous definition of a place of work should be formulated. The law can stipulate that place of work is a district (location) and in some cases the structural division where employee is working.
- Issues connected with business trips (time of work and rest, rights and obligations of parties, labour protection, etc.) require greater regulation. Time restrictions on business trips by foreign employees should be removed.

- There is need for a law regulating the employment of leased personnel. The notion of leased personnel should be defined and the rights and guarantees for such employees determined. It is also necessary to clarify the rights and obligations of employers leasing employees to third parties.
- Legal regulations on representation in individual labour relations should be introduced, including procedures for authorisation of representatives and a framework of issues that an employee can resolve through the representative.
- Regulations should be formulated on the invalidity of labour contracts with provision for grounds for invalidity and its forms. It is also necessary to establish an order for labour contract invalidation.
- Essential terms should be defined, without which a labour contract cannot be concluded. It is also necessary to create guarantees for employees if a contract is recognised as invalid.
- We also support the establishment of legal restrictions for some categories of employees regarding additional grounds for labour contract termination.

BENEFITS

Introduction of the above-mentioned suggestions will contribute to the positive development of the Russian Labour Law and contribute to the creation of a clear legal framework. At the same time, it will reduce the risks employers face as a result of uncertainty in labour law implementation.

Copyright

ISSUES

Russian copyright legislation is currently undergoing major changes due to the adoption of Part 4 of RF Civil Code. After Part 4 enters into force on January 1, 2008, the current Law on Copyright and Neighbouring Rights and the Law on Legal Protection of Software and Databases will be abolished.

- Part 4 of RF Civil Code fills some gaps in copyright legislation. However, it contains many undefined terms, for example "gross violation of exclusive right"
- Part 4 of RF Civil Code essentially changes the legal terminology currently in use, for example the term "author's agreement" is substituted for "agreement for alienation of exclusive right" or "license agreement". At the same time, the old legal terms continue to exist in other laws and subordinate legislation
- The employing organisation may lose the exclusive right to works created in the course of employment, if within 3 years it does not use the work, assign exclusive right to the work to a third party or keep the work secret. Also, the new legislation changes the definition of the legal term "work created in the course of employment"

- The collective administration of rights belonging to copyright holders who have not mandated the organisation to collect remuneration will be allowed only to state accredited organisations. However, Part 4 of the RF Civil Code does not specify the requirements for state accreditation

RECOMMENDATIONS

- We recommend further improvement to Part 4 of RF Civil Code after its entry into force
- Changes to other laws and subordinate legislation also need to be made in order to bring them in line with the legal terms used in Part 4 of RF Civil Code
- Employers should pay more attention to the preparation of documents in respect of works created in the course of employment
- More detailed regulation on the collective administration of rights should be implemented by introducing changes to Part 4 of RF Civil Code or adopting a law on this subject

BENEFITS

- The efficiency of the Copyright legislation would be raised significantly.
- By following the established guidelines, employers will be able to secure their exclusive right to works created in the course of employment.

Credit Law

ISSUES

- The current procedure of registration and reorganisation of credit organisations is time-consuming and overly-complicated.
- The provisions, regulating initial share placement for credit organisations, do not envisage an opportunity for them to reduce the period of the share issuance procedure by means of submitting notification on share placement results instead of a placement report, which is subject to registration by the regulatory authorities.
- There is a lack of legal regulation in transactions with derivatives, including derivatives for differences. Furthermore, Russian legislation does not envisage a concept of liquidation netting.
- There is a lack of legal regulation in the area of securitisation transactions.

RECOMMENDATIONS

- We recommend development of the registration procedure for credit organisations and reorganisation in the area of terms for passing these procedures, as well as simplification of the above procedures.
- A simplified procedure for performing the initial

share placement for credit organisations should be introduced, as it is envisaged for other organisations in Russian securities legislation.

- A series of special laws should be adopted and appropriate amendments to the existing legislation introduced, regulating the procedures for performing the stock exchange and transactions with derivatives, as well as securitisation transactions.

BENEFITS

- Entrance on the Russian banking market would be easier for foreign credit organisations.
- Amendments to the Civil Code of the Russian Federation would be made, envisaging the judicial protection of the term transactions' parties (transactions with the financial instruments for differences).
- Essential liberalisation of currency regulations in Russia would be facilitated.

