



ASSOCIATION OF EUROPEAN BUSINESSES
IN THE RUSSIAN FEDERATION

Presentation of the AEB Guide

“How to invest in Russia in 2010”

March 22, 2010
AEB Premises, Moscow

Investments into strategic sectors of the Russian economy – guidelines and perspective

Alex Stoljarskij

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22 March, 2010 / Moscow

BEITEN BURKHARDT

Introduction – FDI fell in 2009

- Russia's largest investor countries: Cyprus, the Netherlands, Luxembourg, Great Britain, Germany, China, Ireland, France, Japan and the Virgin Islands accounting for 82.8% of total accrued foreign investment and 77.4% of accrued foreign direct investment
- FDI fell 41.1 % to \$ 15.9 billion and portfolio investment 37.7 % to \$ 882 million while other investment was down 13.5% to \$ 65.14 billion

(Source: <http://en.rian.ru/business/20100227/158032336.html>)

Strategic sectors law – objectives and relevance

Objectives:

- ensure national defense and security
- create clear and transparent legal conditions for foreign investors

Relevance:

- SSL came into effect on May 7, 2008, since then repeatedly invoked
- 42 strategic sectors (including atomic power, cryptosystems, defense, aviation and space, television and radio broadcasting, publishing, natural monopolies, mineral resources)
- Part of every DD in M&A transactions now the examination whether SSL is applicable. If applicable, time-consuming prior approval process before the deal can be concluded

Strategic sectors law – thresholds

	Foreign private investor	Foreign state investor
General strategic enterprise	Authorization-based procedure when acquiring over 50% (and under certain conditions less than 50%)	Authorization-based procedure when acquiring over 25%; acquisition of a majority stake is prohibited
Enterprise performing field development of mineral resources	Authorization-based procedure at planned acquisition of stakes in the amount of 10% and more (exception: RF owns over 50%)	Authorization-based procedure when acquiring over 5%; acquisition of a majority stake is prohibited
General enterprise (not in a strategic sector)	No restrictions under the SSL	Authorization-based procedure when acquiring 25% and more (amendment of the law on foreign investments)

Strategic sectors law – problems observed

- Vast majority of relevant sectors are subsoil of federal significance, followed by encryption, natural monopolies and TV broadcasting
- Some sectors not of any relevance yet
- Unintended application of the SSL in certain sectors (e.g. use of radioactivity in health care sector or activities using agents of infections in dairy facilities)
- Definition of “group of persons”
- Imprecisely defined understanding of “control”
- Timeframe does often not correspond with business reality needs
- (Legal power of decisions taken by FAS – potential problem)

Strategic sectors law – proposed amendments

- Banking being exempt from cryptographic activities
- Exemption of transactions to increase charter capital, the result of which does not increase the voting shares of the capital managed by a foreign investor
- Deletion of “group of persons” from the exemption that if prior to the transaction a foreign investor or a group of persons directly or indirectly controlled over 50% of the total voting shares (stock) of such a business entity, no approval is needed
- Increase of timeframe for review by FSB from 20 to 40 days
- Time frame for approval process begins only after submission of complete set of documents
- Model forms to be elaborated by FAS
- Foreign investor may apply for extension of deadline to conclude agreement on obligations imposed on him

Strategic sectors law amendments - evaluation

- Proposed changes are not conceptual, rather technical adjustments
- Provide for some clarity within the administrative process
- No real simplifications for foreign investors, codification of status quo
- Not THE positive signal to foreign investors
- Lot of issues remain unclear, e.g.
 - Definition of “group-of-persons” within the SSL,
 - Definition of “control”,
 - Application of the SSL in asset deals,
 - Incorporation of newly established enterprises,
 - Change of activity.
- Positive that public discussion takes place and will continue

Strategic sectors law – AEB initiatives

- For foreign investors the following improvements are desirable:
 - Clear definition of sectors, deletion of non-important types of activities or types of activities unintended included in SSL
 - Simplification and acceleration of the process, in particular by introducing a procedure of approving the transaction by using fictional clauses or by issuance of a non-objection certification from FAS before the transaction
 - Inclusion of a provision according to which there are no signs of control, if another participant / stakeholder has a bigger stake
 - Introduction of threshold below which control simply can not be obtained (so-called “de-minimis” rule)
 - Inclusion in the law of a requirement on provision of substantiation of a decision

Contact

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BOARD SOLUTIONS

Board Services & Executive Search



« CEOs are not born, they are bred. It is a long and discriminating process. Consequently they are a rare breed. For companies in need of new talent, identifying and attracting senior executives is a daunting task to say the least.»

Jean-Claude Falcou



« Good corporate governance is based on best practices and common sense. Every company is unique and requires the right balance of experience and skills on the board to add value for the shareholders.»

Alexander Ikonnikov



« There are possibly two kinds of successful executives; the ongoing campaigner who succeed by promoting themselves on a continuous basis spending time in looking for new "personal" opportunities, and the achievers who are fully dedicated to excelling in their work. Which one do you want?»

Larisa Rydykova



« Those who build great companies understand that the ultimate throttle on growth for any successful company is not markets, or technology, or competition, or products. It is one thing above all others: the ability to get and keep enough of the right people.»

