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Paul G. Thompson

Rashid R. Sharipov

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CAPITAL MARKETS

Securities Regulation in the Russian Federation*

PAUL G. THOMPSON**
RASHID R. SHARIPOV***

I. INTRODUCTION

Immediately prior to and since the collapse of the Union of Soviet Socialist Republics (USSR), the Russian Federation, the largest of the former Soviet republics, has moved towards establishing a free-market economy. As a central part of this shift, the Russian government privatized state-owned enterprises resulting in the circulation of privatization vouchers and stimulating the development of financial markets in Russia. Since the beginning of privatization, securities trading has expanded but understanding of securities trading is slow to develop.

In the past few years, the government has taken steps to introduce comprehensive regulation of securities transactions. The most important of these steps are the establishment of regulatory authorities for the securities markets and the enactment of the basics of a codified legal system, including the Civil Code,[1] which contains fundamental

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** Partner, Holme Roberts & Owen L.L.P., B.B.A. 1985, University of Iowa; J.D. 1989, University of Michigan; resident in London, England.

*** Senior Associate, Holme Roberts & Owen L.L.P., J.D. 1990, Moscow State Institute of International Relations; LL.M 1992, California Western School of Law-San Diego; resident in Moscow, Russia.

1. Grazhdanskij Kodeks Rossiyskoi Federatsii [Civil Code of the Russian Federation], Part One (Nov. 30, 1994), SOBRANIE ZAKONODATEL'STVA ROSSIYSKOI FEDERATSII [SOBR. ZAKONOD. R.F.] 1994, No. 32, Doc. 3301 and Part Two (Jan. 26, 1996), SOBR. ZAKONOD. R.F. 1996, No. 5, Doc. 410, *translated in* Economic Law of Russia, "Civil Code of the Russian Federation (Parts One and Two)" (Garant-Service

regulation of commercial activities, the Securities Law,[2] and the Joint Stock Company Law.[3] Recently, the Federal Commission on Securities Markets (Federal Securities Commission)[4] replaced the Russian Ministry of Finance as the central regulator of securities markets in Russia.

The current regulatory framework is a leap forward from the period prior to the introduction of codified legislation, during which shareholder and investor protection was limited and investments were poorly regulated. The previous environment promoted schemes such as the MMM pyramid investment fund. Though the fund collapsed in 1994, losses were caused to millions of investors.[5] The new legislation incorporates the main provisions governing securities in a set of codified laws; yet, gaps in the law remain. Directions issued by securities regulators are expected to advance and to clarify the existing law.

II. REGULATORY AUTHORITIES

A. *Political Organization of the Russian Federation*

Most people know that until the last months of the USSR, the Communist Party centrally planned Russia's economy and controlled its political system. When the USSR collapsed at the end of 1991, the 15 former Soviet republics gained their independence. The majority of the republics joined the Commonwealth of Independent States. The

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1996, Doc. 7500), *available in* LEXIS, Intlaw Library, RFLaw File [hereinafter *Civil Code*]. Civil Code, Part One came into force on January 1, 1995 under "Federal Law of the Russian Federation No. 52-FZ" (Nov. 30, 1994), SOBR. ZAKONOD. R.F. 1994, No. 32, Doc. 3302, *translated in* Economic Law of Russia, "Federal Law No. 52 of the Civil Code of the Russian Federation" (Garant-Service 1996, Doc. 7501), *available in* LEXIS, Intlaw Library, RFLaw File. Civil Code, Part Two came into force on March 1, 1996 under "Federal Law of the Russian Federation No. 15-FZ" (Jan. 26, 1996), SOBR. ZAKONOD. R.F. 1996, No. 5, Doc. 411, *translated in* Economic Law of Russia, "Federal Law No. 15-FZ of January 26, 1996 on the Enforcement of the Second Part of the Civil Code of the Russian Federation" (Garant-Service 1996, Doc. 5940), *available in* LEXIS, Intlaw Library, RFLaw File.

2. Federal'nyi zakon "O rynke tsennykh bumag" [Federal Law "On Securities Market"] (Apr. 22, 1996), SOBR. ZAKONOD. R.F. 1996, No. 17, Doc. 1918, *translated in* Economic Law of Russia, "Federal Law No. 39-FZ of April 22, 1996 on the Securities Market" (Garant-Service 1996, Doc. 6464), *available in* LEXIS, Intlaw Library, RFLaw File [hereinafter *Securities Law*].

3. Federal'nyi zakon "Ob Aktsionernykh Obshestvakh" [Federal Law "On Joint Stock Companies"] (Nov. 24, 1995) (amended June 13, 1996), SOBR. ZAKONOD. R.F. 1996, No. 1, Doc. 1, *translated in* Economic Law of Russia, "Federal Law No. 208-FZ of December 26, 1995 on Joint-Stock Companies (with the Additions and Amendments of June 13, 1996) (Garant-Service 1996, Doc. 5712), *available in* LEXIS, Intlaw Library, RFLaw File [hereinafter *Joint Stock Company Law*].

4. *See infra* note 21.

5. Carey Goldberg, *MMM Leaves Bitter Taste of Capitalism in Russia; Finance: Investors Panic After Fund's Collapse, as Shares Worth $50 Days Earlier Drop to Value of 50 Cents*, L.A. TIMES, Jul. 30, 1994, at A10, available in LEXIS, News Library, Allnws File.

Russian Federation, or Russia, is the largest of the former Soviet republics and has a population of about 150 million.[6] Russia assumed the international status and many of the domestic functions of the USSR.

The President of the Russian Federation is Boris Yeltsin. He was democratically elected in June 1991 and re-elected in July 1996. Initially, President Yeltsin supported extensive democratic and free-market economic reforms, but faced opposition from the Soviet-period Congress of People's Deputies. This opposition culminated in the attempted coup of October 1993, during which President Yeltsin called for new Parliament elections and seized the White House from the opposition by military force. In the Parliament's elections in 1993, and again in the elections of 1995, the Communist Party made considerable gains. It currently has a plurality of 157 seats in the State Duma, the lower house of Parliament.[7]

After the attempted coup, President Yeltsin consolidated government authority under his control. The Constitution of the Russian Federation,[8] approved in national elections held at the end of 1993, provided the basis for a democratic system of government. This system is dominated by the President. He issues decrees that are binding throughout Russia[9] and nominates the highest government officials, including the prime minister. Although the President's nominees require Parliament's approval, the President may dissolve Parliament if it rejects his nominee for prime minister three times.[10] President Yeltsen has a cooperative relationship with the prime minister, Viktor S. Chernomyrdin, who was appointed in December 1992.

The Parliament, or Federal Assembly, consists of the 178-member Federal Council and the 450-member State Duma. The Federal Council consists of two representatives from each of Russia's 89 administrative regions.[11] Members of the Duma are elected through direct electoral voting. The Duma is weak in comparison to the President. Nonetheless, if it passes two votes of no confidence in the government within a three-month period, the President must nominate a new government or dissolve the Duma and call for elections.[12] The Federal Council may,

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6. *Sources of Power, Fact Sheet 1,* IBC POLITICAL RISK SERVICES, Apr. 1, 1996, LEXIS, Europe Library, Russia File.

7. *Id.*

8. Konstitutsija Rossiyskoi Federatsii [The Constitution of the Russian Federation], ROSSIYSKAYA GAZETA, Dec. 25, 1993, *translated in* Economic Law of Russia, "The Constitution of the Russian Federation (Adopted at National Voting on December 12, 1993)" (Garant-Service 1996, Doc. 3000), *available in* LEXIS, Intlaw Library, RFLaw File [hereinafter *Constitution*].

9. *Id.* art. 90.

10. *Id.* art. 111.

11. *Id.* art. 95.

12. *Id.* art. 117.

with the support of the Duma and the Supreme Court, impeach the President on the basis of high treason or another serious crime.[13]

Federal laws must be approved by the Duma, the Federal Council, and the President. The President may veto a bill on its first passage through Parliament. On the second reading, the President cannot veto the same bill if it receives two-thirds majority approval in both the Duma and the Federal Council.[14]

The judiciary is independent, subject to constitutional and federal law. The Constitutional Court monitors the activity of the legislative and executive branches of government and settles disputes of competence between state bodies. The Supreme Court reviews civil, criminal, and administrative matters while the Superior Arbitration Court oversees commercial disputes. Judges sitting on these higher courts are nominated by the President, subject to the approval of the Federal Council.[15] The judges of other federal courts are appointed by the President.[16]

Russia enacted the foundations of a codified legal system modeled on the European civil law structure. The Russian Civil Code[17] provides a general framework for civil matters, including civil rights and duties, legal entities, business organizations, security interests, contractual rights, and property rights. The Russian Criminal Code[18] recognizes crimes against the individual, in contrast to the former Soviet emphasis on crimes against the state.

In addition to the Federal Government, Russia is organized into various political subdivisions-89 administrative regions, including 21 autonomous republics such as Tatarstan and Bashkortustan, which have significant devolved powers. There are 66 national administrative divisions of varying autonomy. These consist of 49 oblasts such as Leningrad Oblast and Sverdlovsk Oblast, six krays and eleven autonomous national areas or okrugs. There are also two federal cities with autonomous status, Moscow and St. Petersburg.[19] Each administrative region elects its own representative body.[20]

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13. *Id.* art. 93.
14. *Id.* art. 107.
15. *Id.* art. 102.
16. *Id.* art. 128.
17. *See Civil Code*, *supra* note 1.
18. Ugolovnyi Kodekse Rossiyskoi Federatsii [Criminal Code of the Russian Federation], SOBR. ZAKONOD. R.F. 1996, No. 25, Doc. 2954 [hereinafter *Criminal Code*].
19. *Russia, Economy, EIU Country Profiles* (Jan. 1, 1996) LEXIS, Europe Library, Russia File.
20. *Russia, Political Scene, EIU Country Profiles* (Mar. 7, 1994) LEXIS, Europe Library, Russia File.

B. *State Committee of the Russian Federation on the Securities Market*

The Federal Securities Commission, established by presidential decree in 1994,[21] regulates the Russian securities market and securities market participants.[22] It is a federal executive agency for state policy on securities market implementation[23] and has the status of a state committee[24] and has broad rulemaking authority.[25] It supervises and controls the activities of securities market participants by regulating their activities, licensing market professionals, and supervising the securities market.[26] The Federal Securities Commission has no authority over federal government securities, including federal government bonds (GKOs and OFZs),[27] or securities issued by constituent

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21. Ukaz Presidenta #2063 "O merakh po gosudarstvennomu regulirovanu rynka tsennykh bumag v Rossiyskoi Federatsii" [Presidential Decree #2063 "On Measure of State Regulation of the Securities Market in the Russian Federation"] (Nov. 4, 1994) (amended Mar. 22, 1996), SOBR. ZAKONOD. R.F. 1994, No. 28, Doc. 2972, *translated in* Economic Law of Russia, "Decree of the President of the Russian Federation No. 2063 of November 4, 1994, On Measures of State Regulation of the Securities Market in the Russian Federation (with the Additions and Amendments of March 22, 1996)" (Garant-Service 1996, Doc. 3251, § 6), *available in* LEXIS, Intlaw Library, RFLaw File [hereinafter *Decree # 2063*]. Initially, the Federal Securities Commission was known as the Commission for Securities and Stock Exchanges under the President of the Russian Federation. When the Securities Law was adopted, its name was changed to the Federal Commission on Securities Markets.

22. The authority of the Federal Securities Commission is defined under Chapter 12 of the Securities Law. *Securities Law*, *supra* note 2; *see also* Ukaz Presidenta #1009 "O Federalnoi Komissii po rynku tsennykh bumag" [Presidential Decree #1009 "On Federal Securities Commission"] (July 1, 1996), ROSSIYSKAYA GAZETA, July 12, 1996 [hereinafter *Decree #1009*].

23. *Securities Law*, *supra* note 2, art. 40.

24. Initially, the Federal Securities Commission had the status of a federal ministry reporting directly to the President. Presidential Decree #1177; Ukaz Presidenta #202 "O statuse Federalnoi Komissii po tennsym bumagam i fondovomy rynku pri Pravitelstve Rossiyskoi Federatsii" [Presidential Decree #202 "On Status of the Federal Commission for Securities and Securities Market"] (Feb. 27, 1995), SOBR. ZAKONOD. R.F. 1995, No. 10, Doc. 856, *translated in* Economic Law of Russia, "Decree of the President of the Russian Federation No. 202 of February 27, 1995 on the Status of the Federal Commission for Securities and for the Share Market under the Government of the Russian Federation" (Garant-Service 1996, Doc. 3682), *available in* LEXIS, Intlaw Library, RFLaw File [hereinafter *Decree #202*]. The Chairman of the Federal Securities Commission has *ex officio* status of a federal minister. *See also Securities Law*, *supra* note 2, art. 40. The recent downgrading of its status to a state committee creates uncertainty with respect to the future role of the Federal Securities Commission as the principal regulator of the Russian securities market. Paul Funder Larsen, *Securities Commission Stripped of Status*, MOSCOW TIMES, Aug. 27, 1996, at 1

25. *See generally Decree #202*, *supra* note 24; *Securities Law*, *supra* note 2; *Decree #1009*, *supra* note 22.

26. It is responsible for the provision and withdrawal of licenses to securities market participants, the coordination of all government regulation of the securities market, and the introduction of compulsory regulation of securities market activity. *Securities Law*, *supra* note 2, art. 42.

27. *See infra* part V.C.

republics and regions of the Russian Federation.[28] However, the Federal Securities Commission has authority over securities issued by municipalities.[29]

The principal office of the Federal Securities Commission is in Moscow.[30] It may establish regional offices to assist it if needed.[31] It is administered by a 15-member board headed by the Chairman of the Federal Securities Commission.[32] In addition to the Chairman, the first deputy chairman, the deputy chairmen, and the secretary of the Federal Securities Commission, five representatives of the federal executive agencies responsible for securities market matters serve on the Federal Securities Commission Board. This includes a representative of the Ministry of Finance, a representative of the Central Bank, and two representatives of the Federal Assembly.[33] The appointing authorities for, and the terms of office for, the Board members vary. The Chairman of the Federal Securities Commission is appointed by the prime minister.[34] The office of the first deputy chairman, the deputy chairmen, and the secretary of the Federal Securities Commission are filled by government civil service appointees.[35]

The Securities Law calls for the establishment of a 25-member Expert Council to advise the Board of the Federal Securities Commission on certain matters.[36] Such matters of advisement are the scope of authority of the Federal Securities Commission, securities market regulation, draft instructions, and legislation.[37] The Expert Council can suspend for up to six months the effective date of a decision or an instruction of the Federal Securities Commission.[38] Yet, the Federal Securities Commission Board exercises independent control over the Expert Council.[39] The Expert Council includes representatives of state agencies and organizations involved in the regulation of financial and securities markets, securities market participants, self-regulatory organizations, relat-

28. *Securities Law*, *supra* note 2, art. 40.