Part IV Of The Russian Federation Civil Code

On December 19, 2006, President Putin signed the law Part IV of the Civil Code. The final version of the law incorporated some limited improvements to the sections related to trademarks. However, Part IV still contains significant problems and as a result the legislation does not fully comply with WTO requirements, relevant international treaties (e.g., TRIPS), and international norms generally. Part IV will come into force on January 1, 2008, while the Law on Enactment of Part IV of the Civil Code went into legal force as of the date of its official publication.

ISSUES

- Ambiguous Wording on Prior-Use Rights in Old Soviet Marks: The language of Article 13 of the Law on Enactment of Part IV of the Civil Code could result in some serious consequences for trademark owners. Even though legislators may have been guided by the very best intentions, Article 13 of the Enactment Law does not define the "prior-use" rights in a manner detailed enough to insure that the rights of "legitimate" trademark owners are not infringed upon. In particular, Article 13 has failed to define the volume of prior use that is required for prior use rights arising along with the volume of permitted use after the registration of a third party's trademark is obtained. The current wording of Article 13 extends to all trademarks, irrespective of their notoriety or other factors, including trademarks of foreign manufacturers, which may lead to unforeseeable results.
- Lack of a Uniform Confusion Standard: Early drafts of the law did not appear to impose uniform confusion standards for different means of individualisation (trademarks, company names, commercial designations). This feature, combined with other provisions in Part IV (see below) resulted in too broad a scope of protection for company names and commercial

designations, and too narrow a scope of protection for trademarks. The version of the law that has been passed makes an attempt to remedy this problem by adding a provision imposing a uniform likelihood of confusion standard, which is a major improvement. However, individual confusion standards for each type of mark or name have not been removed, thus creating possible internal inconsistency in the legislation and ambiguity as to which standard applies in any given case and in any given legal proceeding (e.g., examination, invalidation, infringement action, etc.).

- Overbroad Protection of Domain Names: Part IV effectively grants rights in gross to owners of domain names. It provides that the owner of a domain name may block the registration of an identical trademark without showing that the domain name qualifies for trademark protection. Protection for domain names should be removed entirely from Part IV, consistent with international norms.
- Overbroad Protection of Commercial Designations and Company Names: Part IV provides for rights in unregistered "commercial designations" without limiting protection to the territory in which the designation is known. Further, for purposes of trademark registration refusal, these same rights arise not only in commercial designations and company names, but also in "parts" of commercial designations and company names, extending even to the filed trademarks that are similar to such "parts", and can potentially resurrect as obstacles, any names that have obtained protection as either company names or commercial designations in Russia prior to the trademark's priority date, whether "known" or not.
- Insufficient Protection for Well-Known Marks: As required by TRIPS and other treaties, Part IV provides for a broader scope of protection for well-known marks, correctly imposing an "association" standard rather than a confusion standard, so that a violation should be found regardless of the goods for which the junior mark is used. However, Part IV does not prohibit the registration of marks that violate these broader rights of well-known marks (perpetuating a problem that exists in current law), which leads to the extremely inefficient result that such marks will be registered by Rospatent (as they are today) even though such marks violate the rights of the well-known mark owner even though the registrations will then have to be invalidated by means of an administrative or court action. This will make the Russian trademark register less reliable and less reflective of legitimate rights. It will also raise costs for trademark owners, Rospatent and the Russian court system.
- Overprotection of Geographic Indications: Part IV maintains the absolute priority of "appellations of origin" over trademarks, which is directly contrary to TRIPS and the 2005 WTO Panel decision regarding the relative rights of GIs and trademarks.
- Lack of Opposition Procedures: Perpetuating an existing problem at Rospatent, legislation fails to provide for third-party opposition to trademark and

GI applications prior to registration. Given that Rospatent has proven extremely reluctant to overturn a registration once granted, this is a significant problem for trademark owners. It is also contrary to international norms - well over 80% of jurisdictions worldwide provide for third-party opposition prior to registration. Providing for opposition procedures would have many benefits leading to (i) a more reliable trademark register that is more fully reflective of legitimate rights, (ii) a substantial reduction in the number of invalidation proceedings, and (iii) a substantial reduction in the number of court challenges to existing registrations, all of which would save valuable Rospatent and court resources.