Yevgeniy Glazunov

Guide: How to Invest in Russia

VALUE-ADDED CORPORATE GOVERNANCE

Alexander Ikonnikov
Partner, Head of Board Practice

March 22, 2010
Moscow

Success factors for investments

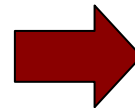
1

Management



2

Corporate
Governance



Successful
Investments

Features of corporate governance in Russia

1. Russian **corporate environment** is characterized by:
 - Highly concentrated ownership
 - Combined ownership and management is common
 - Many “first generation” companies governed by founder / dominant shareholder
 - Lack of widespread share ownership, shareholder democracy tradition, transparency and international standards
 - Lack of appreciation of corporate governance (including Board and non-executive directors), it is often seen as merely “window dressing”
2. **2006**: Listing rules introduced compulsory corporate governance requirements for listed companies (depending on listing category)
3. BUT still **only top 15 A1 listed companies fully comply** with Russian Corporate Governance Code

Who faces corporate governance challenges?

STRATEGIC INVESTORS

Large businesses that need improved positioning with Government, state-owned companies, large business groups

PARTNERSHIPS

International businesses entering Russian market through M&A and other partnership agreements

PORTFOLIO INVESTMENTS

Minority shareholders
Private equity investments

EXAMPLES

Deutsche Bank 



ORKLA



Advisors – advantages for business

Policy Advisor

- Influential advisor with powerful connections
- On as-needed basis



Advisory Board

- Several advisors of different backgrounds and experience
- Less formal than Board of Directors



Non-Executive "Chairman"

- Full-time involvement in business, but outside the usual org structure
- Acts as first face of company



Relative

- Full-time involvement in business
- Help with PR and GR through family connections



- Establish connections with influential government and business groups
- Get access to information
- New deals, new clients
- Improved positioning

Establishing board of directors with non-executive directors (NEDs)

1. Represent and work in the best interests of all shareholders and the business
2. Ensure proper communication between foreign and Russian sides
3. Value-added in terms of the experience and skills for the business, not as formal entity

Example from TNK-BP

From AAR

4



M. Friedman



V. Vekselberg



L. Blavatnik



A. Knaster

From BP

4



A. Inglis



D. Peattie



I. Macdonald



Lord Robertson

NEDs

3



G. Schroeder



A. Shokhin



J. Leng

Advantages of NEDs on a Board

1. Outside “fresh” view on the business and strategy of the company
2. Role of arbiter – decision-making in the interest of the business and not of individual shareholders
3. Mentorship. Professional support and development of management
4. Adaptation of corporate governance systems to the changes in business environment. Improved systems of control and monitoring
5. Increased credibility from the investors, banks, suppliers, government (especially, if independent search process had been ensured)

Survey “Leading in turbulent times: Priorities for your Board”

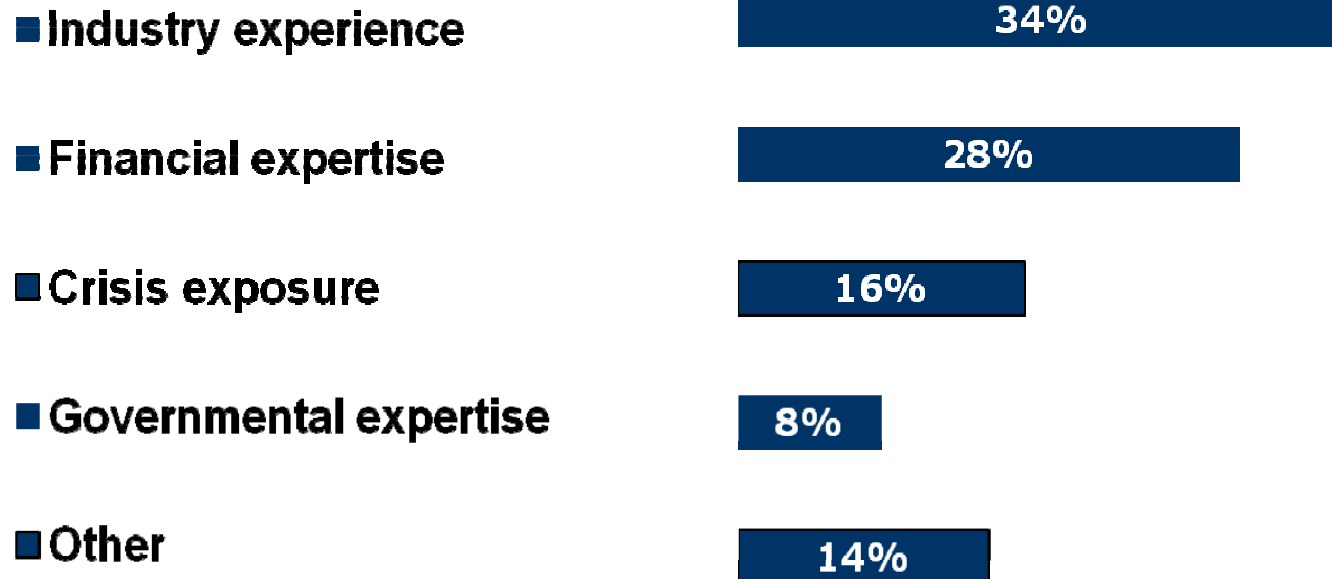
1. In the spring of 2009, a survey “Leading in Turbulent Times: Challenges for the Board” was conducted
2. **Participants from 64 companies**
3. **Participants were:**
 - Chairmen of Boards of Directors
 - Non-executive directors (NEDs)
 - CEOs
 - Shareholders of companies



Key conclusions

- **73%** consider corporate governance to be important, **50%** from them think even more important in crisis
- Doubts exist that Russian Boards have the necessary experience and independence
- Majority understand the value of having professional NEDs on Board

Key competencies for directors on the Board



Other include:

- Experience/expertise with government banks
- Replace foreign directors with Russian directors who know the market
- Relevant expertise from female directors

Expectations from directors on Boards

«During a crisis, an independent director should have **the courage to stand and say openly if he disagrees** with controlling shareholders, to ask tough questions and play the devil's advocate role. All of this is in order to exercise his powers in the interests of the company as a whole»