29. *Id.* art. 2.

30. *Id.* art. 46. The official address of the Federal Securities Commission is Leninsky Prospect # 9, Moscow, Russia.

31. *Id.* art. 47. Regional offices may be established by decree of the Federal Securities Commission with concurrence of the executive agencies of the constituent members of the Russian Federation. *Id.* The chairman of each regional office is confirmed by the Federal Securities Commission based on a joint proposal by the head of the executive authorities of the affected constituent member of the Russian Federation and the Chairman of the Federal Securities Commission. *Id.*

32. *Id.* art. 41.

33. *Id.*

34. *Decree #1177*, *supra* note 24.

35. *Securities Law*, *supra* note 2, art. 40.

36. *Id.* art. 41.

37. *Id.* art. 45.

38. *Id.*

39. *Id.* art. 41.

ed union associations, and independent experts.[40] State agencies and organizations nominate their representatives. The Federal Securities Commission Board confirms or denies the nominations.[41] The Board also confirms representatives nominated by securities market participants.[42] The Chairman of the Expert Council, who serves as an *ex officio* member of the Federal Securities Commission Board,[43] is elected by the Expert Council and confirmed by the Chairman of the Federal Securities Commission.[44] Members of the Expert Council may be appointed for an unlimited number of two-year terms.[45]

At the time the Federal Securities Commission was established, both the Ministry of Finance and the Federal Securities Commission had overlapping authority for securities market regulation as a result of different presidential decrees and government legislation.[46] Presidential decree recently clarified the authority of the two parties. Now, the Federal Securities Commission is primarily responsible for the regulation of the securities market. Without its approval, no other agency may act on matters within the Federal Securities Commisssion's competence.[47] Nevertheless, the Federal Securities Commission's jurisdiction is not exclusive because some of its actions require the concurrence of the Central Bank,[48] authorities of certain constituent republics, and regions of the Russian Federation, or various other agencies.[49]

C. *The Central Bank of the Russian Federation*

The Central Bank of the Russian Federation (Central Bank) was established in 1990 as an independent central bank, replacing its predecessor, the USSR Gosbank.[50] The Central Bank is responsible for con-

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40. *Id.*
41. *Id.* art. 45.
42. *Id.*
43. *Id.* art. 41.
44. *Id.* art. 45.
45. *Id.* art. 41.
46. The Ministry of Finance is the most important government ministry in terms of its influence over the economy. The board of the Federal Securities Commission includes a representative of the Ministry of Finance. *See supra* text accompanying note 33.
47. *Decree #1009*, *supra* note 22, § 9. *But see supra* note 24.
48. *See infra* text accompanying note 72.
49. *See supra* note 31.
50. Federal'nyi zakon "O Tsentralnom Banke Rossiyskoi Federatsii" [Federal Law No. 394-1 "On the Central Bank of the RSFSR (Bank of Russia)"] (Dec. 2, 1990),VEDOMOSTI S'EZDA NARODNYKH DEPUTATOV I VERKHOVNOGO SOVETA ROSSIYSKOI FEDERATSII 1990, No. 27, Doc. 356, *translated in* Economic Law of Russia, "Federal Law No. 394-1 of December 2, 1990, on the Central Bank of the Russian Federation (Bank of Russia)" (Garant-Service 1996, Doc. 5802) *available in* LEXIS, Intlaw Library, RFLaw File [hereinafter *Central Bank Law*], *reworded and amended by* Federal'nyi zakon #65-FZ "O vnecenii ismenenii i dopolnenii v Zakon RSFSR O Tsentralnom Banke RSFSR (Banke Rossi)" [Federal Law No. 65-FZ "On Amending the RSFSR Law on the

ducting a single state monetary-credit policy in cooperation with the Russian government. Its aim is to stabilize and protect the ruble[51] and to regulate the banking system,[52] the supervising banks, and other credit organizations.[53] It can issue prospective regulations consistent with federal legislation.[54] It also may grant credits of up to one year against securities; buy and sell securities of companies and government securities; conduct settlement, cash, and deposit operations; and function as a custodian and asset manager.[55] The Central Bank has its own reserve funds, the use of which are determined by its Board of Directors.[56]

Central Bank of the RSFSR (the Bank of Russia)"] (Apr. 26, 1996) (amended July 31, 1995, and Jan. 4, 1996), SOBR. ZAKONOD. R.F. 1995, No. 18, Doc. 1593, *translated in* Economic Law of Russia, "Federal Law No. 65-FZ of April 26, 1996 On Amending the RSFSR Law on the Central Bank of the RSFSR (the Bank of Russia)(with the Additions and Amendments of July 31, 1995, January 4, 1996)" (Garant-Service 1996, Doc. 4640), *available in* LEXIS, Intlaw Library, RFLaw File; Federal'nyi zakon #214-FZ "O vnesenii dopolnenia v statu 83 Federalnogo zakona "O Tsentralnom Banke Rossiyskoi Federatsii" [Federal Law No. 214-FZ "On Supplementing Article 83 of the Federal Law on the Central Bank of the Russian Federation (Bank of Russia)"] (Dec. 27, 1995), SOBR. ZAKONOD. R.F. 1996, No. 1, Doc. 7, *translated in* Economic Law of Russia, "Federal Law No. 214-FZ of December 27, 1995, On Supplementing Article 83 of the Federal Law on the Central Bank of the Russian Federation (Bank of Russia)" (Garant-Service 1996, Doc. 5701), *available in* LEXIS, Intlaw Library, RFLaw File . The Central Bank Law came into force on December 2, 1995, under Postanovlenie VS RSFSR ot 2 dekabria 1990 g. "O poriadke vvedenia v deistvie Zakona RSFSR O Tsentralnom Banke RSFSR (Banke Rossii) i Zakona RSFSR" and "O bankakh i bankovskoi deitelnosty v RSFSR" [Resolution of the Supreme Soviet of the RSFSR of December 2, 1990, on Entry into Force of the Laws of the RSFSR "On the Central Bank of the RSFSR (The Bank of Russia)" and "On Banks and Banking in the RSFSR"], VEDOMOSTI S'ESDA NARODNYKH DEPUTATOV I VERKHOVNOGO SOVETA ROSSIYSKOI FEDERATSII 1990, No. 27, Doc. 358, *translated in* Economic Law of Russia "Resolution of the Supreme Soviet of the RSFSR of December 2, 1990 on Entry into Force of the Laws of the RSFSR on the Central Bank of the RSFSR (the Bank of Russia) and on Banks and Banking in the RSFSR" (Garant-Service 1996, Doc. 5804), *available in* LEXIS, Intlaw Library, RFLaw File.

51. *Central Bank Law*, *supra* note 50, art. 35. The basic instruments of the single monetary-credit policy of Russia regulated by the Central Bank are interest rates, reserve requirements of the Central Bank, market operations, bank refinancing, currency regulation, guidelines for the growth of monetary stock, and direct qualitative restrictions on the refinancing of banks and the banking operations carried out by credit organizations. *Id.*

52. *Id.* art. 4. The main functions of the Central Bank in relation to banking operations include: (1) issuing currency and organizing cash circulation; (2) acting as a creditor of the last resort for credit organizations and organizing a bank refinancing system; (3) establishing rules for settlements and banking operations; (4) registering, licencing, and supervising credit organizations; (5) registering securities issued by credit organizations; (6) forecasting the balance of payments; and (7) carrying out all types of banking operations for the fulfillment of its functions. *Id.*

53. *Id.* arts. 77-79.

54. *Id.* art. 6.

55. *Id.* art. 45.

56. *Id.* art. 10.

The seat of the Central Bank is in Moscow.[57] It also has territorial institutions or regional divisions, including the National Banks of the constituent republics.[58] The functions of its divisions are determined by Central Bank regulations.[59] Although the heads of the territorial institutions may be invited to participate at the meetings of the Board of Directors of the Central Bank,[60] the territorial institutions do not generally have any rule-making authority.

The main decision-making body of the Central Bank is its twelve-member Board of Directors,[61] headed by the Chairman of the Bank.[62] The Minister of Finance and the Minister of Economics are, by custom, members of the Board of Directors. The Central Bank consults the Ministry of Finance about government securities and the national debt.[63] The Central Bank also has a consultative body, the National Banking Council,[64] to review policy and legislation.[65]

The Central Bank is responsible to the Duma. The Duma appoints and removes the Central Bank's Chairman and its members of the Board of Directors.[66] Additionally, it appoints auditors to the Central Bank.[67] The Chairman reports to the Duma on the Central Bank's activities.[68]

The Central Bank has one representative on the Board of the Federal Securities Commission.[69] In conjunction with the Federal Securities Commission, the Central Bank determines certain rules, including those governing securities issued by banks,[70] and those regulating securities denominated in foreign currency.[71] The Central Bank must approve in-

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57. *Id.* art. 1.
58. *Id.* art. 83.
59. *Id.* art. 84.
60. *Id.* arts. 14, 19.
61. *Id.* art. 16.
62. *Id.* art. 11. The Chairman is nominated by the President and appointed by the Duma. *Id.* art. 12.
63. *Id.* art. 19. *See also supra* text accompanying note 49.
64. *Central Bank Law*, *supra* note 50, art. 20. The Chairman of the Central Bank presides over the National Banking Council which includes two representatives from each house of the Federal Assembly and one representative of each of the Executive Office, the Government, and the Ministries of Finance and Economics. Representatives of the Central Bank, credit organizations, and additional experts are appointed to the Council by approval by the Duma of the Chairman's nomination. *Id.*
65. *Id.* art. 21. The National Banking Council considers the drafts of the basic directions of the monetary-credit policy that are issued each year by the Central Bank to the Duma for approval. The drafts reflect the policy of currency regulation and control, give opinions thereon and analyze the results of their implementation; examine the draft legislative and normative acts related to banking; considers the regulation of credit organizations; and assist in the formulation of settlement regulations. *Id.*
66. The members of the Board are nominated by the Duma. *Id.* art. 13.
67. *Id.* art. 5.
68. *Id.*
69. *Securities Law*, *supra* note 2, art. 41.
70. *See generally id.* arts. 27-34.
71. *Id.* art. 43.

structions issued by the Federal Securities Commission affecting banks and the regulation of currency fund assets.[72]

D. *Self-Regulatory Organizations*

Self-regulatory organizations (SROs), such as the National Association of Securities Market Participants (NAUFOR),[73] regulate professional securities market participants, protect the clients and security owners thereof, and determine rules and standards for transactions with securities that enhance market efficiency.[74] SRO members are subject to the overlapping jurisdiction of the SROs, the Federal Securities Commission, and other federal ministries and agencies, such as the Ministry of Finance.

Each SRO must adopt rules and regulations governing its operations and its members. Such rules must provide for professional qualifications of certain persons associated with the SROs' members, minimum capital requirements, standards of conduct, price manipulation limitations, sanctions of SRO members and persons associated with members, and nondiscriminatory procedures for the application of sanctions.[75] The rules and regulations must be submitted to the Federal Securities Commission forming one of the bases on which the Federal Securities Commission may grant a permit authorizing the formation of an SRO.[76] If an SRO was licensed prior to April 25, 1996, it has up to one year, subject to an additional one-year extension, to conform its constituent documents and other rules to the Securities Law.[77]

SROs are primarily concerned with policing their members and persons associated with their members, adopting rules governing trading in securities, and settling disputes among their members. For the most part, SROs are not concerned with disclosure requirements nor with substantive regulation of the companies because the securities are traded by their members. Each SRO establishes the requirements for listing on its exchange and, in the case of NAUFOR, for quotation outside the stock exchanges.

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72. *Id.*

73. Until recently, NAUFOR was known as the Professional Association of Securities Market Participants, or PAUFOR. *See* ADAM SMITH INSTITUTE, CAPITAL MARKET REPORT 2, 2 p.12 (July 4, 1996).

74. *Securities Law*, *supra* note 2, art. 48.

75. *Id.* art. 50.

76. *Id.*

77. *Id.* art. 52.

III. SECURITIES LAWS

A. *Civil Code of the Russian Federation*

The Civil Code of the Russian Federation provides a general framework for securities legislation[78] and for legal entities such as general and limited partnerships, limited liability companies, and joint stock companies.[79] The Civil Code is supplemented by other federal legislation, such as the Securities Law[80] and the Joint Stock Company Law.[81] The types of securities recognized by the Civil Code are discussed below.[82]

B. *Federal Law "On Securities Market"*

The Securities Law, effective as of April 25, 1996,[83] is the primary legislation concerning the issuance of securities by companies and operations of securities markets in the Russian Federation. The Securities Law is divided into several sections concerning, *inter alia,* securities market participants, offerings of securities by companies, continuous disclosure of information about issuers of securities, market regulation, the organizational structure of the Federal Securities Commission, and enforcement. The Securities Law also defines the responsibilities of various securities market participants that were formerly regulated by several government resolutions.[84]

C. *Government Resolutions Concerning Securities*

Until recently, the principal regulations concerning securities were government resolutions and instructions of several government agencies, one of them being the Ministry of Finance. Before the adoption of the Securities Law, Government Resolution #78[85] regulated most aspects of the securities markets and provided the legal framework for conducting securities operations. Although Government Resolution #78 has not

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78. *Civil Code, supra* note 1, ch. VII.

79. *Id.* ch. IV.

80. *See Securities Law, supra* note 2.

81. *See Joint Stock Company Law, supra* note 3.

82. *Civil Code, supra* note 1, arts. 143, 149. *See generally infra* part V.

83. The Securities Law came into force on April 25, 1996, the date of its official publication in ROSSIYSKAYA GAZETA. *See Securities Law, supra* note 2, art. 53.

84. *Id.* arts. 3-15.

85. Postanovlenie Pravitelstva RF #78 "Ob uterjdenii polojenia o vypuske i obrahsenii tsennykh bumag i fondovykh birjakh v RSFSR" [Government Resolution #78, "Regulations of Issuance and Circulation of Securities and Stock Exchanges"] (Dec. 28, 1991), FINANCIAL NEWSPAPER 1992, No. 5, *translated in* Economic Law of Russia, "Regulations for the Issue and Circulation of Securities and for Stock Exchanges in the RSFSR of December 28, 1991 (Approved by Decision of the Government of the RSFSR No. 78 of December 28, 1991)" (Garant-Service 1996, Doc. 5034), *available in* LEXIS, Intlaw Library, RFLaw File [hereinafter *Government Resolution #78*].

been repealed, some of its provisions are no longer applicable, because they have been codified by the Securities Law. However, certain aspects of Government Resolution #78 remain important. For example, the provisions concerning investment institutions, such as financial consultants and investment companies, are beyond the scope of the Securities Law and are not otherwise regulated.