- Lack of Transparency at Rospatent: Perpetuating another current problem at Rospatent, legislation fails to provide for official publication of pending trademark applications prior to registration and fails to provide public access to the full examination file either before or after registration. Official publication of pending trademark applications, and public availability (at the requestor's expense) of the full examination and registration file would (i) support the invalidation (and opposition) processes, making them more effective, and (ii) improve public confidence in Rospatent and the trademark protection system.
- Trademark Licensing and Franchising: Part IV contains several highly problematic provisions for trademark licensors, namely:

Taking the concept of quality control far beyond international norms, legislation imposes joint liability on trademark licensors for the goods and services of the licensee for which the mark is licensed.

Perpetuating current Russian practice, the legislation provides for mandatory recording of all trademark licenses against the registration of the licensed mark, an burdensome and costly requirement that serves no legitimate purpose and has been abandoned by all but a handful of countries around the world. Failure to record results in the invalidity of a license agreement. Moreover, if the licensed mark is not yet registered in Russia (e.g. the application is still pending), the license cannot be recorded and is therefore invalid. In other words, a trademark owner cannot enter a valid and enforceable trademark license until the licensed mark has been registered.

- Fair Use: Part IV contains no provision for the fair use of trademarks, arguably making a simple descriptive or nominative use an infringing act.
- Each of these provisions is contrary to international norms and goes further than necessary to prevent trafficking in trademarks and maintain public confidence in licensed brands. Moreover, the costs and burdens are so great for trademark licensors that many licensors choose not to license marks in Russia, to the detriment of Russia's economy.

RECOMMENDATIONS

- It is imperative to establish clear and exhaustive criteria for application of Article 13 of the Enactment Law that sets forth specific requirements for prior-use rights into Soviet-era marks to arise along with territorial, volume, and other necessary limitations to such rights.
- A uniform confusion standard for all means of individualisation should be introduced (trademarks, company names, commercial designations).
- Domain names should be excluded from the respective section of Part IV of the Civil Code that deals with grounds for trademark registration refusal (Article 1483, p.9).
- There should be a reduction in the scope of protection granted to company names and commercial designations (compared to the protection granted to trademarks).
- The grounds for trademark registration refusal set out by Article 1483 of Part IV of the Civil Code should be supplemented by relevant wording providing that earlier well-known trademarks will ban registration of similar trademarks irrespective of the goods for which the earlier well-known trademark is registered, provided that such an association between the well-known trademark and the mark filed for registration may damage the interests of the owner of the earlier registered well-known trademark.
- A revision is needed of the provisions set out by Part IV of the Civil Code maintaining absolute priority of “appellations of origin” over trademarks with the view to bringing them in line with the practice of the WTO Panel’s construction of the TRIPS Agreement.
- Legislators should introduce opposition procedures and procedures for official publication of pending trademark applications prior to registration.
- The requirements for mandatory recording of trademark licenses should be abolished along with the provisions setting forth joint and several liability of the licensors and licensees.
- Finally, the introduction of “fair-use” provisions allowing use of trademarks for descriptive/indicative purposes.

ANTI-MONOPOLY WORKING GROUP

Chairman: Evgeny Voevodin, CMS Cameron McKenna
Committee Members: Allen & Overy Legal Services; Baker Botts L.L.P;
Beverages and Trading LLC (Member of Bacardi-Martini Group); British American
Tobacco Russia; CMS Cameron McKenna; Deloitte; Ernst & Young (CIS) Limited;
Gide Loyrette Nouel; LeBoeuf, Lamb, Greene & MacRae L.L.P; Noerr Stiefenhofer
Lutz; Nutricia LLC; Salans; Skadden, Arps, Slate, Meagher & Flom LLP
(Individual Membership)

**ISSUES**

- Lack of Subordinate Regulations for Competition. In October 2006, the new Russian Competition Law (No. 135-FZ, dated 26th July 2006) entered into force. However, to date most of the subordinate acts provided for in the new law have not yet been introduced.
- Delay in Implementation of the Competition Law. The provisions under the new law have not yet been fully implemented due to difficulties in their interpretation.
- Ambiguities in the Law. The new Competition Law still contains some discretionary categories and norms, which creates problems in their practical application.
- No Significant Sanctions for Non-Compliance. The introduction of the new Competition Law will not lead to toughening of administrative sanctions for non-compliance. Administrative sanctions for violation of the Competition Law are not established by the Competition Law, but by the Russian Code of Administrative Offences. Not all violations of the anti-monopoly law entail the imposition of administrative liability, and the maximum penalty is approximately US\$18,000.