«The Board should keep a **cool head and avoid panic**. It does not help to have Board members who get nervous. It will be helpful to have lived through other crises – even if they weren't as severe as this one»

«A company should maintain **stronger relationships with analysts, investors and shareholders** through regular and open dialogue. A crisis and crash in valuations cannot be an excuse to stop communicating. Once a company has accepted public money, it has to comply with stock exchange regulations and good corporate governance»

«**Time availability of directors** is even more important than their professional skills. If the company has a 'star director' who is too busy to be actively engaged in Board meetings he will have little value during a crisis»

Development on Corporate Governance issues

Development of directors

- Workshops for Russian partners on corporate governance best practices
- Development of board directors and chairmen, as well as management, on corporate governance best business practices and developments

Board Assessment

- Regular Board assessments
- Independent Board assessments

Advantages of Board Assessment

ADVANTAGES

1. Improve individual director performance
2. Increase effectiveness of the Board as a group
3. Improved collaboration with management team and shareholders



World-renowned experts in corporate governance bring in best business practices

ADVANTAGES

4. Independently conducted assessment sends a signal to the market that best practice is being followed
5. Follow-up after the Board assessment provides stimulus for board members to implement recommendations

Recommendations for companies investing in Russia

1. Take into consideration corporate governance system differences
2. Chose optimal path to address these issues for your own business
3. Continuous development to increase efficiency of your business

Contact information

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The background features abstract, colorful swirls in shades of green, purple, and blue, interspersed with small yellow triangles, creating a dynamic and artistic feel.

Trojan Swaps A Wake up call for Financial Regulation

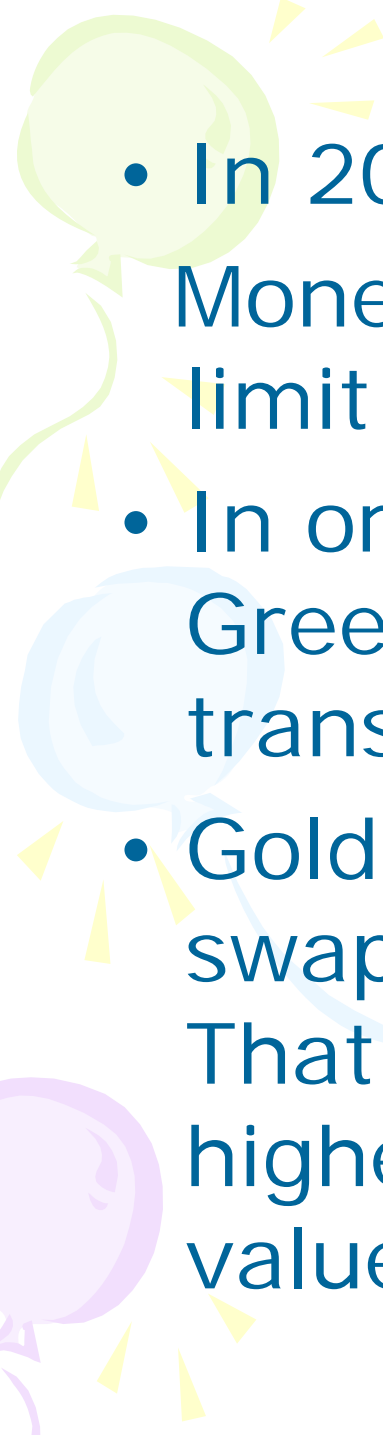
**Art Franczek , President of The American
Institute of Business and Economics**

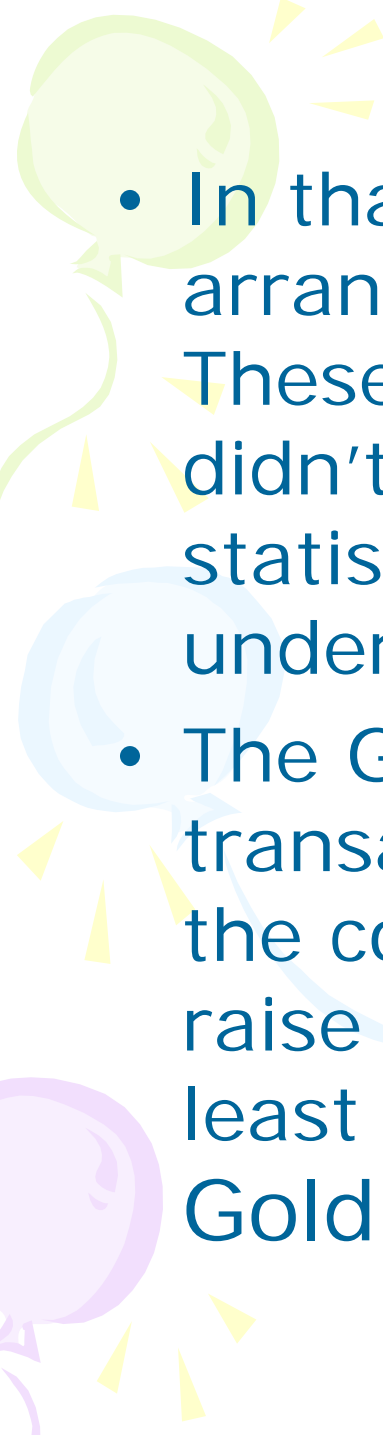
**artf@online.ru
www.aibec.org**




Outline

- 2001 Greece uses Financial Engineering for Window Dressing.
- 2009 Financial Speculators take advantage of Greece's debt troubles.
- Some Financial Regulatory in the US and EU.