Government Resolution #78 was supplemented by other instructions and orders of government agencies having jurisdiction over the securities market. In particular, several instructions of the Ministry of Finance elaborated on specific matters of securities issuance, trading rules, and registration requirements.[86] Most of these regulations have been super-

86. Some of the more important regulations and instructions are Instruktsia Minfina RF #2 "O pravilakh vypuska i registratsii tsennykh bumag na territorii Rossiyskoi Federatsii" [Instruction of the Ministry of Finance #2 "Regulations on the Issuance and Registration of Securities on the Territory of the Russian Federation"] (Mar. 3, 1992) (amended Jan. 27, Feb. 4, and Nov. 15, 1993), FINANCIAL NEWSPAPER 1992, No. 11, *translated in* Economic Law of Russia, "Instruction of the Ministry of Finance of the RSFSR No. 2 of March 3, 1992 on Rules for Issue and Registration of Securities on the Territory of the Russian Federation (with the Additions and Amendments of January 27, February 4 and November 15, 1993)" (Garant-Service 1996, Doc. 5102), *available in* LEXIS, Intlaw Library, RFLaw File; Pismo Minfina RF #59 "O poriadke sostavlenia i predstavlenia emitentami tsennykh bumag otchetov ob itogak vypuska tsennykh bumag i o sostavlenia i predstavlenia aktsionernymi obshestvami godovykh otchetov po tsennymi bumagami" [Ministry of Finance Letter #59 "On Procedures for Submission by the Issuers of Securities the Reports on the Results of the Issue of Securities and Procedures for Submission by Joint Stock Companies of Annual Reports on Securities"] (May 5, 1994) ROSSIYSKIE VESTI No. 95, May 26, 1994, *translated in* Economic Law of Russia, "Letter of the Ministry of Finance of the Russian Federation No. 59 of May 5, 1994 on the Procedure for Making Up and Submitting by the Issuers of Securities the Reports on the Results of the Issue of Securities and the Procedure for Making Up and Submitting by Joint Stock Companies Annual Reports on Securities" (Garant-Service 1996, Doc. 2981), *available in* LEXIS, Intlaw Library, RFLaw File; Pismo Minfina RF#53 "Instruktsia o pravilakh sovershenia i registratsii sdelok s tsennymi bumagami (izdana na osnovanii postanovlenia Pravitelstva Rossiyskoi)" [Ministry of Finance Letter #53 "On Securities Trading"] (July 6, 1992) FINANCIAL NEWSPAPER 1992, No. 28, *translated in* Economic Law of Russia, "Letter of the Ministry of Finance of the Russian Federation No. 53 of July 6, 1992 on Securities Trading (issued pursuant to Decision of the Government of the RSFSR No. 78 of December 28, 1991)" (Garant-Service 1996, Doc. 7080), *available in* LEXIS, Intlaw Library, RFLaw File; Pismo Minfina RF 5-1-04 "O Vypolneni osobykh uslovii sovershenia sdelok, sviazannykh s priobreteniem krupnykh paketov aktsii" [Ministry of Finance Letter #5-1-04 "On Fulfillment of Special Conditions for Acquisition of Large Shareholdings"] (May 13, 1993) ROSSIYSKIE VESTI No. 95, May 26, 1994, *translated in* Economic Law of Russia, "Letter of the Ministry of Finance of the Russian Federation No. 5-1-04 of May 13, 1993 on the Fulfillment of Special Conditions for Making Transactions with Acquired Large Shareholdings" (Garant-Service 1996, Doc. 1743), *available in* LEXIS, Intlaw Library, RFLaw File; Prikaz GKAP "Ob utverjdenii instruktsii o poriadke kontrolia za priobreteniem paev dolei uchastya tovarishestv i prostykh imennykh aktsii aktsionernykh obshestv i poriadke priznania lits, kontrolirushikh imushestva dryg dryga" [Instruction of the Russian State Anti-monopoly Committee No. 5 "Control Over the Acquisition of Shares and Stakes of Partnerships and Common Shares of Joint Stock Companies and on the Recognition of Persons Con-

seded by the Securities Law.

D. *Instructions of the Federal Securities Commission*

The Federal Securities Commission exercises its rule-making authority by instructions approved by the Federal Securities Commission Board and signed by its Chairman.[87] All decrees must be considered by the Expert Council before their adoption is valid.[88] Instructions issued by the Federal Securities Commission concerning matters within its authority are binding on all federal ministries and executive agencies, the executive agencies of constituent members of the Russian Federation, agencies of local government, securities market participants, and SROs.[89] No regulations concerning the securities markets, or the activities of securities market participants and SROs, may be adopted by other federal ministries and executive agencies without concurrence of the Federal Securities Commission.[90]

When the Federal Securities Commission was established in 1994, it was primarily responsible for creating a legal framework for mutual funds in Russia.[91] During 1994-1995, most of the activities of, and instructions issued by, the Federal Securities Commission concerned mutual fund regulation.[92] Recently, the Federal Securities Commission has

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trolling the Property of One Another"] (Jan. 18, 1994) ROSSIYSKIE VESTI No. 55, Mar. 29, 1995, *translated in* Economic Law of Russia, "Order of the State Committee of Russia for Anti-monopoly Policy and Support for New Economic Structures No. 5 of January 18, 1994 on the Approval of the Instructions on the Control over the Acquisition of Shares and Stakes of Partnerships and Ordinary Registered Shares of Joint-stock Companies and on the Recognition of Persons Controlling the Property of One Another (with the Additions and Amendments of December 29, 1994) (abolished)" (Garant-Service 1996, Doc. 1538), *available in* LEXIS, IntlawLibrary, RFLaw File; Ministry of Finance letter #5-1-06 (Aug. 19, 1993) "On Stock Exchange Activity", NORMATIVNYE ACTY PO FINANSAM, NALOGAM I STRAKHOVANIYU 1994, No. 2 (1994), *translated in* Economic Law of Russia, "Letter of the Ministry of Finance of the Russian Federation No. 5-1-06 of August 19, 1993 on Stock Exchange Activity" (Aug. 30, 1995)(Garant-Service 1996, Doc. 3605), *available in* LEXIS, Intlaw Library, RFLaw File.

87. *Securities Law*, *supra* note 2, art. 43.

88. *Id.*

89. *Id.*

90. *Id.*

91. *Decree #2063*, *supra* note 21, art. 6.

92. Postanovlenie Federalnoj Komissii po Tsennum Bumagam #7 "O poryadke litsenzirovaniya deyatelnosti po otsenke nedvizhimogo imushchestva paevykh investitisionnykh fondov" [Resolution of the Federal Securities Commission #7 "On licensing evaluation activities of mutual funds real estate property"] (Aug. 30, 1995) ECON. AND LIFE 1995, No. 41, *translated in* Economic Law of Russia, "Decision of the Federal Commission for Securities and the Capital Market No. 7 of August 30, 1995 on the Procedure for Licensing the Activity Involved in the Appraisal of the Real Estate of Share Investment Funds" (Garant-Service 1996, Doc. 4937) *available in* LEXIS, Intlaw Library, RFLaw File; Postanovlenie Federalnoj Komissii po Tsennum Bumagam #9 "O programme razvitiya paevykh investitsionnykh fondov" [Resolution of the Federal Securities Commission #9 "On development program of mututal funds in Russia"] (Oct. 10, 1995), ECON. AND LIFE 1995, No. 40, *translated in* Economic Law of Russia "Deci-

focused its attention on development of the Russian securities market. It assisted with the preparation of the new Joint Stock Company Law adopted by the Russian Parliament at the end of 1995,[93] and was primarily responsible for drafting the Securities Law.

E. *Privatization Legislation*

The process of privatization of state and municipal enterprises in the Russian Federation is regulated by The Law on "Privatization of State and Municipal Enterprises in the Russian Federation" of July 3, 1991, as amended;[94] Presidential Decree #1535 "On State Privatization

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sion of the Federal Commission on Securities and the Share Market under the Government of the Russian Federation No. 9 of September 1, 1995 Programme of the Development of the Share Investment Funds" (Garant-Service 1996, Doc. 4888), *available in* LEXIS, Intlaw Library, RFLaw File; Postanovlenie Federalnoj Komissii po Tsennym Bumagam #13 "O tipovkykh pravilakh otkrytogo investitsionnogo fonda" [Resolution of the Federal Securities Commission #13, Model Rules of Open Mutual Funds] (Oct. 12, 1995) (as amended), ROSSIYSKAYA GAZETA, Nov. 18, 1995, *translated in* Economic Law of Russia, "Decision of the Federal Commission on Securities and the Capital Market No. 13 of October 12, 1995 on the Standard Rules for an Open Unit Investment Fund (with the Amendment and Addenda of January 12, 1996)" (Garant-Service 1996, Doc. 5513), *available in* LEXIS, Intlaw Library, RF Law File [hereinafter *Resolution #13*]; Postanovlenie Federalnoj Komissii po Tsennym Bumagam #15, O tipovom prospecte emissii investitssionnykh paev [Resolution of the Federal Securities Commission #15, Model Stock Prospectus of Investment Shares of Mutual Funds] (Oct. 18, 1995) (as amended), ROSSIYSKAYA GAZETA, Nov. 16, 1995, *translated in* Economic Law of Russia, "Decision of the Federal Commission on Securities and the Capital Market No. 15 of October 18, 1995 on the Standard Prospectus for an Issue of Investment Units (with the Amendments and Addenda of January 11, 1991)" (Garant-Service 1996, Doc. 5515), *available in* LEXIS, Intlaw Library, RFLaw File [hereinafter *Resolution #15*]; Postanovlenie Federalnoj Komissii po Tsennym Bumagam #14 [Resolution of the Federal Securities Commission #14 Model Rules of Interval Mutual Funds] (Oct. 16, 1995) *translated in* Economic Law of Russia, "Decision of the Federal Commission on Securities and the Capital Market of the Government of the Russian Federation No. 14 of October 16, 1995 on Standard Rules for an Interval Unit Investment Fund (with the Amendments and Addenda of January 11, 12, 1996)" (Garant-Service 1996, Doc. 5515), *available in* LEXIS, Intlaw Library, RFLaw File. *See infra* part IX.B. One exception is Postanovlenie Federalnoj Komissii po Tsennym Bumagam #6, Vremennyi poryadok litsenzirov aniya deyatelnosti po vedeniyu reestrov vladeltsev immennykh tsennykh bumag [Temporary Regulations on Licensing Activities of Specialized Registrars approved by the Resolution of the Federal Securities Commission #6] (Aug. 30, 1995) *translated in* Economic Law of Russia, "Declaration of the Federal Commission on Securities and the Capital Market No. 6 of August 30, 1995 on Interim Procedures for Licensing and Maintenance of Registries of Holders of Registered Securities" (Garant-Service 1996, Doc. 6943), *available in* LEXIS, Intlaw Library, RFLaw File [hereinafter *FSC Regulation #6*], which concerns registrars. *See also infra* part VI.C.4.

93. *See Joint Stock Company Law*, *supra* note 3.

94. Zakon "O Privatizatsii gosudarstvennykh i munitsipialnykh predpriyatiy v Rossiyskoi Federatsii" [Law on "Privatization of State and Municipal Enterprises in the Russian Federation"] (July 3, 1991)(as amended) ROSSIYSKAYA GAZETA, July 19, 1991, *translated in* Economic Law of Russia, "Law of the Russian Federation of July 3, 1991 on the Privatization of State (Additions and Amendments of June 5, 1992") (Garant-Service 1996, Doc. 5710), *available in* LEXIS, Intlaw Library, RFLaw File.

Program for State and Municipal Enterprises after July 1, 1996" of July 22, 1994;[95] RF GKI[96] Regulations #342-R "Regulations on Investment Tenders for Sale of Shares of Privatized State and Municipal Enterprises" of February 15, 1994;[97] and RF GKI Instruction #151-r on "Investment Tenders" of January 28, 1993, as amended.[98] Although other federal regulations may be relevant, they are supplemental in nature to the legal framework established by the above-mentioned legislation.

Privatization in Russia was introduced following the collapse of the USSR and at the beginning of the market reform. The distribution of state and municipal property among the general public through voucher privatization provided its cornerstone. Each Russian citizen received one voucher worth of 10,000 rubles that could be exchanged for shares in privatized companies. Privatization attempted to create mass shareholder capital in Russia through organization of voucher tenders, sale of government shares in companies to workers and the general public, and investment tenders. In addition, with respect to regional and municipal enterprises, certain local regulations are relevant, but only if they are consistent with federal legislation. It is worth noting that, with the exception of Moscow, very few Russian autonomous republics or municipal-

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95. Ukaz Presidenta #1535 "Ob osnovnykh polozheniyakh gosudarstvennoy programmy privatizatsii gosudarstvennykh i munitsipalnykh predpriyatiy v Rossiyskoi Federatsii posle 1 iyulya 1994 goda" [Presidential Decree #1535 "On State Privatization Program for State and Municipal Enterprises after July 1, 1994"] (July 22, 1994), SOBR. ZAKONOD. R.F. 1994, No. 13, Doc. 1478, *translated in* Economic Law of Russia, "Basic Provision of the State Programme of Privatisation of State-owned and Municipal Enterprises in the Russian Federation After July 1, 1994 (Approved by Decree of the President of the Russian Federation No. 1535 of July 22, 1994)" (Garant-Service 1996, Doc. 1222), *available in* LEXIS, Intlaw Library, RFLaw File.

96. "RF GKI" are the Russian language initials of the State Property Committee of the Russian Federation or *Gosudarstveney Kommityet Imuschestva*. *See infra* note 97 for full cite.

97. Rasporyazhenie Goskomimushchestva RF ot 15 fevralya 1994 goda #342-r Ob utverzhdenii Polozheniya ob investitisionnom konkurse po prodazhe paketov aktsiy aktsionernykh obtschest, sozdannykh v poryadke privatizatsii gosudarstvennykh i munitsipalnykh predpriyatiy [RF GKI Regulations #342-R "Regulations on Investment Tenders for Sale of Shares of Privatized State and Municipal Enterprises"] (Feb. 15, 1994), ROSSIYSKIE VESTI, No. 52, Mar. 24, 1994, *translated in* Economic Law of Russia, "Order of the State Committee of the Russian Federation for the State Property Management No. 342-r of February 15, 1994 on Approving the Regulations for Investment Contests for Sale of Shareholdings of Joint-stock Companies Set up by Way of Privatization of State owned and Municipal Enterprises" (Garant-Service 1996, Doc. 1537), *available in* LEXIS, Intlaw Library, RFLaw File.