RECOMMENDATIONS

- Legislators should refer closely to the EU’s extensive experience in regulating competition issues. The new Competition Law is primarily based on EU competition legislation. Therefore, when drafting the outstanding subordinate regulations legislators should take into account EU experience.
- Legislators should cooperate more closely with Russian and European legal experts. The Russian competition enforcement authorities do not engage with lawyers who practice Russian and European law when forming practice under the new Russian Competition Law.
- Legislators should also consult with practicing lawyers and businesses to avoid ambiguity of the Competition Law



REAL ESTATE COMMITTEE

Chairman: Holger Mueller, Rhine Capital
Deputy Chairman: Marti Whelan, Astera
Committee Members: ASTERA, BEITEN BURKHARDT, Bene Office Furniture, Blackwood Real Estate, Cushman and Wakefield Stiles and Riabokobylo, DTZ Zadelhoff Tie Leung, Ernst & Young, Evans Property Services, Intermark, Jones Lang LaSalle Moscow, Knight Frank LLC, KPMG, CB Richard Ellis Noble Gibbons, OOO Rhine Capital, PricewaterhouseCoopers, Ruperti Project Services International Ltd, Russia Consulting, SIBC GmbH Representative Office, Sunbury Heights Project Management

The Russian property market is extremely fragmented and shadowed by a murky past. However, the sheer market volume and steady moves towards a mature and transparent market have put Russia firmly on the map with foreign investors and developers, all keen to profit. Today, the Russian Real Estate Sector is viewed as one of the most attractive in Europe. The number of Russian delegates present at international property shows speaks for the heightened activity and interest in the Russian market. Only a few years ago, the Russian market was regarded with fear. Despite developments which have made Russia one of the hottest markets around, active involvement on the part of the Russian government is required in order to progress to international standards.

ISSUE

Construction of properties is controlled by norms dating back to the 1970's and 1980's. These rules are outdated and often hinder the approval process, which does not allow for the use of modern and less expensive building materials.

RECOMMENDATIONS

Re-evaluate the old, out-dated construction norms bringing them in line with modern construction practices.

ISSUE

Utilities – the lack of electrical capacity and poor water treatment facilities have resulted in authorities forcing investors to upgrade their own substations or build new water waste facilities.

RECOMMENDATIONS

Municipalities should invest in the development of a utility infrastructure that follows the European example where authorities invest in utilities to attract investors.

ISSUE:

A haphazard zoning plan for development results in warehouse developments often being located next to residential properties.

RECOMMENDATIONS

We would like to see the development of a comprehensive, overall zoning plan separating industrial and residential developments.

ISSUE

There is a significant shortage of industrial zoned land.

RECOMMENDATIONS

Transfer agricultural land to industrial and/or residential land to make it available to investors in a shorter time frame.

ISSUE

The lengthy and complicated process for changing a land category from agricultural to other uses (this process takes one year or is not possible at all) significantly impacts project financials.

RECOMMENDATIONS

We recommend the development of a uniform set of rules for investor applications, both for privately owned land and municipal land

ISSUE

The approvals procedure is time-consuming and often unclear.

RECOMMENDATIONS

The licensing procedure should be simplified with clear rules and a transparent policy.

ISSUE

The process for obtaining a construction license is too lengthy (28 papers must be obtained).

RECOMMENDATIONS

We propose that the government set up a committee to which investors can apply and obtain all dispositions.

ISSUE

The poor road network is characterised by congestion and low-quality roads causing problems for developers.

RECOMMENDATIONS

We recommend the creation of a plan of coordination between the Moscow and Moscow region governments for the development of the road network. Investment in area development and the building infrastructure would attract investors.

ISSUE

The lack of paid parking facilities in the city centre leads to traffic jams and overcrowding.

RECOMMENDATIONS

We would like to see paid parking facilities in the Moscow city centre.

BENEFITS

Investing in area development by building infrastructure will act as a magnet for investors resulting in increased foreign direct investments in Russia.

Zoning of land will rationalise land prices and aid the development of the various sectors.

Potential tax income from increased commercial activity will aid the government in funding much-needed reform.