- 
- In 2001 Greece joined the European Monetary Union and was required to limit its budget deficit to 3% of GDP
 - In order to meet this requirement Greece entered into Currency Swap transactions with Goldman Sachs
 - Goldman devised a special kind of swap with fictional exchange rates. That enabled Greece to receive a far higher sum than the actual market value of 10 billion dollars or yen.

- 
- In that way Goldman Sachs secretly arranged additional loans for Greece. These loans were disguised as swaps and didn't show up on Greek financial statistics. These transactions were legal under EU rules.
 - The Greeks also entered into swap transactions that effectively mortgaged the country's airports and highways to raise much needed money. There were at least 12 swap arrangements organized by Goldman.

- 
- A decorative background on the left side of the slide featuring a stylized sun with yellow rays and three balloons in light green, light blue, and light purple.
- Greece's debt problems came to light in 2009 when an ECONFIN audit revised Greece's budget deficit ratio from 3.7% of GDP to 12.5% of GDP, significant accounting irregularities were noted.
 - From 2001 to 2008 Greece was required to revise its' budget ratios 5 times. Greece's average budget ratio for the years 2001-2008 was over 5%.Greece has achieved the 3% requirement only once.

- 
- There are 2 ways to speculate on the deterioration of Greek debt:

1. Trading on the iTraxx SovX Western Europe index. This index includes the top traded Credit Default Swaps in Europe including Greece. It was organized by a group of banks that included Goldman Sachs. The more traders purchase these derivatives the cost of insuring Greece's debt becomes greater. This sends a bearish signal to the market that causes investors to shun Greek bonds, making it harder to borrow.

- 
- Traders also speculate by purchasing Credit Default Swaps on Greek debt. CDS are illustrated in the next few slides.
 - The use of CDS greatly exasperated the World Financial Crisis because of their use in AIG, Lehman, Bear Stearns and others.
 - Trading of CDS is largely unregulated
 - The spread on Greek CDS have increased by over 400% in the last 6 months.
 - Warren Buffet calls CDS "Financial Weapons of Mass Destruction"
 - Goldman Sachs has invested heavily in Greek CDS.

The New York Times

February 17, 2008

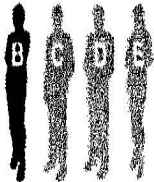
A Primer on Credit Default Insurance

THE PLAYERS

The insurance buyer is often a bond investor seeking protection against default on an asset he owns. But many are speculators, who do not own the asset, but use the credit default swap to bet on the health of a company.

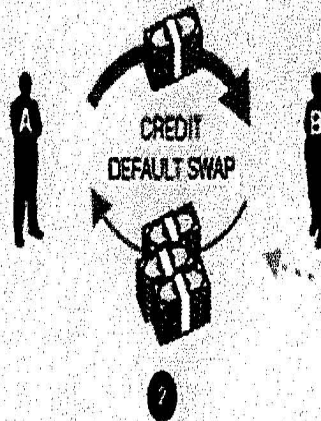


The insurance seller is often a hedge fund, insurance company or bank. It receives premiums from the buyer throughout the contract.



THE PROCESS

1
Party A buys credit default insurance from Party B to protect against default on a bond, or to bet on a company's health.



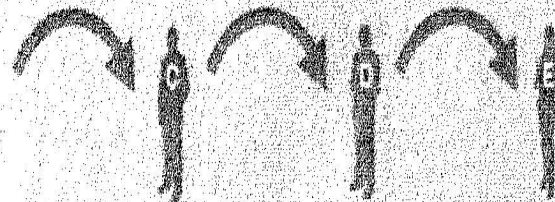
2
In the case of a default, Party B would pay the bond's full value to Party A.

THE PROBLEM

3
Party B can assign the insurance contract to another party

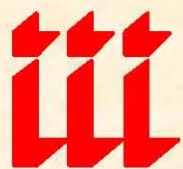
...who can assign it to another...

...and he to another.