98. Rasporyazhenie Goskomimushchestva RF ot 28 fevralya 1993 #151-r O dopolnenii vtorogo razdela plana privatizatsii predpriyatiy, predusmatrivayushchikh prodazhu chasti aktsiy na investitsionnom konkurse [RF GKI Instruction #151-r on "Investment Tenders"] (Jan. 28, 1993) (as amended), ECONOMY AND LIFE NEWSPAPER 1993, No. 32, *translated in* Economic Law of Russia, "Order of the State Property Management Committee of Russia No. 151-r of January 28, 1993 on Adding the Second Section of Privatization Plan of Enterprises Envisaging Sale of a Part of the Shares on Investment Tenders (with the Additions and Amendments of Oct. 8, 1993)" (Garant-Service 1996, Doc. 1502), *available in* LEXIS, Intlaw Library, RFLaw File.

ities enacted significant privatization regulations to supplement federal regulations.

F. *Other Legislation Affecting Securities*

1. Federal Law "On Joint Stock Companies"

The Joint Stock Company Law, effective as of January 1, 1996,[99] supplements the provisions of the Civil Code concerning joint stock companies.[100] The Joint Stock Company Law is organized into several chapters concerning, *inter alia*, company formation and liquidation,[101] securities and dividends,[102] meetings of shareholders and other constituent bodies (such as boards of directors),[103] purchases by a company of its own shares,[104] transactions involving large blocks of shares,[105] conflicts of interest,[106] and reporting and disclosure requirements.[107] It is a significant addition to Russian company law.

The Joint Stock Company Law authorizes several types of securities, including common stock,[108] convertible securities,[109] bonds and debentures,[110] cumulative preferred stocks,[111] and voting preferred stock.[112] It also permits authorized but unissued shares[113] and treasury shares to be sold to new investors at any time upon the decision of a company's board of directors without further approval of its shareholders. This concept was a novelty in Russian law first introduced by the Joint Stock Company Law.

2. Law "On Currency Regulation and Currency Control"

Another legislative act that impacts securities operations in Russia is the Law "On Currency Regulation and Currency Control" of October 9, 1992 (the "Currency Control Law").[114] It concerns securities denomi-

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99. *Joint Stock Company Law*, *supra* note. 3, art.94.
100. *See generally Civil Code*, *supra* note 1, ch. VI.
101. *See Joint Stock Company Law*, *supra* note 3, ch. II.
102. *See Id.* chs. III, IV, V, and VI.
103. *See Id.* chs. VII and VIII.
104. *See Id.* ch. IX.
105. *See Id.* ch. X.
106. *See Id.* ch. XI.
107. *See Id.* ch. XIII.
108. *Id.* art. 11.
109. *Id.* art. 39.
110. *Id.* art. 33.
111. *Id.* art. 32.
112. *Id.* art. 32.
113. *Id.* art. 27.
114. Zakon "O valyutnom regulirovanii i valyutnom kontrole" [Law "On Currency Regulation and Currency Control"] (Oct. 9, 1992), VEDOMOSTI S'EZDA NARODNYKH DEPUTATOV I VERKHOVNOGO SOVETA ROSSIYSKOI FEDERATSII 1992, No. 45, Doc. 2542, *translated in* Economic Law of Russia, "Law of the Russian Federation No. 3615-1 of

nated in foreign currency and governs procedures for Russian securities transactions in when using foreign currency. The Currency Control Law classifies such securities and transactions as "operation[s] related to the movement of capital,"[115] thus subjecting them to Central Bank licensing procedures.[116]

IV. SECURITIES MARKETS AND PARTICIPANTS

A. *Distribution Markets*

Distribution markets in Russia include companies that first issue securities to the public as well as secondary distributions involving sales of large blocks of outstanding shares by insiders.[117] These markets are largely undeveloped. The initial distributions of securities of most formerly government-owned companies occurred through voucher privatization, a process that is now relevant for historical purposes.[118] To date, most other primary distributions have been carried out by investment banking firms affiliated with major Russian commercial banks and Western investment banking houses, many of which have established operations in Russia. Issuances of securities in the distribution market governed by the Securities Law are discussed below.[119]

October 9, 1992 on Hard Currency Regulation and Control" (Garant-Service 1996, Doc. 2479), *available in* LEXIS, Intlaw Library, RFLaw File [hereinafter *Currency Control Law*].

115. *Id.* arts. 1(8), 10.

116. *Id.* arts.1-2. Pismo Gosbanka SSSR #352 ot 24 maya 1991 goda "Osnovnye polozheniya o regulirovanii valyutnykh operatsiy na territorii SSSR" [Letter of the USSR Gosbank # 352, as subsequently amended by the Russian Central Bank] (May 24, 1991), NORMATIVNYKH ACTOV MINISTERSTV I VEDOMSTV SSSR 1991, No. 12, *translated in* Economic Law of Russia, "Letter of the State Bank of the USSR No. 352 of May 24, 1991 on Basic Provisions of Regulation of Foreign Exchange Operations in the Territory of the USSR (with the Amendments and Additions of Nov. 18, 1991, Jan. 20, Mar. 25, July 16, 1993, and September 2, 1994)" (Garant-Service 1996, Doc. 5607), *available in* LEXIS, Intlaw Library, RFLaw File (providing for detailed procedures on licensing the operations related to the movement of capital. According to these regulations, any sale or purchase of securities for foreign currency has to be licensed by the Central Bank of Russia. Since the licensing process is difficult and time consuming, many Western companies that are heavily engaged in securities trading in Russia, open special investment accounts with Russian banks for settlement purposes. Such accounts may be used for sale and purchase of Russian securities through a two-way conversion of foreign currency into rubles).

117. Transactions concerning large blocks of shares are discussed below. *See infra* part VIII. D.

118. *See* B. Weinstein, *The Russian Federation and the Central Asian Republics, in* INTERNATIONAL CAPITAL MARKETS AND SECURITIES REGULATION § 8E.02[1] (H. Bloomenthal and S. Wolff, eds., 1995).

119. *See infra* part VI.

B. *Trading Markets*

The Russian Trade System (RTS) is an electronic interdealer quotation system operated by NAUFOR for securities traded outside the stock exchanges. The RTS was established by NAUFOR pursuant to the Rules of Trade in the Russian Trade System,[120] which were approved by the NAUFOR board of directors on August 8, 1995. NAUFOR calculates and distributes an inside quotation for each security quoted for which there are at least two market makers displaying firm two-sided quotations.

The Trade Rules apply to transactions in securities among participants in the RTS, provided that such securities are quoted in the RTS by at least one participant.[121] The participant need not be a market maker.[122] A participant must place a firm quotation in the RTS except in certain cases when indicative quotations (*i.e.*, offers wanted, bids wanted) are allowed.[123] Trading sessions on the RTS are from 11:00 a.m. to 6:00 p.m. on business days.[124] The minimum unit of trading cannot be less than US $10,000 and the maximum spread inside quotations may not exceed ten percent of the best quotation. If a quotation is beyond the allowed spread, the participant must alter its quote or withdraw it.[125] All quotations must indicate the currency, using either rubles or US dollars, in which transaction will be settled.[126] If the quotation allows settlement in any currency, then the currency of settlement is determined by whomever initiates the transaction.[127] As of July 1996, there were 21 securities quoted on the RTS.[128] Securities of several substantial Russian companies, including, LukOil, Norilsk Nikel, Mosenergo, Chernogorneft, Rostelekom, and several other, primarily oil, companies, are actively traded on the RTS.

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120. NAUFOR Rules of Trade in the Russian Trade System as approved on August 8, 1995, *Unpublished material available* on file at NAUFOR offices [hereinafter *Trade Rules*].

121. *Id.* art. 5.1.

122. A market maker is a participant approved by the NAUFOR Trading Committee that has assumed certain obligations for quoting securities in RTS. *Id.* Definitions. RTS has a list of market makers that are registered by NAUFOR. Market markers are required to make quotations for a particular lot in the amount not less than U.S.$20,000. *Id.* attachment 2. In the United States, the decision to act as a market maker is often a result of sponsorship by an integrated dealer of a particular security which its investment banking department has previously underwritten. H. Bloomenthal, *United States, in* INTERNATIONAL CAPITAL MARKETS AND SECURITIES REGULATION § 3.03[2][b] (H. Bloomenthal and S. Wolff eds., 1995).

123. *Trade Rules*, *supra* note 120, art. 3.

124. *Id.* Definitions.

125. *Id.* attachment 2, art. 1.1.

126. *Id.* art. 3.2.

127. *Id.*

128. Craig Mellow, *After Slow Start, the New Russia Inspires Bulls,* INT'L HERALD TRIB., July 15, 1996, at 13.

Indicative quotations are permitted either outside or during the trading sessions if a participant announces its quotation and must alter or withdraw it. They are also allowed if the participant is a market maker; otherwise, transactions must be concluded under firm quotations.[129]

Unless otherwise agreed by the participants before conclusion of the transaction, the participants must comply with an integral part of the Trade Rules, the Standard Agreement on Purchase and Sale of Securities (NAUFOR Agreement).[130] The participants must complete the procedure for execution of the NAUFOR Agreement within one business day following the transaction conclusion date, as deemed by the Trade Rules. However, the participants can agree to a later date for procedural compliance, if the participants agree at the moment of conclusion of the transaction.[131] The procedures provide, *inter alia,* that the NAUFOR Agreement be registered with NAUFOR on the date of its execution.[132] The seller of securities may register the NAUFOR Agreement prior to its execution.[133] Violation of the procedures is not a sufficient basis for refusal to conclude a transaction or for the termination of an executed NAUFOR Agreement.[134]

The Trade Rules require the seller of securities to report the transaction to NAUFOR before 7:00 p.m. of the day of conclusion of such transaction.[135] The report must include the price, number of securities, terms of payment, name of the buyer, and the name of the party that undertook the registration of the transaction.[136] Registration of transactions on RTS must be effected within three business days, if the registrar is located in Moscow. If the registrar is located outside of Moscow, registration must occur within seven business days.[137]

The importance of stock exchanges is uncertain; however, the relative importance of exchanges, especially the larger exchanges, such as the Moscow Stock Exchange, the St. Petersburg Stock Exchange, and the Vladivostok Stock Exchanges, can be expected to grow in importance as the Russian securities market continues to develop. Presently, there are 66 stock exchanges, or the securities departments of commodities exchanges, operating on the basis of licenses awarded by the Ministry of Finance.[138] Shares, some bonds issued by privatized companies, and government securities, bonds, and negotiable promissory notes are trad-

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129. *Trade Rules, supra* note 120, art. 3.2.
130. *Id.* attachment 1, art. 5.6.
131. *Id.* art. 5.7.
132. *Id.*
133. *Id.*
134. *Id.*
135. *Id.* art. 7.1.
136. *Id.* art. 7.
137. *Id.* art. 6.3.
138. A. Bürger, *Capital Markets in Central and Eastern Europe: Impact of the European Agreements,* INT'L BUS. LAWYER, Mar. 1996, at 122 [hereinafter *Capital Markets*].

ed.[139]

C. *Securities Market Participants*

The Federal Securities Commission's authority with respect to licensing of securities market participants extends to brokers, dealers, clearing organizations, asset managers, depositaries, and registrars.[140] Securities market participants also include so-called "investment institutions," a concept that survived from Government Resolution #78. Investment institutions may function in all the securities market participant categories identified under the Securities Law.[141] Another category of securities market participants are nominees which are not separately licensed by the Federal Securities Commission. The Securities Law contemplates integration of securities market participants in most phases of the securities business.[142] Currently, a commercial bank may act in any of the foregoing capacities without a separate license from the Federal Securities Commission. Commercial banks do not require a separate license for acting as security market participants, because they must be independently licensed by the Central Bank to operate.[143] Securities market participants also are regulated by the SROs, if any, to which they belong.[144]

1. Brokers and Dealers

According to the Securities Law, in order to engage in brokerage and dealing activities in Russia, brokers[145] and dealers[146] (broker-dealers) must be licensed by the Federal Securities Commission or by state agencies to which the Federal Securities Commission has granted

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139. *Id.*

140. *Securities Law*, *supra* note 2, ch. 2, arts. 3-10.

141. Government Resolution #78, *supra* note 85, provision III, arts. 14-15. Government Resolution #78 defined four categories of investment institutions: broker, investment consultant, investment company, and investment fund. The Securities Law codified the status of a broker. There is a draft law on investment funds which is expected to clarify their status. It is not clear, however, what will happen to investment consultants and investment companies since the regulation of their activities is not covered in the Securities Law.

142. Registrar activities may not be combined with other securities market participant activities. Integration may be further limited by determination of the Federal Securities Commission. *Securities Law*, *supra* note 2, art. 10.

143. *Id.* art. 52. *See infra* part IV.E. This authority is temporary. *See infra* text accompanying note 151.

144. *See infra* part IV.D.

145. A "broker" is a securities market participant that concludes securities transactions as an agent or commission agent under an instruction or commission or a power of attorney for the account of others. *Securities Law*, *supra* note 2, art. 3.

146. "Dealers" are securities market participants that conclude securities transactions on their own behalf, and at their own expense, through public two-sided quotations. *Id.* art. 4.

general licensing authority.[147] Since the Federal Securities Commission has not yet issued licensing requirements concerning broker-dealers, the existing regulations of the Ministry of Finance and other government agencies still apply to the extent that they are consistent with the Securities Law.[148] The scope of exemptions from licensing is uncertain.[149] Currently, a bank may act as a broker-dealer based on its Central Bank license without a separate license from the Federal Securities Commission.[150] Broker-dealers also are subject to regulation and disciplinary proceedings by SROs in which they participate.[151]

The authority of the Ministry of Finance to issue licenses to broker-dealers has been technically superseded by the authority granted to the Federal Securities Commission under the Securities Law. Nonetheless, all current brokerage licenses were issued by the Securities Department of the Ministry of Finance.[152] At the beginning of 1995, there were approximately 13,000 specialist brokers registered with the Ministry of Finance.[153]

In 1993 and 1994, 1,380 and 1,400 investment institutions were issued licenses by the Ministry of Finance.[154] Before beginning operation, an investment institution must obtain a special license of the Ministry of Finance or of a financial department of local municipal administrations, as appropriate.[155] A company's application for licensing must include, *inter alia,* its certificate of incorporation and other corpo-

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147. *Id.* arts. 39, 44(1), 51(6).