TAXATION COMMITTEE

Acting Co-chairmen: Alina Lavrentieva, Pricewaterhouse Coopers and Vadim Zaripov, Pepelyaev, Goltsblat & Partners
Committee Members: BEITEN BURKHARDT; CMS Bureau Francis Lefebvre; Continental Tires RUS; Delegation of the European Commission; Deloitte; Denton Wilde Sapte; DLA Piper Rudnick Gray Cary; Ernst & Young (CIS) Limited; Gide Loyrette Nouel; Grant Thornton Trid ZAO; Impex Consult; Interexpertiza; KPMG; LeBoeuf, Lamb, Greene & MacRae, L.L.P.; Marks & Sokolov LLC; Mazars; Noerr Stiefenhofer Lutz; Pepelyaev, Goltsblat & Partners; PricewaterhouseCoopers; Roedl & Partner; Salans; TNK-BP Management; Total

1. Preliminary Rulings

ISSUES

Tax law is not keeping pace with economic development and new business demands.

- Lack of advance information on the Russian Government's final position on the tax implications of certain types of planned transactions and economic operations
- Lack of regulation on prohibited means of mitigating the tax burden
- Revision of tax liability over the course of 3-year tax audits; the fines and penalties charged and initiation of court proceedings

RECOMMENDATIONS

- To develop permanent procedures for issuing the preliminary conclusions of government agencies on the tax implications of planned transactions and economic operations
- To develop procedures for legal control over the issuing of preliminary conclusions
- To develop a set of measures for preventing abuse related to the issuing of preliminary conclusions

BENEFITS

- Guarantee of a stable and predictable financial status for each company
- Opportunity of calculating tax costs when planning investment projects
- Implementation of a tax planning tool as used internationally

2. Liability For Tax Violations

ISSUES

- Criminal proceedings for non-payment of taxes claim non-payment of a sum of 1.5 million roubles, regardless of the company's size or the amount of tax it actually owes

- Increased risk for developing and expanding companies
- Lack of incentives for a responsible attitude to tax payment among small businesses
- Considerable difficulties in the application of the double test as provided for in notes to Sections 198 and 199 of the Criminal Code of the Russian Federation.
- Companies splitting their business in order to avoid liability within the limits

RECOMMENDATIONS

- To update Sections 198 and 199 of the Criminal Code of the Russian Federation to include exclusive percentage criteria when identifying gross tax evasion (10% of tax amounts payable in the respective period) and extremely gross tax evasion (50% of tax amounts payable in the respective period)

BENEFITS

- Protection from a biased approach of investigating agencies in initiating criminal proceedings
- Elimination of difficulties in double test applications
- Elimination of increased risks related to business expansion

3. Vat Refund

ISSUES

- Abuse of the VAT refund system, particularly via "one-day" companies
- Government proposals for resolving this issue, such as the Determination of the Constitution Court of the Russian Federation of 08.04.04 No. 169-O to replace VAT with sales tax, are ineffective and inconsistent
- Most companies cannot get VAT refunds via the notification or administrative routes, and have to start court proceedings
- In its Resolution of January 9, 2007 the European Court of Human Rights expressed its disapproval of the delays in VAT refunding
- Faster VAT refunds are needed on exports

RECOMMENDATIONS

- To involve the business community in finding a resolution to the problem and learn lessons from the experience of other countries
- To develop and implement a set of measures to prevent abuses of the VAT refund system, including the improvement of legal entity registration procedures.
- To provide taxpayers with better access to information on potentially unfair suppliers and disqualified managers/founding members.

BENEFITS

- Favourable conditions for decreasing the time taken to refund VAT on exports
- A reduction in losses to the Federal Budget

4. Vat On The Distribution Of Advertising Materials

ISSUES

- Goods (work/services) that are provided for advertising purposes are subject to taxation
- Low ceiling (100 roubles) on non-taxable transactions of goods for advertising purposes (Section 149, clause 3, paragraph 25 of the Tax Code of the Russian Federation) and the impossibility of applying deductions to these transactions
- The tax authorities have demanded payment of tax on the distribution of advertising materials in the period 2001-2005 without having any economic grounds for collecting the tax

RECOMMENDATIONS

- To make amendments to Chapter 21 of the Tax Code of the Russian Federation, exempting the distribution of advertising materials from taxation

BENEFITS

- Abolition of economically unjustified taxation, which penalises advertising services that are ultimately beneficial to the market
- Tax regulation will keep pace with today's market conditions