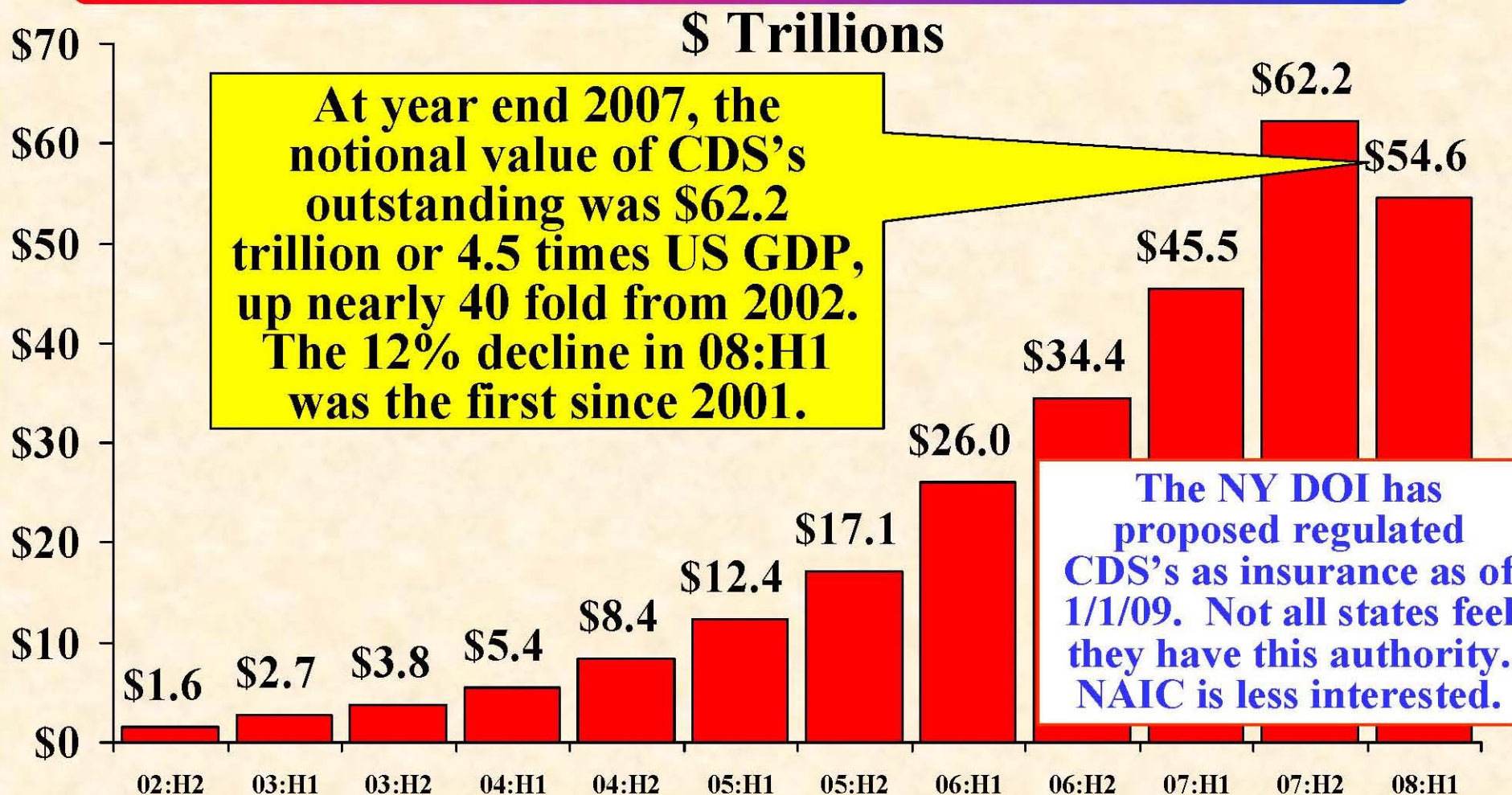


In the case of a default, Party A may have to track down the final party in the insurance agreement. However, this party may or may not be in a position to pay the bond's full value.

THE NEW YORK TIMES

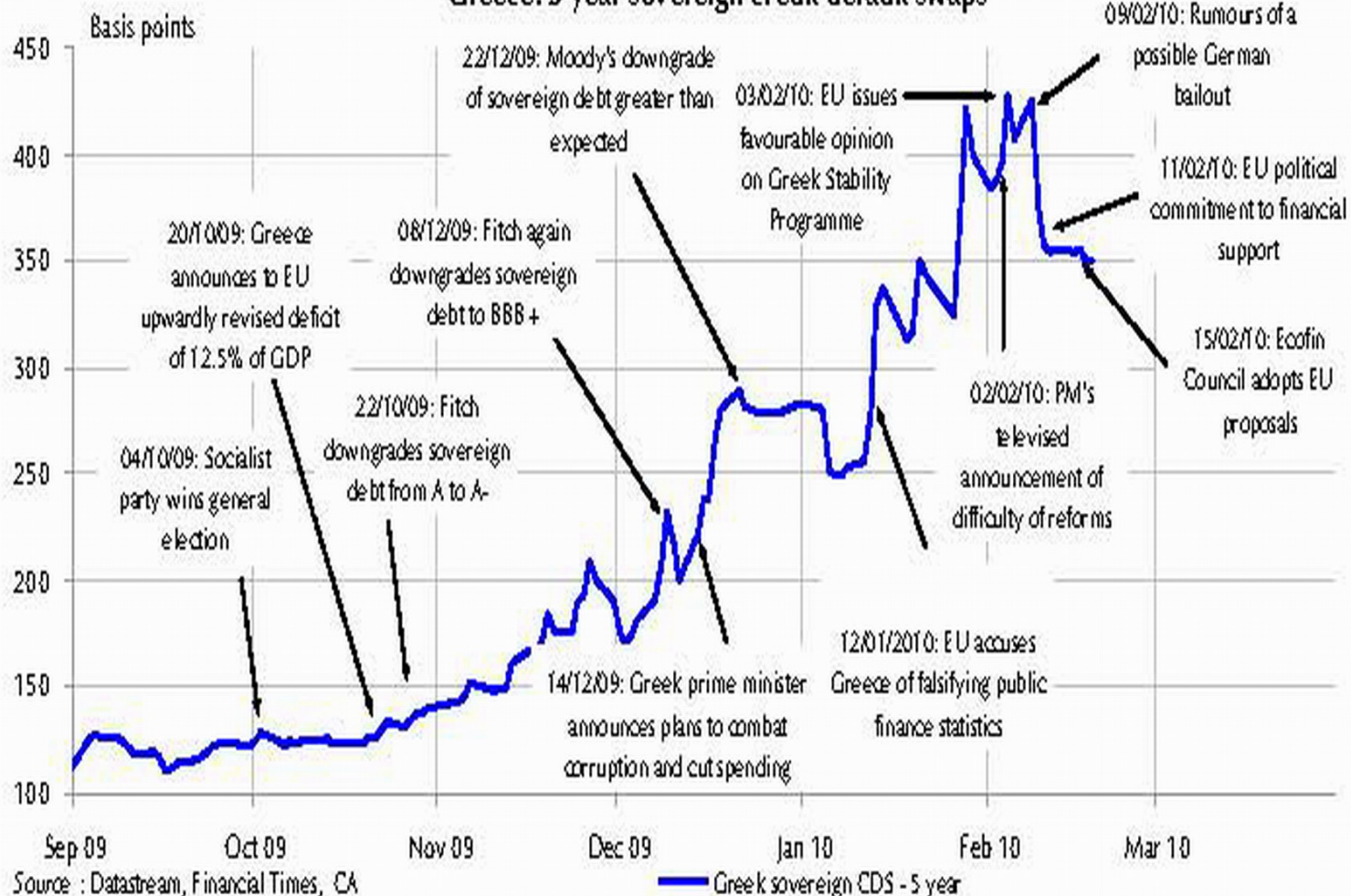


*Credit Default Swaps: Notional Value Outstanding, 2002:H2 – 2008:H1**



*End of calendar half (H1 = June 30, H2 = December 31).