148. Today the principal documents governing the licensing of broker-dealers are Government Resolution #78 and the Pismo Ministerstva Finansov RF "O litsenzirovanii deyatelnosti na rynke tsennykh bumag v kachestve investitsionnykh institutov" [Letter of the Ministry of Finance of the Russian Federation No. 91 "On Licensing the Activities of Investment Institutions on the Securities Market"] (Sept. 21, 1992) (amended Dec. 28, 1992, Dec. 22, 1993, Mar. 31, 1993, May 11, 1994, and Aug. 15, 1994), ECONOMY AND LIFE NEWSPAPER 1992, No. 42, *translated in* Economic Law of Russia, "Letter of the Ministry of Finance of the Russian Federation No. 91 of September 21, 1992 on the Licensing of Activities of Investment Institutions on the Securities Market (with the Additions and Amendments of December 28, 1992, December 22, March 31, 1993, May 11, August 15, 1994)" (Garant-Service 1996, Doc. 2474), *available in* LEXIS, Intlaw Library, RFLaw File [hereinafter *MinFin Letter #91*].

149. Persons dealing exclusively in private securities transactions, *i.e.,* where there is no public quotation, and persons announcing one-sided quotations, by definition, may be exempt from the licensing requirements under the Securities Law. *See Securities Law, supra* note 2, arts. 4, 39. It remains to be seen whether Federal Securities Commission instructions will be more expansive.

150. *Id.* art. 52. *See infra* part IV. E. This is consistent with legislation in the European Union.

151. *See infra* part IV.D.

152. *See generally Government Resolution #78, supra* note 85, provision II, art. 2.

153. *Capital Markets, supra* note 138, at 122.

154. *Id.*

155. *Government Resolution #78, supra* note 85, provision III, art 21. Although this provision has been superseded by the Securities Law, all the current brokerage licenses have been issued by the Securities Department of the Ministry of Finance.

rate documents (*i.e.*, charter and founders' agreement), its certified balance sheet, and its qualification certificates entitling its specialists to conduct securities market operations in Russia.[156] MinFin Letter #91 sets forth minimum capitalization requirements for companies that apply for an investment institution license.[157] It is expected that these requirements will be amended by the Federal Securities Commission for each particular type of the investment institution.

The Federal Securities Commission may deny, suspend, or cancel broker-dealer licenses under certain circumstances. The grounds on which a broker-dealer license may be denied are uncertain and will likely be the subject of future instructions of the Federal Securities Commission. "[I]n cases of repeated or gross violation . . . of the legislation of the Russian Federation concerning securities," the Federal Securities Commission may suspend or cancel a broker-dealer's license.[158] If the Federal Securities Commission suspends a broker-dealer's license, the state agency that issued the license must cause the broker-dealer to remedy the violation or cancel the license.[159]

The Securities Law broadly outlines a broker-dealer's obligations to its clients. Thus, a broker-dealer must conscientiously comply with all of its clients instructions.[160] Authority to complete transactions may be assigned to another broker-dealer, but only if the client agrees or, in the absence of the client's agreement, where necessary to protect the client's interests.[161] In every situation, the client must be informed of the assignment. A broker-dealer must complete its clients' transactions before completing transactions on its own behalf.[162] Further, a broker-dealer

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156. *MinFin Letter # 91*, *supra* note 148, art. 7. Qualification certificates were issued by the Ministry of Finance in accordance with the procedures set forth in Pismo Ministerstva Finansov Rossiyskoi Federatsii #23 [Letter of the Ministry of Finance of the Russian Federation #23] (Apr. 21, 1992), FINANCIAL NEWSPAPER 1992, No. 17, *translated in* Economic Law of Russia "Letter of the Ministry of Finance of the Russian Federation No. 23 of Apr. 21, 1992 on the Procedure for Certifying the Specialists Investment Institutions and Stock Exchanges (Stock Departments of Exchanges) for the Conduct of Transactions with Securities (with the Additions and Amendments of Mar. 31, May 5, Dec. 22, 1993, and June 8, 1994)" (Garant-Service 1996, Doc. 5110), *available in* LEXIS, Intlaw Library, RFLaw File.

157. *MinFin Letter #91*, *supra* note 148, art. 3.

158. *Securities Law*, *supra* note 2, art. 44(4). For example, it is grounds for suspension or cancellation of a broker-dealer's license if a broker-dealer is found to have engaged in price manipulation on the securities markets or in securities transactions on the basis of misleading information about securities, issuers, or prices. *Id.* art. 51(2).

159. *Id.* art. 44(4).

160. *Id.* art. 3. Of course, the broker's instructions may specify otherwise, in which case the broker must follow the instruction. *Id.*

161. *Id.*

162. *Id.* "Recent regulations have begun to put rules into place to ensure that the line between brokers and dealers is clear. For instance, entities which hold shares as both nominees and beneficial owner must have two 'personal accounts' in the shareholder register." M. Schwartz, *Russia Capital Markets Update*, 7 LAW OF THE C.I.S.,

is obliged to inform its clients of its interests in transactions that may conflict with its ability to effect the clients' transactions on terms most favorable to the client.[163] In addition, if the broker-dealer acts according to its client's instructions but to the client's detriment without informing the client of conflicts of interest, a broker-dealer must repay its client's losses.[164]

Where a broker-dealer is acting as a commission broker, the commission contract may require the broker-dealer to retain funds for securities investment or to retain securities sale proceeds in the broker-dealer's balance accounts. Further, the commission contract may impose conditions on the broker-dealer's rights to utilize such funds before they are returned to the client.[165] The broker-dealer may not offer any assurance or guarantee to its client regarding profits to be paid while the funds are in the brokers possession.[166] A broker-dealer that trades securities on the RTS must guarantee its client's performance.[167] Thus, if its client fails to perform, the broker-dealer is liable to the other party for any damages incurred as a result of such failure.[168]

Additional conditions of trading may be set by a broker-dealer, such as the amount of securities offered for trade at the declared rate or the duration that the quoted prices apply. If other essential conditions are not included in a broker-dealer's commission contract, then the broker-dealer must act according to any essential conditions proposed by the client. The client may attempt to legally compel the dealer to enter a contract containing such essential conditions. The broker-dealer may be financially liable for any losses suffered by its client by its failure to contract.[169]

2. Clearing Organizations

A clearing organization operates as intermediary in the settlement of securities transactions, including the collection, verification, and correction of information for securities transactions and related documentation.[170] Clearing organizations settle securities transactions through

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Mar. 1996, at 6.

163. *Securities Law*, *supra* note 2, art. 3. For example, a broker-dealer who is also a market maker of a security probably must disclose this fact to its clients; whether more must be disclosed, such as, the structuring of the broker-dealer's commission structure to favor trading in securities in which the broker-dealer is a market maker, is uncertain.

164. *Id.*

165. *Id.*

166. *Id.*

167. *Trade Rules*, *supra* note 120, art. 5.4.

168. *Id.*

169. *Securities Law*, *supra* note 2, art. 4.

170. *Id.* art. 6. The Depositary Clearing Company is one of the first clearing organizations established in Russia.

accounting procedures stipulated in their contracts with their broker-dealer clients. Clearing organizations must maintain special funds to reduce the risks of default in securities transactions.[171] The Federal Securities Commission, in conjunction with the Central Bank, determines the minimum size of the special funds that clearing organizations must maintain.[172]

3. Asset Managers

The Securities Law provisions concerning asset managers were intended to provide a framework for regulation of mutual fund managers. An asset manager is defined as any person, which over a specified period of time and for compensation, manages in trust for its client securities, funds intended to be invested in securities and the proceeds thereof.[173] The Securities Law and contractual obligations define the asset manager's business procedural requirements and the asset manager's rights and obligations.[174] An asset manager must disclose the capacity in which it is transacting business.[175] Conflicts of interest must also be disclosed because asset managers are liable to their clients for any conflict of interest between the client and itself or the client and its other clients, which are not disclosed and which result in financial loss to a client.[176]

4. Registrars

Registrars are legal entities that maintain a register of owners of securities (register) by collecting, recording, processing, storing, and disseminating pertinent ownership information.[177] The register must contain sufficient data to permit identification of all securities holders so that information may be sent to and obtained from them.[178] The registrar's management system also must contain a record of each security holder's rights related to the securities registered in its name.[179] The register consists of a list of registered owners with a statement of the number, the nominal value, and the class of securities owned.[180] Bearer securities are not maintained in a register.[181]

There are two general types of registrars in Russia: independent registrars and so called "pocket" registrars. Pocket registrars are con-

171. *Id.*
172. *Id.*
173. *Id.* art. 5.
174. *Id.*
175. *Id.*
176. *Id.*
177. *Id.* art. 8(1).
178. *Id.*
179. *Id.*
180. *Id.*
181. *Id.*

trolled by, or maintained by, the issuer acting as a registrar.[182] An independent registrar is usually affiliated with a securities market participant or a bank and maintains a register on behalf of more than one issuer,[183] pursuant to instructions of such issuers.[184] The register for companies with more than 500 shareholders must be maintained by an independent specialized registrar.[185] Issuers may contract for the maintenance of the register with only one registrar, although the registrar may delegate some of its functions to other registrars.[186]

Registrars are licensed as a separate class, distinct from licenses issued to other securities market participants, in terms of the types of licenses authorized under the Securities Law.[187] This may be because regulations concerning registrar licensing was one of the first initiatives undertaken by the Federal Securities Commission.[188] In addition to requirements applicable to investment institutions[189] and set forth in MinFin Letter #91,[190] an application for a registrar's license must include, *inter alia,* the registry's internal maintenance rules and a list of joint stock companies planning to use the registrar.[191] The license is issued by the Federal Securities Commission within sixty days after the application[192] for a term of one year and is not transferable to any third party.[193]

Registrars are limited in what they can do to ensure their independence. Registrars may not buy or sell securities of an issuer whose securities are maintained on its register.[194] Indeed, registrars are prohibited from acting as a broker, dealer, clearing organization, asset manager,

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182. *Id.*

183. The number of issuers for whom a registrar may maintain a register is unrestricted. *Id.*

184. In the event of termination or expiration of the contract between the registrar and the issuer, the registrar must transfer all information and documents, including the register as of the date the contract ended, to another registrar selected by the issuer. The issuer must notify the mass media or, in the alternative, send notification to all of its securities holders in writing. *Id.* art. 8(3).

185. *Id.* art. 8(1).

186. *Id.* Such delegation does not relieve the primary registrar of its liabilities to the issuer. *Id.*

187. *Id.* art. 39.

188. *FSC Regulation #6, supra* note 92. Recently, the Federal Securities Commission has amended the regulations concerning registrar activities. Postanovlenie Federalnoy Komissii po rynku tsennykh bumag #18 at 17 Sentyabrya 1996 goda "06 izmeneniyahk idopolneniyahk poryadba Petzenzirovaniya deyatel'nosti po vedeniyu reestra vladeltzev immennykh tsnnykh bumag" [Federal Securities Commission Regulation #18 "On Amending the Procedure for Licensing Registrar Activities"](Sept. 17, 1996)[hereinafter with *FSC Regulation #6, Registrar Regulations*].

189. *See supra* text accompanying note 156 and note 157.

190. *See supra* note 157.

191. *Registrar Regulation, supra* note 188, § 5.

192. *Id.* § 6.

193. *Id.* § 10.

194. *Securities Law, supra* note 2, art. 8(1).

or depositary.[195] Registrars must meet certain minimum capital requirements, equalling approximately U.S. $70,000. Registrars of companies whose controlling shareholders are federally owned require approximately U.S. $140,000 as a minimum capital requirement.[196] The Securities Law also proscribes how a registrar may charge fees and authorizes the Federal Securities Commission to set maximum rates for certain transactions.[197]

Securities owners or their nominees have the right to request a statement of their personal account from the registrar.[198] The registrar must provide this statement containing data on the ownership and the number and type of securities registered to the account within five days of the request free of charge. Fees for the registrar's services generally correspond to the complexity of an issuer's instructions regarding the transfer of securities.[199] The Federal Securities Commission defines the maximum rates for the keeping of a register. The registrar is prohibited from setting fees as a percentage of the value of a securities transaction.[200]

A registrar must maintain a personal account for each owner and nominee of securities,[201] comply with the owners' and nominees' instructions regarding their personal accounts, record transactions in its registered securities,[202] inform securities holders on behalf of the issuer, ensure that owners and nominees holding more than one percent of the issuer's voting securities receive the register, and inform owners and nominees about the rights conferred by their securities and procedures for exercising such rights.[203] Registrars are liable for errors in their op-

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195. *Id.* art. 10.

196. *FSC Regulation #6*, *supra* note 9, §§ 2, 4.

197. The registrar has the right to charge the parties to a transaction a fee corresponding to the number of instructions concerning the transfer of securities, and the fee must be identical for all persons. The registrar may not charge the parties to a transaction a fee based on a percentage of the value of a transaction. The Federal Securities Commission controls the procedure for determining the maximum amount that may be charged for a registrar's services in entering data in the register and issuing statements. *Securities Law*, *supra* note 2, art. 8(3).

198. *Id.*

199. *Id.*

200. *Id.*

201. *Id.* Personal account statements must indicate the owner of the personal account, the number of securities from each issue registered to the account, whether the securities are encumbered, and other information. *Id.*

202. *Id.* A transaction must be recorded if the owner, his agent, or nominee instructs a security transfer. The instruction for the transfer should be in accordance with the registrar's rules of management as defined by the law of the Russian Federation. Alternatively, if the transaction is an initial placement of securities, the instruction should be in accordance with the procedure defined in the present article or on the basis of other documents confirming the transfer of property rights in securities under the civil law of the Russian Federation. *Id.* A registrar may not refuse to record a transaction except in the instances specified by federal laws. *Id.*

203. *Id.*

erations and compilations and for breaches of accounting procedures. In such event, registrars must compensate the affected parties for losses, including lost profits, resulting from the loss of opportunity to exercise the rights conferred by the securities.[204]

5. Nominees

Securities market participants, such as banks, investment institutions, broker-dealers, and depositaries, may act as nominees for shareholders.[205] Nominees are not separately licensed. The Securities Law proscribes detailed arrangements for registrars concerning securities registered in the name of a nominee.[206] The presence of a nominee's name in the register does not indicate any transfer of property rights to the nominal holder. Nominees are permitted to enjoy the rights associated with a security only if the owner expressly conveyed that authority.[207] Securities transactions among clients of the same nominee are not reflected in the register or by the depositary of the nominee.