5. Taxation Of "Directors And Officers Liability Insurance"

ISSUES

- More responsibilities placed on company management as a result of harsher corporate laws and IPO
- The refusal to allow income tax deductions on Directors and Officers Liability Insurance is economically unjustified

- Tax barriers are holding back development in this new market segment

RECOMMENDATIONS

- To take into account standard international practice
- To take the costs of Directors and Officers Liability Insurance into account when calculating a company's profit tax payments
- To legislate so as to exclude payments from the unified social tax base
- To legislate so as to exclude tangible benefits of directors and officers from the personal income tax base

BENEFITS

- Greater financial stability for companies, their directors and officers
- Russian companies will find it easier to attract talented and in-demand foreign executives to their board of directors
- Encourage further development in the insurance market

6. Legal Proceedings

ISSUES

- Non-compliance with the requirements for independent judges
- Shifting of evidential burden of proof onto the taxpayer during investigation
- Violation of the adversarial principle by judges (courts tend to regard unproved circumstances as evidences)
- Courts go over the limits of disputed subject examination (courts often undertake repeated reviews of circumstances proved by a taxpayer, reconsider tax authorities' conclusions)
- Tax authorities abuse their procedural rights (illegally restore limitation periods for cases arising from administrative and other public legal relations);
- Court practice lacks uniformity
- Low quality of reason statements in judicial acts hinders the formation of interpretation criteria and unified court practice (i.e. conclusions reached in judicial dispositions are not logically linked to the circumstances related in the reason statements)
- There are no factors preventing the tax authorities' from abusing their procedural rights (making unjustified resolutions on prosecution in advance, intentionally dragging out proceedings, non-payment of state duties)
- There are no independent (other than civil law) unified principles and procedures for tax law interpretation.

RECOMMENDATIONS

- To develop a set of measures that restrict opportunities for abuse by tax authorities

BENEFITS

- Guarantee of fair and legally founded resolutions
- Reduction of costs to the taxpayer that arise out of the impeachment of unjustified resolutions
- Reduction in the number of cases arising from administrative or other public legal relations being referred to the arbitration courts

7. Preliminary Opinions**ISSUES**

- Preliminary conclusions on the outcome of a business transaction undertaken at a taxpayer's request presuppose fiscal interest, i.e. they are not aimed at the exemption of the taxpayer from additional tax charges in the event of claims from the tax authorities

RECOMMENDATIONS

- To establish legal control over procedures for taxpayer exemption from additional tax charges in the event of claims from the tax authorities

BENEFITS

- Impermissibility of additional tax charges

8. Taxpayers' Rights Protection**ISSUES**

- Lack of a prompt administrative response to redress illegal actions on the part of the tax authorities (it is currently only possible to recover infringed rights in judicial proceedings).

RECOMMENDATIONS

- To develop a set of prompt administrative measures for redressing illegal actions on the part of the tax authorities.

BENEFITS

- Better protection for taxpayers

TECHNICAL REGULATIONS AND STANDARDS TASK FORCE (TRS)

Chairman: Isabelle Heller, M.A.M. Consulting
Task Force Members: ABB, Acem, Air Liquide, BASF, Bayer, DaimlerChrysler, DuPont, Honda, M.A.M. Consulting, Mazda, Michelin, Philips, Renault, Royal Haskoning, Saint-Gobain,



The TRS was established in the second half of 2006 on the initiative of AEB members with an interest in Technical Regulation and Standards. The TRS has already gained momentum and made considerable moves to forward its activities with the support of the Delegation of the European Commission to Russia and the DG Enterprise and Industry at the European Commission.

ISSUE

Many European companies doing business in Russia have encountered difficulties due to technical regulation. Due to the significant differences between the EU and Russia in technical regulations, conformity assessment procedures and standards relating to industrial products, "Technical Regulation" is a major issue of the "Common Economic Space" between the EU and Russia. The EU-RU Regulatory Dialogue, which began in December 2005 exhibits strong commitment on both sides to making this dialogue a success.

In order to carry out these discussions as effectively and relevantly as possible, the European Commission, represented by DG Enterprise, requires the input and feedback from European business players themselves and the AEB TRS can play a major role in meeting this demand.

Significant reform of Russian technical regulation, launched at the end of 2002 by the FZ Federal Law 183 "on technical regulating", is now moving forward and the active participation of the TRS is essential. The old Soviet system of mandatory standards and certification procedures is being replaced by a system of technical regulations which use voluntary standards in a manner that is closer to the EU New Approach, and which aims to be WTO compatible. About 200 technical regulations are listed in the 2006-2008 program and among them, several final drafts have already been submitted to the Government. However, progress is slow and there is a great deal of misunderstanding about the changes, and resistance from vested interests.