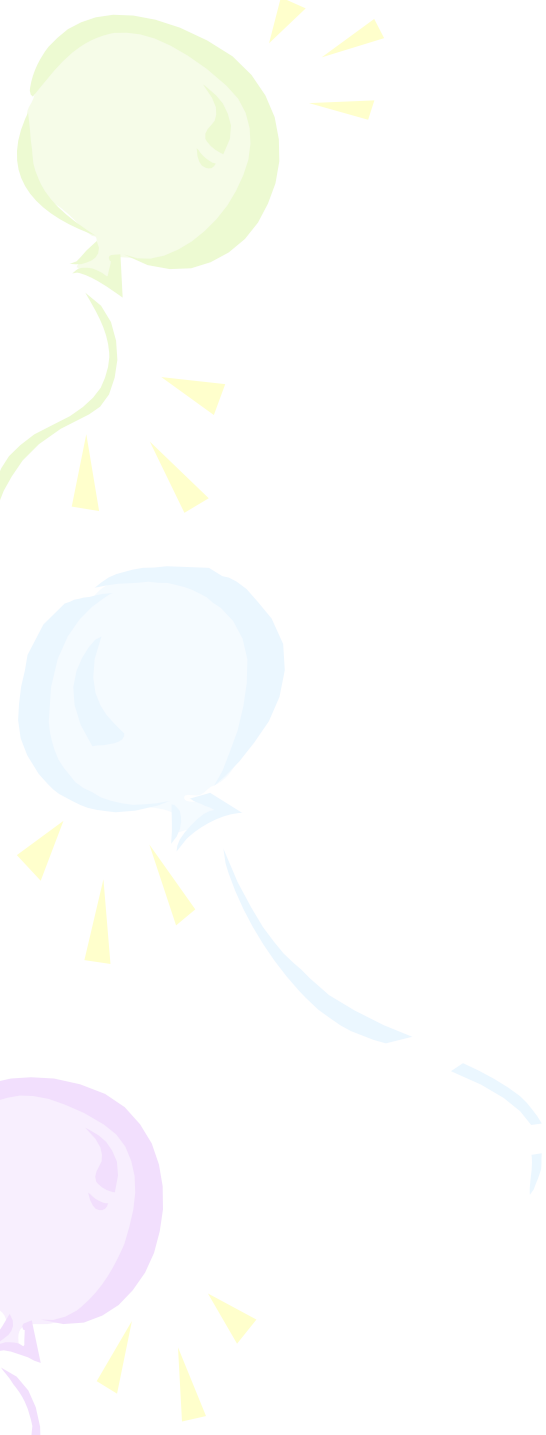
Greece: 5-year sovereign credit default swaps





Future Financial Reforms

- US proposals would require that CDS be traded in central clearing houses
- In US the Volker rule would reinstate Glass Seagle and ban proprietary trading
- The EU is studying a ban on “naked CDS”



- Thank You
- Art Franczek
- artf@online.ru
- AIBEc



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Russian Banking sector: to arrive at the bottom
Philippe Delpal

March 22, 2010
AEB Premises, Moscow



FORENSIC

Integrity Due Diligence, Russia

Corporate Intelligence

ADVISORY



What is it and Why do you need it?