Nominees holding registered securities must act conscientiously on behalf of their clients, including obtaining and transferring payments due to the clients, following instructions of the clients, and maintaining separate records and accounts on behalf of the clients.[208] Registration of securities held by nominees must be transferred to the name of the owner at the owner's request. A nominee is required to comply with requests from registrars for a complete list of the owners represented by such nominee.

In order to protect the interests of securities owners, nominees are required to record the assets of their clients on separate off-balance accounts. Such assets are not the nominee's property. Thus, the nominee cannot pledge, mortgage, or otherwise encumber the assets. In the case of the nominee's insolvency or bankruptcy, the nominee must return all assets it held on behalf of its client. Such assets are not included in the bankruptcy proceedings.[209] A typical nominee agreement in Russia

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204. *Id.*

205. *Id.* art. 8(2). A depositary may be registered as a nominal holder of securities under the terms of a depositary contract. A broker-dealer may be registered as a nominal holder pursuant to a brokerage agreement. *Id.* In practice, a separate nominee or custodial agreement is executed in connection with depositary and brokerage contracts.

206. *Id.*

207. *Id.*

208. *Id.*

209. Ukaz Presidenta #662 "O merakh po formirovaniyu vserossiyoskoy Telekommukatsionnoy sistemy i obespecheniyu prav sobstvennikov pri khranenii tsennykh bumag i raschetakh na fondovom rynke Rossiyskoi Federatsii" [Presidential Decree #662 "On Measures of Creating Russian Telecommunication System and Protecting the Rights of Owners in Safekeeping of Securities and Settlements on the Russian Securities Market"] (July 3, 1995) (amended Jan. 4, 1996), SOBR. ZAKONOD. R.F. 1995, No. 28, Doc. 2639, *translated in* Economic Law of Russia, "Decree of the President of the Russian Federation No. 662 of July 3, 1995 on the Measures for the For-

obliges the nominee to keep his assets separate from his client's assets. However, a nominee may keep the assets of all his clients together, provided that it has definitive rules to separate such assets among the clients if requested.

6. Depositary

Article 7 of the Securities Law governs security depositaries. Depositaries provide safekeeping for the certificates evidencing securities, as well as other documents evidencing the rights afforded by such securities and transfer instruments[210] and custodial services.[211] Broker-dealers may act as custodians,[212] but safekeeping functions may be performed only by securities market participants licensed to provide depositary and safekeeping services.[213] Depositaries may not engage in any other activities with securities without special permission of the Federal Securities Commission.[214]

Depositary contracts must be in writing and must contain certain essential terms, including the following: a detailed definition of the services provided by the depositary; the method by which the depositor informs and instructs the depositary; the duration of the contract, payment and fee information; the frequency of depositary reports to the depositor; and other obligations of the depositary.[215] The contract also must verify the conditions under which the depositary operates.[216]

No property rights are transferred by a depositary contract. Accordingly, the depositary may not manage, sell, or utilize the depositor's securities unless expressly provided for in the depositary contract and pursuant to the depositor's instructions. The depositary must register any restrictions or duties encumbering the depositor's securities, maintain a separate deposit account for each depositor, and inform the depositor of any securities information recieved from the issuer or relevant registrar. To fulfill its obligations, a depositary may contract with other

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mation of the All Russian Telecommunication System and the Ensuring of the Rights of Owners in the Custody of Securities and in the Settlements of the Russian Federation (with the Additions and Amendments of January 4, 1996)" (Garant-Service 1996, Doc. 3748), *available in* LEXIS, Intlaw Library, RFLaw File, art. 2.

210. *Securities Law*, *supra* note 2, art. 7.

211. Postanovleni Federalnoj Komissi po Tsennum Bumagam #20 "Vremennoey polozhenie o depositarnoy deyatelnosti na rynke tsennykh burnag Rossiyskoj Federatsii i poryadke ee litsuzirovakiya" [Federal Securities Commission Regulation #20 "Temporary Procedures on Depositary Activities on the Securities Market of the Russian Federation and Licensing of Depositary Activities"] (Oct. 20, 1996) § 3, VESTNIK FEDERALNOJ KOMISSII PO RYNKU TSENNYKH BUMAG #4 (Oct. 22, 1996) [hereinafter *Depositary Regulations*].

212. *Id.* § 8.1.

213. *Id.* § 9.1.

214. *Id.* § 9.2.

215. *Securities Law*, supra note 2, art. 7.

216. *Id.*

depositaries or choose to act itself as a depositary.[217] They may also cooperate with another depositary to act as a nominee shareholder, if so authorized under their depositary contracts.[218] Additionally, depositary contracts may allow a depositary to retain revenue obtained from securities held for transfer to its depositors' accounts.[219]

Depositaries are licensed by the Federal Securities Commission or agencies authorized by the Federal Securities Commission.[220] A depositary license authorizes its holder to provide depositary services in any region of the Russian Federation.[221] Applications for licenses are reviewed within thirty days, although the licensing agency may extend the review period by notifying the applicant in writing.[222] Licenses are issued for an indefinite term and cannot be transferred,[223] although they may be revoked if the licensee violates Russian law, engages in activities outside the scope of its license, fails to submit periodic reports ot the Federal Securities Commission, or misrepresents information in the license application or subsequent reports.[224]

The role of the depositaries is expected to increase in the Russian securities market. There have been several attempts to create a unified Russian depositary system that would facilitate all settlements, provide easy access to security ownership information, and ensure the property rights of the securities holders. One of the attempts to create such a system is the recently established Depositary Clearing Company. Currently, it services several Russian companies and brokerage houses. Depositaries are anticipated to play a significant role in investment fund transactions.[225]

D. *National Association of Securities Market Participants (NAUFOR)*

NAUFOR, an SRO with authority over its members, is analogous to the NASD in the United States. Any securities market participant with capitalization over U.S. $100,000 may become a NAUFOR member.[226] Admission decisions are made by the NAUFOR board of directors upon recommendations of an existing member and the NAUFOR

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217. *Id.*
218. *Id.*
219. *Id.*
220. *Depositary Regulations*, supra note 211, § 36.
221. *Id.* § 37.
222. *Id.* §42.
223. *Id.* § 47.
224. *Id.* § 51.
225. For the discussion of the investment funds and the draft legislation on investment funds, see *infra* part IX.A.
226. NAUFOR Membership Rules as approved on April 21, 1995, *unpublished material available* on file at NAUFOR offices, art. 1.1 [hereinafter *NAUFOR Membership Rules*].

membership committee.[227] A nominal admission fee for new membership[228] with a recurring, nominal monthly fee is required.[229] Any NAUFOR member may assign its membership to another entity that is eligible to be admitted if the NAUFOR board of directors approves such assignment.[230] Members may be expelled on the following grounds: payment default of the membership fees during any three-month period, violation of the NAUFOR Membership Rules, or dissolution of the membership. Expulsion requires the vote of three-fourths of the NAUFOR board of directors.[231]

All NAUFOR members must submit disputes among themselves related to securities operations to the NAUFOR arbitration tribunal. Any operation agreement between members must include an arbitration provision.[232]

E. *Role of Commercial Banks in Securities Markets*

Commercial banks may act as issuers of the securities, brokers-dealers, clearing organizations, depositaries, and investors. As issuers, banks may issue shares and bonds, checks, savings books and certificates of deposit, and promissory notes. The issuance of shares by the banks is regulated by Central Bank Instruction #8.[233] Most Russian commercial banks are established as joint stock companies; thus, the issue of shares and bonds by such banks is subject to CB Instruction #8 as well as the Joint Stock Company Law.

Commercial banks also act as depositaries. Large banks, including several subsidiaries of Western banks, initiated American Depositary Receipt programs for their securities in the United States and other markets. The Central Bank promulgated the rules of providing depos-

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227. *Id.* arts. 2.2, 2.3, 3, 4.1, 4.3.

228. U.S.$5,000 is payable within five days after the decision of the board of directors. *Id.* art. 5.1.

229. All members of the association are also required to make periodic payments in the amount of U.S.$500 per month. *Id.* art. 5.2.

230. *Id.* arts. 7.1, 7.5.

231. *Id.* arts. 8.3, 8.5.

232. *Id.* art. 6.3.

233. Instruktsiya Tsentralnogo Banka #8 "O pravilakh vypuska i registratsii tsennukh bumag i kommercheskimi bankami na territorii Rossiyskoi Federatsii" [Central Bank Instruction #8 "On Issuance and Registration of Securities by Commercial Banks in the Russian Federation"] (Feb. 11, 1994) (amended Oct. 6, 1994, Aug. 4, 1995, Jan. 3, 1996, Apr. 11, 1996), FINANCIAL NEWSPAPER 1996, No. 20, *translated in* Economic Law of Russia, "Instructions of the Central Bank of the Russian Federation No. 8 on the Rules for the Issue and Registration of Securities by Commercial Banks on the Territory of the Russian Federation (New Edition) (Approved by Letter of the Central Bank of the Russian Federation No. 75 of February 11, 1994) (with the Additions and Amendments of Oct. 6, 1994, Aug. 4, 1995, Jan. 3, Apr. 11, 1996)" (Garant-Service 1996, Doc. 395), *available in* LEXIS, Intlaw Library, RFLaw File [hereinafter *CB Instruction #8*].

itary services.[234] These rules stipulate that banks may only provide depositary services for Russian securities.[235] They also establish procedures for conducting and reporting depositary operations and for safekeeping of share certificates.[236]

As the government securities market developed,[237] commercial banks played a key part. The Russian Central Bank acts as the main agent for the placement of the federal government securities and appoints commercial banks to act as dealers and depositaries for government securities.

Although banks do not regularly act as broker-dealers (other than through their brokerage departments), in certain cases clients prefer to use a bank rather than a brokerage house. This is particularly true for Western companies that do not have any presence in Russia. In addition, clients often use banks to overcome restrictions imposed by Russian currency regulations.[238] Banks that are licensed to conduct foreign currency operations simplify settlements for a Western company that wants to buy or sell Russian securities for foreign currency. This is because such banks may perform currency conversion operations and may make and receive payments in any currency. In that respect, commercial banks and their brokerage departments have significant competitive advantages over independent Russian broker-dealers that are prohibited from dealing in foreign currency. Recently, some NAUFOR members have raised concerns that commercial banks may eventually oust independent broker-dealers from the market for foreign clients.

V. WHAT IS A SECURITY?

A security is broadly defined under the Civil Code as a document confirming property rights, the exercise or transfer of which must be made by presentment.[239] Thus, for purposes of the Civil Code, securities include bonds (government and company issued), promissory notes, cheques, deposit and savings certificates, bearer savings bank books, bills of lading, shares, privatization securities, and similar docu-

234. Pismo Tsentralnogo Banka #176 "Vremennoe Polozhenie o depositarnykh operatsiyakh bankov v Rossiyskoi Federatsii" [Temporary Regulations on Depositary Operations of Banks in the Russian Federation, approved by the Central Bank Letter # 167] (May 10, 1995), *available in* USIS, *translated in* Economic Law of Russia, "Letter of the Central Bank of Russia No. 167 of May 10, 1995 on Approval Provisional Regulations on the Depositary Operations of Banks in the Russian Federation" (Garant-Service 1996, Doc. 21070), *available in* LEXIS, Intlaw Library, RFLaw File [hereinafter *CB Depositary Regulations*].

235. *Id.* art. 2.1.

236. *Id.* arts. 5.6, 6.1-6.3.

237. For the discussion on government securities, *see infra* part V. C.

238. For the discussion of the Currency Control Law, see *supra* part III. F. 2.

239. *Civil Code*, *supra* note 1, art. 142.

ments.[240] The Civil Code recognizes that securities may be issued in bearer and registered forms[241] and in documentary or non-documentary form.[242]

Similarly, the Securities Law broadly defines a security as a document conferring property and other rights placed by means of issues.[243] Moreover, the rights conferred must be identical within any one issue, regardless of when the security was acquired.[244] Although shares and bonds are particularly identified by the Securities Law, promissory notes, certificates of deposit, and cheques are not expressly excluded and, provided they meet the foregoing criteria, fall within the definition of securities for purposes of the Securities Law. As for joint stock companies, the Joint Stock Company Law identifies typical corporate securities, such as common stock, preferred stock (including voting, nonvoting, and convertible preferred stock), and bonds.[245]

A. *Corporate Securities*

A share is a security that confers on its owner the right to receive dividends, participate in the management of a company (for a joint stock company, through the general meeting of shareholders),[246] and receive distributions in liquidation.[247] The Joint Stock Company Law provides that a company may issue shares of common and preferred stock.[248] Holders of common stock must be given identical rights; however, preferred stock may be issued in several classes with different rights for each class. Nonetheless, the rights granted within each class must be identical.[249] If a company issues several classes of preferred stock, its charter must specify the rights of each class and the priority rights of the preferred stock holders with respect to dividend distributions and distributions in liquidation.[250] A company may issue bearer shares up to a percentage established by the Federal Securities Commission. The percentage is related to a company's paid-up charter capital.[251]

A bond confers on its holder the right to receive the nominal value of the bond at the expiration of the bond's term and a set rate of interest. The bond may stipulate other property rights for its owner in accor-

240. *Id.* art. 143.
241. *Id.* art. 145.
242. *Id.* art. 149.
243. *Securities Law*, *supra* note 2, art. 2.
244. *Id.*
245. *Joint Stock Company Law*, *supra* note 3, arts. 31-33.
246. *Id.* art. 31(2).
247. *Securities Law*, *supra* note 2, art. 2.
248. *Joint Stock Company Law*, *supra* note 3, art. 25(2).
249. *Id.* art. 32.
250. *Id.* art. 32(2).
251. *Securities Law*, *supra* note 2, art. 2.

dance with law.[252] A company may issue bonds only after its charter capital is fully paid. Unsecured bonds may not be issued until a company has at least a three-year operating history. The par value of such bonds may not exceed the amount of the paid-up charter capital. A company may issue asset-backed securities in the form of secured bonds at any time even without an operating history, so long as the aggregate par value of such bonds does not exceed the value of the related collateral.[253]

B. *Promissory Notes*

The Civil Code defines promissory notes as securities that certify the unconditional obligation of a promisor to pay to the holder on a certain date a stated amount of money.[254] The inconsistency between the Civil Code and the Securities Law definitions of "security" creates uncertainty with respect to the issuance and circulations of promissory notes. If a promissory note is not a security under the Securities Law, the promisor does not have to register the promissory note prior to its issue.[255] The Securities Law, however, does not expressly exclude promissory notes from its ambit. For example, if a company issues promissory notes for equal amounts of money and places them in series, the Securities Law governs. Nonetheless, in practice, the potential application of the Securities Law to issuances of promissory notes creates substantial difficulties for Russian companies, particularly in the regions where the local registering agencies believe that all promissory notes should be registered in accordance with the Securities Law. Thus, the drafters of the Securities Law did not learn from the experience of the United States, where the applicability of the securities laws to promissory notes has been a major source of litigation.