RECOMMENDATIONS

The major mission of the Task Force is to act as a specific link with European Commission representatives in charge of the EU-Russia Regulatory Dialogue as the representative of European Business in Russia to express the needs and provide useful information and feedback. The signing of an agreement for effective cooperation with the influential Russian Union of Industrialists and

Entrepreneurs (RSPF) illustrates the common interest for the harmonisation of Russian technical regulation with European technical regulation in terms of reference documents and conformity assessment procedures.

The AEB TRS and RSPF have proposed the initiation of cooperation to define common positions on general issues to be presented to concerned authorities and to draw up concrete common proposals for several specific industry branches.

Electrical Equipment and Machinery (TRS sub-group)

Following a proposal made by several member companies, a sub-group of the Technical Regulation and Standardisation Task Force (TRS) dedicated to "Electrical Equipment and Machinery" has been initiated in the framework of the task force.

The main objectives of its activities are:

- To allow member companies to actively participate in the EU-Russia Regulatory Dialogue by appointing a representative to the corresponding "Electrical Equipment and Machinery" sub-group, if it is started within the framework of the EU-Russia Regulatory Dialogue.
- To establish direct communication and partnership with the relevant Russian industries and institutions with the aim of presenting and promoting proposals made by AEB member companies

Good working relations have already been established with the Industrial Policy Mechanical & Electrical Equipment unit of the Enterprise & Industry Directorate-General of the European Commission, as well with the major industry association in Europe, ORGALIME.



TRANSPORT AND CUSTOMS COMMITTEE

Chairman: Dmitry Tcheltsov, Suomen Posti Corporation (Finland Post Corporation)
Deputy Chairmen: Galina Dontsova, Ernst & Young; Dmitry Larionov, IRU
Committee Members: Alcoa, Bayer, BMW, Deloitte, DHL, Ernst & Young, Ford, Honda, IRU, Karlshamn Express, Lufthansa Cargo, Nissan, Pepelyaev, Goltsblat & Partners, PricewaterhouseCoopers, Saint Gobain, Shell, Sheremetyevo Airport, Suomen Posti Corporation, Targo Group, TNT

BACKGROUND

The Transport & Customs Committee has already been working with the new version of the Russian Customs Code for over 3 years. Both the business community and customs authorities have now enough experience to identify which provisions of the Code require further development and clarification.

The fact that Federal Customs Service is now reporting to the Russian Government is considered to be a positive move, increasing the level of accountability in both customs controls and international trade facilitation.

The recent Federal Customs Development Concept contains a number of provisions designed to improve the business environment and customs practices. Development and modernisation of the customs infrastructure at border-crossing checkpoints, preparations for joining international and European customs conventions, cooperation with customs administrations of other countries and the law-abiding business community in Russia, activities focused on preventing 'grey' imports – all these elements of the Concept have an important role to play.

We believe that in parallel with providing preliminary information and using preliminary electronic declarations, steps should be taken to unify electronic databases of key customs services in order to reduce the amount of hard copy documentation provided for customs purposes. Amendments to the Customs Code and other overlapping legislative acts are still required to ensure conformity and easier application in practice.

Discrepancies between the Tax and Customs Codes

ISSUE

The problem of export VAT refunding is still acute due to discrepancies between the Tax and Customs Codes. VAT may be recovered only through litigation. Still unresolved is the problem of refunding VAT on the Russian portion of goods that will be used in processing in the customs territory where the processed goods are further exported. The Customs Code has introduced certain changes to the export regime definition. According to the new definition, the customs regime for export sales will only apply to goods in free circulation. These, and other Tax Code provisions that remain in the former wording, do not in the aggregate provide for an exemption of exported processed goods for VAT purposes.

RECOMMENDATIONS

We recommend the introduction of changes in the Tax Code related to the application of VAT at zero rate to exported processed goods (Ministry of Finance).

Investment through Charter In-kind Contributions

ISSUE

Disposal of equipment imported as a charter capital contribution.