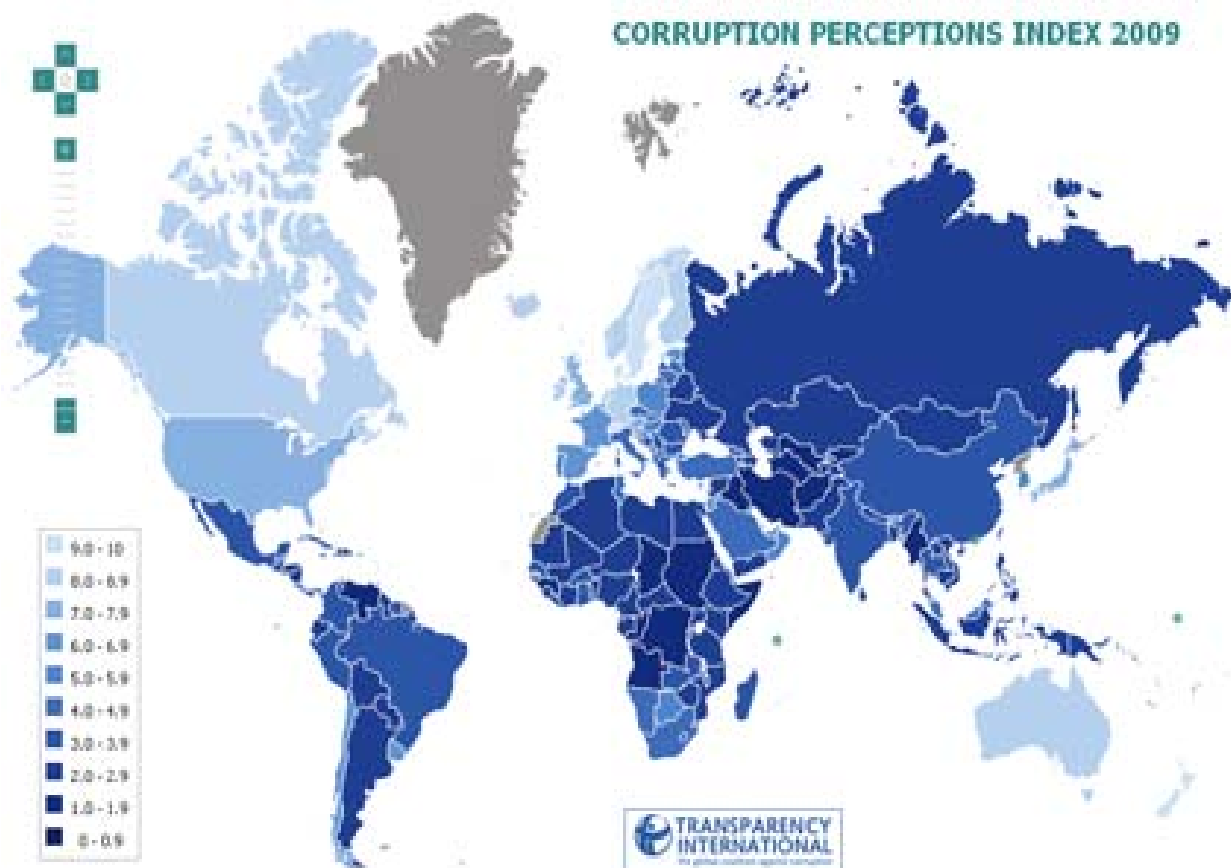
WHAT?

- Integrity Due Diligence (IDD) is a key service provided to M&A teams, in-house counsels, investment bankers, corporate lawyers, CFOs and internal strategy teams
- It involves the gathering and analysis of information on the background, track record, business interests, reputation and likely integrity of prospective investment and acquisition targets
- It identifies risks not addressed by mainstream legal and financial due diligence
- It is undertaken confidentially and does not require the collaboration or agreement of the target company
- It is considered essential by many companies when operating in emerging markets
- It is a tool to enable stakeholders to identify hidden risks and liabilities as well as commercial opportunities
- Independent assessment of a company's relationships with stakeholders (JV partners, agents and intermediaries, suppliers, distributors, acquisition targets)

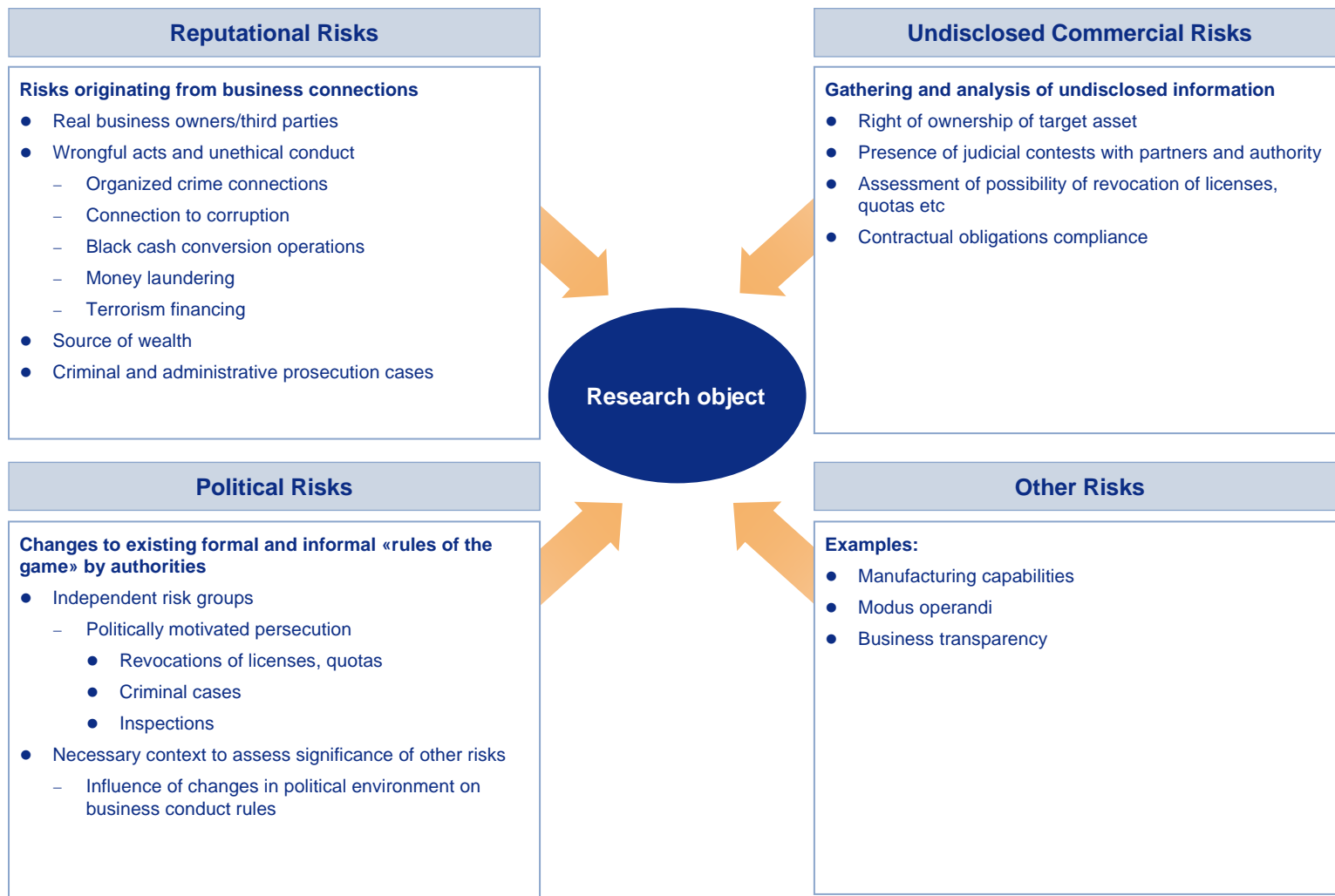
WHY?