C. *Government Securities*

Government securities are primarily debt obligations of local or federal authorities issued to the general public or large financial institutions and banks. At present, most government securities issued by the federal government are one of two types: short-term couponless govern-

252. *Id.*

253. *Joint Stock Company Law*, *supra* note 3, art. 33.

254. *Civil Code*, *supra* note 1, art. 815.

255. Uzak Presidenta #1233 "O zashchite interesov investorov" [Presidential Decree # 1233 "On Protection of Investors' Rights"] (June 11, 1994) (amended Nov. 6, 1996), SOBR. ZAKONOD. R.F. 1994, No. 8, Doc. 803, *translated in* Economic Law of Russia, "Decree of the President of the Russian Federation No. 1233 of June 11, 1994 on the Protection of the Rights of Investors (with the Additions and Amendments of November 6, 1994)" (Garant-Service 1996, Doc. 3093), *available in* LEXIS, Intlaw Library, RFLaw File, art. 1 (providing that promissory notes are not subject to state registration and cannot be placed among unlimited number of investors through public offering).

ment bonds (GKOs) or federal bonds (OFZs). GKOs are primarily traded at a discount and redeemed by the Ministry of Finance at their par value; OFZs, on the other hand, have a fixed interest rate payable quarterly, semi-annually, or annually.

Bonds are issued by the Ministry of Finance in numbered series for a limited time period. The rate of interest is fixed such that all issues of bonds with the same maturity date have the same value.[256] Authorized Russian banks act as depositaries and payment agents. They are selected upon agreement with the initial holders of the bonds, federal ministries, and departments.[257]

Issued in a non-documentary form as entries in the accounts of authorized depositaries, government bonds may be presented for payment or exchanged for tax exemptions within the time periods prescribed by the Ministry of Finance and recorded on a global certificate.[258] A depositary must redeem government bonds for cash or exchange them for tax exemptions within five days after a bond holder submits its application to the depositary.[259] Bond holders can demand immediate payment of the nominal value of their bonds plus accrued interest if the issuer is unable or refuses to perform its obligations under the bond.[260]

The Ministry of Finance may impose restrictions on the circulation of government bonds, including restrictions on settlement, transfer, transactions, and restrictions on maturities.[261] The Ministry of Finance also controls the exchange of government bonds for tax exemptions.[262] Consequently, the Ministry of Finance must publish notices about such restrictions and controls, as well as the issuance and pricing of new bond series on a regular basis.

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256. Pismo Ministerstva Finansov #140 "Polozhenie o poryadke razmeshcheniya, obrascheniya i pogasheniya kaznacheiskikh obyazatelstv" [Letter of the Ministry of Finance # 140] (Oct. 21, 1994) (amended Mar. 9 and Mar. 28, 1995), ROSSIYSKIE VESTI, No. 10, Jan. 19, 1995, *translated in* "Letter of the Ministry of Finance of the Russian Federation No. 140 of October 21, 1994, the Regulations for the Procedure of Placement, Circulation and Payment of Treasury Bonds (with Amendments and Additions of Mar. 9 and Mar. 28, 1995)" (Garant-Service 1996, Doc. 3258), *available in* LEXIS, Intlaw Library, RFLaw File, §§ 1.3, 1.4, 1.6 [hereinafter *MinFin Letter #140*].

257. *Id.* §§ 1.7, 1.9, 2.1.

258. *Id.* §§ 1.8.

259. *Id.* §§ 4.1.1, 4.1.2, 4.1.3.

260. Postanovlenie Pravitelstva Rossiyskoi Federatsii #229 "O vypuske obligatsij vnutrennego gosudarstvennogo valutnogo obligatsionnogo zajma" [Resolution of the Russian Federation Government # 229 "On Issuance of Hard Currency Bonds of Domestic Debt"] (Mar. 4, 1996), SOBR. ZAKONOD. R.F. 1996, No. 12, Doc. 1115, *translated in* Economic Law of Russia, "Decisions of the Government of the Russian Federation No. 229 of March 4, 1996 on the Issuance of Bonds of Internal State Currency Bond Loan (with the Amendments and Additions of Aug. 13, 1996)" (Garant-Service 1996, Doc. 5329), *available in* LEXIS, Intlaw Library, RFLaw File, art. 9.

261. *MinFin Letter #140*, *supra* note 247, § 2.4.

262. *Id.*

The market for federal government securities has recently become more liberalized with respect to foreign investors. As of August 15, 1996, foreign investors may open special "S" accounts at accredited Russian financial institutions to purchase rubles that may be invested in either GKOs or OFZs.[263] Purchases of GKOs or OFZs are made through auctions of new issues or in the trading market. Some restrictions on the operation of the financial markets are still maintained; for example, the Central Bank retains its control of the exchange rates used by Russian banks for transactions with foreign investors and the new regulations did not remove limits on repatriation of funds.

VI. PUBLIC OFFERINGS OF SECURITIES BY COMPANIES

All issuances of securities by companies in Russia require some registration. If securities are not publicly offered, the issuer must register its decision to issue the securities under the Securities Law with an authorized registering agency or the Federal Securities Commission.[264] If securities are publicly offered by a domestic issuer in Russia, the issuance will require registration under the Securities Law and filing of a prospectus. The registering agency's, or the Federal Securities Commission's, authority in this regard is broad. Either registering entity may refuse to register an issue of securities if the issuer has violated Russian law. In practice, however, the registering agency or the Federal Securities Commission probably will limit its role to determining the adequacy of the registration application and accuracy of prospectus disclosure.[265] The registering agency or the Federal Securities Commission must act within thirty days after receipt of the registration application and related documents.[266] A decision to refuse registration may be ap-

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263. Prikaz Tsentralnogo Banka #02-262 [Order of the Central Bank # 02-262] (July 26, 1996).

264. *See generally Securities Law*, *supra* note 2, arts. 16-18. Issues of securities which have not been registered in accordance with the requirements of the present Federal Law shall not be placed. *Id.* art. 18. *See also Id.* art. 24. The issuer may only commence the placement of securities the issuer is issuing after their issue has been registered.

265. The grounds on which the Federal Securities Commission may refuse to register an issuance of securities include:

> a violation by the issuer of the requirements of the legislation of the Russian Federation concerning securities, . . . ; the failure of the documents presented and the information contained therein to correspond to the requirements of the present Federal Law; the inclusion in the issue prospectus or the decision to issue securities (or other documents which represent the basis for the registration of the issue of securities) of false information or information which does not correspond to the true facts (inaccurate information).

Id. art. 21.

266. *Id.* art. 20. "The registering agency is obliged to register an issue of securities or to provide grounds for a decision to refuse registration no later than 30 days after the date of receipt [sic] of the documents indicated in this article." *Id.*

pealed in a court or arbitrage tribunal.[267] The Federal Securities Commission has adopted regulations that provide general guidance for registration and preparation of prospectuses by joint stock companies.[268]

A. *Registration*

The issuer must register its decision to issue securities with a sample certificate, if any, evidencing such securities. To be valid, the issuer's decision to issue securities must include, *inter alia,* the name and legal address of the issuer, the date of its decision to issue securities, the form of securities, the state registration number of the securities, the rights conferred by the security on its owner, the procedure for placement of the securities, the issuer's obligation to protect the owner's rights, and the number of securities to be issued.[269] The decision also must comply with the issuer's charter and other applicable laws, including the Joint Stock Company Law.[270] Where securities are issued in documentary form, a sample certificate must be filed.[271] The certificate must include most of the elements of the decision and whether the securities are issued in documentary form with or without compulsory centralized storage.[272] Both bearer and registered securities may be issued.

The legal significance of a registered decision is that it certifies the rights conferred by the security on its owner. In the case of certificated securities, the decision and the certificate together certify such rights. However, in the case of conflict, the certificate controls.[273] This provision is designed to protect the rights of the security holders in the face of changes in the issuer's constituent documents. A significant investor may be able to negotiate for charter amendment protections as well. When an issue of securities is registered, the issue is allocated a state registration number.[274]

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267. *Id.* art. 21.

268. Postanovleni Federalnoj Komissi po Tsennum Bumagam #19 "Standarty emissi aktsiy pri uchrezhdenii aktsionernykh obschestv dopolnitel'nykh aktsiy, obligatsiy i ikh prospektov emisii" [Federal Securities Commission Regulation #19 "Standards on the Issue Shares upon Formation of Joint Stock Companies, Issue of Additional Shares and Bonds and Model Stock Prospectus"] (Sept. 17, 1996), VESTNIK FEDERALNOJ KOMISSII PO RYNKU TSENNYKH BUMAG #4 (Oct. 22, 1996) [hereinafter *Standards*].

269. *Id.* art. 17.

270. *See, e.g., Joint Stock Company Law, supra* note 3, art. 28 (concerning increases of a company's charter capital).

271. *Securities Law, supra* note 2, art. 17.

272. *Id.* art. 18.

273. *Id.*

274. *Id.* art. 20.

B. *Prospectus Filing and Approval*

If securities are publicly offered by a domestic issuer in Russia, the issuance requires registration under the Securities Law with a registering agency or the Federal Securities Commission and filing of a prospectus. A prospectus must be registered "if the securities are placed with an unlimited number of owners or if it [sic] is known in advance that the number of owners exceeds 500, and also in cases where the total issue volume exceeds the value of the minimum [sic] wage by 50 thousand times."[275] A prospectus also must be registered if a foreign issuer is placing the securities issuance, whether or not the securities are publicly offered.[276]

1. Contents of the Prospectus

The contents of the prospectus are prescribed by the Securities Law and instructions of the Federal Securities Commission. The Securities Law requires that a prospectus include: (1) information about the issuer's legal status, significant shareholders, management, subsidiaries and branches; (2) financial information about the issuer; and (3) information about the offering.

Information about the issuer must include: (1) the issuer's name and legal address and the names of its founding partners; (2) the number and date of the certificate of state registration of the issuer as a legal entity; (3) information about holders of five percent or more of the issuer's authorized capital; (4) the issuer's management structure; (5) the names of its directors and officers, their experience, and their interests in the issuer's authorized capital; (6) a list of all legal entities in which the issuer owns five percent or more of authorized capital; (7) a list of all the issuer's subsidiaries and branches;[277] (8) a list of affiliated companies; (9) the issuer's main business acitivities; and (10) its material contracts.[278]

Financial information about the issuer must include: (1) the issuer's balance sheets and financial reports concerning its business, for the last three complete financial years or for each complete financial year since the decision was taken to issue securities; (2) a report on the sources and uses of the issuer's reserve fund for the last three years; (3) the issuer's overdue debts to its creditors and payments overdue to the government at the date on which the decision to issue securities was adopted; (4)

275. *Id.* art. 19.

276. *Id.* art 16. Securities issued by foreign issurers may be accepted for circulation or initial placement on the securities market of the Russian Federation after the issue prospectus of these securities has been registered with the Federal Commission for the Securities Market. *Id.*

277. *Id.* art. 22.

278. *Standards*, *supra* note 267, attachment 3, paras. 26-30.

information about the issuer's authorized capital (including the amount, the number of securities, and their nominal value) and the owners of the securities whose shares in the authorized capital exceed the norms established by the anti-monopoly legislation[279] of the Russian Federation; and (5) a report on previous issues of securities by the issuer, including the types of securities issued, the number, and date of state registration, the title of the registering agency, the size of issue, the number of securities issued, the terms on which dividends are paid, and other rights of the owners thereof.[280]

Information about the offering must include: (1) a description of the securities, including the form and type of securities offered, the accounting of rights in the securities, the amount of the issue, and the number of securities in the issue; (2) the procedure for issuance of the offered securities (including the date on which the decision was adopted, the title of the agency which took the decision, the restrictions on potential owners, where potential owners can obtain the securities, and where the securities certificates are stored, if an accounting of rights is conducted in a depositary, and the title and legal address of the depositary); (3) the dates on which the placement of the securities begins and ends; (4) the price and procedures for payment for securities offered; (5) the names of securities market participants or their associations that are involved in the placement of the securities; (6) if dividends are to be paid, the procedure for the payment, and the method used to calculate dividends; and (7) the name of the registering agency.[281] The prospectus also should include information on securities transfer restrictions, risk factors, and where the securities may be purchased.[282]

2. Delivery and Publication Requirements; Placement Conditions

In offerings requiring a prospectus, within five days after registration of its prospectus, the issuer must provide access to the information contained in the prospectus and publish an announcement of the procedure for the disclosure of such information in a newspaper or other printed periodical with a circulation of at least 50,000 copies and in the attachments to the Official Digest of the Federal Securities Commission.[283] The issuer and stock market participants who carry out the placement of the securities must provide offerees with access to the in-

279. *See infra* text accompanying note 338.

280. *Securities Law*, *supra* note 2, art. 22.

281. *Id.*

282. *Standards*, supra note 267, attachment 3, paras. 47-52.