Many Russian companies have been facing issues related to the disposal of equipment imported as a charter capital contribution with exemption from customs duties and VAT. After customs clearance of such equipment, customs legislation provides that these goods be recognised as conditionally released and imposes heavy restrictions on their use and disposal in Russia. For example, this equipment can only be sold in Russia once the customs duty and VAT is paid. Yet legislation does not set any time-frame for customs control over the equipment's intended use in Russia. Many companies are forced to keep old equipment and continue to use it because they have no way of upgrading their production facilities.

RECOMMENDATIONS

We propose amending Russian Government Resolution No. 883 of July 23, 1996 On Reduced Import Duty and Value-Added Tax for Goods Imported by Foreign Investors as Charter Capital Contributions to Companies with Foreign Participation and Article 150 of the Tax Code of the Russian Federation. These norms should state that control over the purposeful use of goods imported as in-kind contributions to the charter capital of Russian organisations end once they are booked as payment of debt to a shareholder. We also propose that the new regulations cover goods previously imported as charter capital contributions to Russian companies.

These amendments will allow many Russian companies, including those with foreign investment, to fully modernise their core production equipment and will provide favourable conditions to increase foreign investments. Technological equipment previously imported to Russia that needs to be replaced with new and upgraded equipment can be sold to middle and small businesses in Russia, which should help the development of this sector.

ISSUE

Importation of Technological Equipment as Charter Capital Contribution

With respect to charter capital contribution, VAT exemptions are granted only to "technological equipment", as well as to the components and spare parts for such equipment. The list of technological equipment was promulgated by the State Customs Committee (see Order No. 131 of February 7, 2001). This list is more restrictive than the All Russian Classifier of Fixed Production Assets and may not extend VAT exemptions to all assets intended to be contributed. While the list is formally exhaustive (it does not include the phrase "and other goods"), goods not included in the list may also be exempted from value-added tax upon a special decision of the Federal Customs Service taken together with subsequent Ministry. Previously, it was the Ministry of Economic Development and Trade, but now due to administrative reform, the issuing of such exemptions is postponed.

RECOMMENDATIONS

Two measures should be taken to resolve this problem: an update to the list of technological equipment and introduction of a procedure of obtaining exemption for technological equipment not included in the list.

Introduction of new forms of customs declarations

ISSUE

On January 1, 2007, customs freight declaration (CFD) and transit declaration (TD) forms were replaced by a new, unified CFD/TD form – a Russian analogue of the Single Administrative Document (SAD) used in countries of the European Union.

The introduction of the Single Administrative Document in January 2007 is a step towards bringing customs clearance practice in Russia into line with two international conventions – Customs Transit Procedure and Simplified Procedures for International Trade. It will help to harmonise the electronic transit systems between the EU and Russia. Effective implementation of the Single Administrative Document in Russia will reduce the number of documents during the customs clearance process, and simplify control over goods flow. Unification of customs clearance standards in Russia and the EU will not only make Russia a more attractive transit destination, but also reduce costs to business.

Special Simplified Procedures for Customs Clearance

ISSUE

When Russia's new Customs Code took effect on January 1, 2004, many foreign trade players expected customs procedures to get simpler. They based these hopes on the provisions of Clause 68 of the RF Customs Code (Special Simplified Procedures of Customs Clearance for Certain Persons). The philosophy of the Practices is to reduce the customs clearance time for imports, thus cutting the costs of customs procedures.

As they evaluate the first results of simplified customs clearance in operation, foreign trade players have also identified its imperfections. An entity changing to the commercial documentation processing system frequently incurs substantial financial costs because 'double' accounting is actually required. The clause of the three year term for foreign trade poses a problem. If the entity is reorganised, or if it changes its legal form or official address etc., it may confront a refusal from customs when it applies for simplified customs clearing procedure.

On the whole, it can be said that the provisions of Clause 68 of the RF Customs Code are based not only on the standard rule of the General Annex of the Kyoto Convention, but also on the experiences of the customs administration of more developed nations. A concept of Authorised Economic Operator is currently to be introduced into the Customs Code of the European Community. Authorised Economic Operator status will be granted to a party involved in the international movement of goods in whatever function (an importer, exporter, a carrier, a customs broker, a warehouse owner, etc.) that has been approved by a national customs administration as complying with established requirements.

RECOMMENDATIONS

Changes to the legislation will enable the introduction of an Institute of Authorised Economic Operators in Russia.

The AEB expresses its thanks to the following Member companies for their time and effort in contributing to the 2007 Position Paper:

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