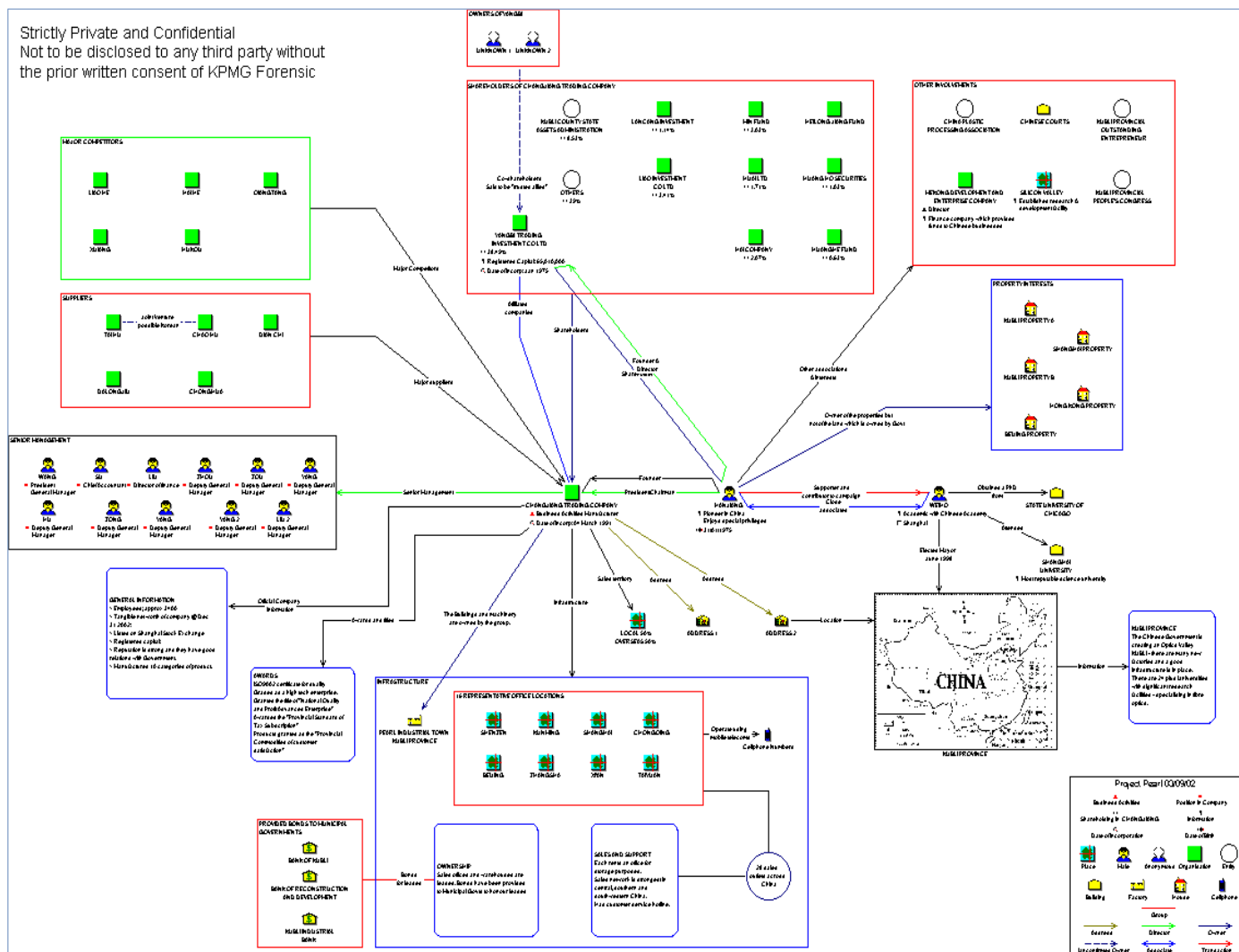
- Better understanding of business partners
- Greater clarity of non-transparent issues
- Provides an independent view on reputational risks to complement legal and regulatory advice
- Compliance with regulatory requirements (3rd EU AML Directive, KYC, SOX, FCPA)
- Creates a paper trail
- Aligns with corporate governance values

Corruption Perceptions Index, 2009



Corporate Intelligence





Contact details



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22 March 2010

8 Steps to Improve Tax Protection under SPAs



Andrey Shpak

Partner / Tax

andrey.shpak@gbplaw.com

Improving Tax Protection under SPAs (1/4)

- * Start with choosing which entities to buy
- * Ask for explicit "Euro-for-Euro" (or Rouble-to-Rouble) tax indemnity

Improving Tax Protection under SPAs (2/4)

- * Ask for 4 years limitation period for tax indemnity
- * Select parties giving the indemnity

Improving Tax Protection under SPAs (3/4)

- * Ensure proper tax gross-up clauses
- * Ask for comprehensive tax warranties

Improving Tax Protection under SPAs (4/4)

- * Insist on disclosures to be specific and quantifiable
- * Make collection against tax claims under indemnity easy for you



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