283. *Securities Law*, *supra* note 2, art. 23; Postanovleniye Federalna Komissi po Rynku Tsennykh Burnag #8 ot 7 maya 1996 goda "O poryadke u ob'eme informatsii, kotoruyu aktsionernoye obtschestvo obyaza no publikovat'y slychae publichnogo razmetscheniya im obligatsii inykh tsennykh bumag" [Federal Securities Commission Regulation #8 (May 7, 1996) "On Procedures and Scope of Information to be Disclosed by Joint Stock Companies in case of Public Placement of Bonds and Other Securities"].

formation before any securities are acquired.[284]

The number of securities placed may not exceed the amount covered by the decision concerning the issue and disclosed in the prospectus. Yet, the issuer can place a smaller number of securities. The actual number of securities placed must be reflected in the issuer's report following the placement.[285]

Placement must be completed within one year from the date of the commencement of the issue process but may not commence until two weeks after all offerees have had the opportunity to consult the information on the issue disclosed under the Securities Law.[286] The price of an issue need not be established until the day that placement commences.[287] Particular potential investors are not allowed any advantage over other potential investors in acquiring securities in a public offering. Exceptions to the rule against bias are: an issue of state securities; a joint stock company where the existing shareholders are excercising their preemptive rights; or issuer restrictions on non-resident shareholders are applicable.[288]

The issuer must present a report on the results of the issue to the registering agency within thirty days after completing the placement. The report must contain: (1) the dates on which the placement began and ended; (2) the price of the securities placed; (3) the number of securities placed; and (4) the total consideration received, including (a) the amount paid for the securities in rubles; (b) the amount of foreign currency paid, expressed in rubles at the exchange rate of the Central Bank on the date of payment; and (c) the value of other consideration given for the securities, expressed in rubles.[289] If the securities placed were shares, the report must include a list of the owners of blocks of shares of a certain size as determined by the Federal Securities Commission.[290] The registering agency may review the report for up to a period of two weeks after its filing. If it finds no violations of law, it will register the report. The registering agency is responsible for the completeness of the report once it is registered.[291]

284. *Securities*, *supra* note 2, art. 23.
285. *Id.* art. 24.
286. *Id.*
287. *Id.*
288. *Id.*
289. *Id.* art. 25.
290. *Id.*
291. *Id.*

VII. TRANSACTIONS INVOLVING LARGE BLOCKS OF SHARES, TRADING BY AFFILIATES, AND PURCHASE BY A COMPANY OF ITS OWN SHARES

A. *Large Block of Shares*

The Joint Stock Company Law includes special procedures for a company issuing a large block of shares. A block of shares is a large block if, in one or a series of related transactions, a company issues common or convertible preferred stock (convertible into common stock) representing more than twenty-five percent of the company's authorized and issued shares of common stock.[292] If the value of the shares to be issued[293] is more than twenty-five percent and less than or equal to fifty percent of the balance sheet value of the company's assets,[294] the company's board of directors or supervisory board must unanimously approve the issuance. The value of the shares is determined by the company's board of directors or supervisory board.[295] If the issuance does not receive unanimous approval, a majority of directors or supervisory board members may refer the matter to the company's shareholders for approval.[296] The general meeting of shareholders acts on the matter in accordance with the company's charter. Most often company charters require a majority vote of shareholders present at a duly constituted general meeting. If the value of the shares to be issued exceeds fifty percent of the balance sheet value of the company's assets, the matter must be referred to the company's shareholders for approval. In that case, a three-fourths majority vote of shareholders present at a duly constituted general meeting is required.[297] These provisions, which are designed to protect investors, also apply to sales and purchases by a company of assets of substantial value relative to a company's total assets.[298]

B. *Trading by Affiliates*

Certain restrictions apply to transactions by affiliates of a company, including securities transactions by such affiliates. Under the Joint Stock Company Law, the term "affiliate" includes an officer, members of a company's board of directors and supervisory board, a shareholder owing more than twenty percent of a company's voting stock, and certain relatives of such persons.[299] Affiliates are required to provide the com-

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292. *Joint Stock Company Law*, *supra* note 3, art. 78(1).

293. *Id.* art. 78(2).

294. The balance sheet value is determined as of the date the decision concerning the issuance is taken by the board. *Id.* art. 79(1).

295. *Id.*

296. *Id.* Presumably no further approval of the board of directors or supervisory board is required if the matter is duly authorized by the general meeting of shareholders.

297. *Id.* art. 79(2).

298. *Id.* arts. 78-79.

299. *Id.* art. 81.

pany certain information about substantial share ownership equalling twenty percent or more of the voting stock in other companies, offices held in other companies, and certain affiliate transactions. Substantial share ownership in other companies is defined as twenty percent or more of the voting stock.[300] For companies with fewer than 1,000 shareholders, affiliate transactions must be approved by a majority of the company's disinterested directors or supervisory board members.[301] For companies with 1,000 or more shareholders, affiliate transactions must be approved by a majority of the company's independent directors or supervisory board members[302] having no interest in the transaction.[303] A majority of the disinterested shareholders must approve an affiliate transaction if the consideration involved exceeds two percent of the company's assets. Additionally, a disinterested shareholder majority vote is required if the transaction, or a series of related transactions, involve issuing of voting stock or other securities convertible into voting stock that exceed two percent of the voting stock issued prior to the transaction or transactions in question.[304] Shareholder approval is not required for loans made to the company by an affiliate. Nor is shareholder approval needed for transactions entered into in the ordinary course before the affiliate/company relationship began.[305] If the foregoing approval requirements are not satisfied, the affiliate transaction is deemed invalid[306] and the affiliate may be liable to the company for losses caused.[307] In addition, reporting requirements under the Securities Law may also be triggered in the case of acquisitions by affiliates.[308]

C. *Purchase by a Company of its Own Shares*

If its charter so stipulates, a company may redeem its own shares upon a decision of its board of directors.[309] Nevertheless, redemption is prohibited in the following cases: (1) if the charter capital of the company is not fully paid; (2) if the company is bankrupt or insolvent; (3) if the net assets of the company are less than its charter capital, reserve fund, and the amount payable on its preferred stock in liquidation;[310] and (4) if as a result of the redemption, the authorized and issued shares

300. *Id.* art. 82.
301. *Id.* art. 83(1).
302. *Id.* art. 83(2). A director is an independent director if his spouse, parents, children, brothers, or sisters are not persons holding office in the management bodies of the company.
303. *Id.*
304. *Id.* art. 83(3).
305. *Id.* art. 83(4).
306. *Id.* art. 84(1).
307. *Id.* art. 84(2).
308. *See infra* part VIII. D.
309. *Joint Stock Company Law*, *supra* note 3, art. 72(1), (2).
310. *Id.* art. 73(1).

of the company would be less than ninety percent of its charter capital.[311] If the redemption is effected to reduce a company's charter capital, the redeemed shares must be canceled; otherwise, they become treasury shares and may be resold within one year after their redemption.[312] The value of the net assets of the company determines the redemption price of the common stock.[313] Preferred stock may be purchased by a company at a price stipulated in its charter or at fair market value.[314]

In certain cases, holders of voting stock have appraisal rights whereby they may force a company to repurchase their shares. For example, a dissenting shareholder has appraisal rights in the case of a company's reorganization, the purchase of a large block of a company's shares, or if a charter amendment is effected limiting such shareholder's rights.[315] The Joint Stock Company Law contains detailed procedures for the purchase of shares upon demand from shareholders[316] at the price calculated based upon the value of the company's then net assets.[317]

VIII. CONTINUOUS DISCLOSURE OF INFORMATION

The Joint Stock Company Law and the Securities Law require issuers of securities to report periodically to their shareholders, the Federal Securities Commission, and the public. Although the reporting requirements under the two laws overlap in certain respects, the requirements under the Securities Law differ both in breadth and in scope from the Joint Stock Company Law. The Securities Law requirements are generally more detailed than the Joint Stock Company Law requirements. These differences obviously reflect the emphasis of the Securities Law on disclosure designed to promote transparency and the efficiency of Russian securities market. Consequently, the emphasis of the Joint Stock Company Law emphasizes effective corporate governance.

A. *Joint Stock Company Law Disclosure Requirements*

An open joint stock company[318] must publish the following infor-

311. *Id.* art. 72(2).
312. *Id.* art. 72(3).
313. *Id.* arts. 72(4), 77.
314. *Id.* art. 72(6).
315. *Id.* art. 75.
316. *Id.* art. 76.
317. *Id.* art. 7.
318. *Id.* art. 7. The shareholders of an open joint stock company may dispose of the stock owned by them without the consent of the other shareholders. The company has the right to hold open subscriptions to stock to be issued and sell such stock without limitations, subject to federal law. It may also hold closed subscriptions to the stock it is issuing, except for instances when the possibility of holding closed subscriptions is limited by the company charter or federal law. *Id.*

mation annually: (1) its annual report, balance sheet, and profit and loss account; (2) any prospectus for the issue of its securities; (3) notices of shareholders' general meetings; (4) lists of its affiliates specifying their shareholdings; and (5) other information determined by the Federal Securities Commission.[319] A closed joint stock company[320] involved in a public issue of bonds or other securities must publish information as determined by the Federal Securities Commission.[321]

The Joint Stock Company Law also addresses the issue of disclosure of a company's charter. Every shareholder of a company is entitled to receive a copy of the company's charter.[322] Persons interested in the company, as well as the company's auditors, must be given access to the company's charter, although such persons may not be entitled to a copy of the charter.[323] The charter of the company contains the full and abbreviated names of the company, the location of the company, the type of company (open or closed), the number, par value, classes of shares, and the types of preferred stock to be placed by the company, the rights of shareholders of each class of shares, the amount of the charter capital of the company, the composition and authority of the governing bodies of the company and the procedure for adopting resolutions by them, the procedure for conducting general meetings of shareholders, and details of the branches and representative offices of the company. The charter may also impose limits on the quantity and total par value of stock held, or the maximum number of votes cast, by any one shareholder.[324]

B. *Quarterly and Current Reports*

Issuers that have issued securities under circumstances requiring a prospectus must prepare quarterly reports disclosing information about their securities and its financial condition and business.[325] In addition, such issuers must provide periodic current reports.[326] The Federal Securities Commission has not yet prescribed the forms or other requirements concerning quarterly and current reports. In addition, the Securities Law does not expressly contemplate an annual report. An instruction of the Federal Securities Commission will likely address the issue

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319. *Id.* art. 88.

320. *Id.* art. 7. A closed company's stock is only distributed among its founders or a previously determined range of persons. Its shareholders have preemptive rights when the company issues stock. The company may not hold open subscriptions or offer its stock to be issued to an unlimited number of persons. The maximum number of shareholders in a closed company is 50. *Id.*

321. *Id.* art. 88.

322. *Id.* art. 11(4).

323. *Id.*

324. *Id.* art. 11(3).

325. *Securities Law*, *supra* note 2, art. 23. The quarterly report also must include information about the formation and use of the issuer's reserve fund and other special funds. *Id.*

326. *Id.*

soon.

1. Quarterly Reports

Issuers of publicly offered securities must prepare quarterly reports that contain the following information: (1) information about the issuer, including (a) a list of directors, officers, and their shareholdings and the issuer's subsidiaries, branches, and dependent companies, (b) a list of the issuer's shareholders with more than twenty percent of its authorized capital, and (c) information concerning the reorganization of the issuer, its subsidiaries, and dependent companies; (2) information about the issuer's financial and economic activity, including (a) its balance sheets and profit and loss statements for the last three complete financial years and for the quarter of the report, (b) information about substantial increases in the issuer's profits or losses during the quarter, (c) information about the formation and use of the issuer's reserve fund and other special funds, and (d) information about significant transactions; (3) information on the issuer's securities, including the classes of securities issued during the quarter and information about dividends; and (4) other information, in particular, the minutes of shareholder general meetings during the quarter.[327] Quarterly reports must be prepared within thirty days after the end of each quarter and submitted to the Federal Securities Commission or the registering agency.[328] An issuer must provide its quarterly report to each of its shareholders who request the report; however, the issuer may charge requesting shareholders for the cost of preparing the report.[329]

2. Current Reports

Issuers of publicly offered securities also must file a current report if certain events occur. These events include: (1) a reorganization of the issuer, its subsidiaries or dependent companies; (2) an increase or decrease by more than ten percent in the value of the issuer's assets, net income, or net loss or a single transaction completed by the issuer that involves consideration valued at ten percent or more of the issuer's assets at the date of the transaction; (3) the issuance of the issuer's securities, a decision about such issuance or the termination of an issuance and information about dividends declared, accumulated, or paid on the issuer's securities; (4) the acquisition of more than twenty-five percent of the issuer's securities of any class; (5) the establishment of a record date for the exercise of shareholder rights with respect to a particular matter; (6) changes in the officers, directors, managers, supervisory board, management board, or audit board of the issuer; (7) changes in management's shareholdings in the issuer, its subsidiaries, and depen-

327. *Id.* art. 30.
328. *Id.* arts. 23, 30.
329. *Id.*

dent companies; (8) changes in management's shareholdings in entities in which management owns more than twenty percent of the share capital; (9) changes of control of the issuer with respect to shareholders owning twenty percent or more of the issuer's share capital; (10) acquisitions or dispositions of entities in which the issuer owns twenty percent or more of the share capital; (11) the redemption by the issuer of its shares; and (12) a shareholder acquires more than twenty-five percent of any class of an issuer's securities.[330] The issuer must file its current reports with the Federal Securities Commission or the registering agency and publish such report in a newspaper, or other periodical publication with wide circulation, no later than five days after any triggering event takes place.[331]

C. *Auditing Standards*

All financial information disclosed by a joint stock company, including the issuer's balance sheet and profit and loss statement, must be certified by an independent auditor approved by the issuer's shareholders.[332] A statutory audit is required for all open and closed joint stock companies that plan to make a public offering of their securities.[333] In addition, any shareholder that owns more than ten percent of the authorized and issued shares of a company may demand the audit of the company's books at any time.[334] Russian auditing standards are set forth in Temporary Regulations of Audit Activities in the Russian Federation approved by Presidential Decree #2263 of December 22, 1993.[335] All audits must be conducted in accordance with Russian accounting standards in effect at the time of the audit.[336] Audit reports contain three sections: (1) an introduction that identifies the auditor; (2) an analytical part that identifies the company's name, the period covered by the audit, and any violations of tax and accounting principles discovered by the auditors; and (3) a statement by the auditor verifying the company's financial statements.[337] Under the Audit Regulations, a company is only required to disclose the auditor's statement.[338]

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330. *Id.*

331. *Id.*

332. *Joint Stock Company Law*, *supra* note 3, arts. 86, 88.

333. *Civil Code*, *supra* note 1, art. 97.

334. *Id.* art. 103.

335. Ukaz Presidenta #2263 [Temporary Regulations of Audit Activities in the Russian Federation approved by Presidential Decree #2263] (Dec. 22, 1993), COMPILATION OF THE LEGISLATIVE ACTS OF THE PRESIDENT AND GOVERNMENT OF THE RUSSIAN FEDERATION 1993, No. 52, Doc. 5069, *translated in* Economic Law of Russia, "Decree of the President of the RF No. 2263 of December 22, 1993 on Auditing in the Russian Federation," (Garant-Service 1996, Doc. 2821), *available in* LEXIS, Intlaw Library, RFLaw File [hereinafter *Audit Regulations*].

336. *Id.* art. 5.

337. *Id.* art. 18.

338. *Id.*

D. *Disclosure Related to Acquisitions*

Under the Securities Law, a person must report to the registering agency or the Federal Securities Commission information about its ownership of an issuer's securities if it acquires twenty percent or more of any class of an issuer's securities or if after acquiring twenty percent or more of any class of securities, there is a material change in such ownership.[339] In this context, a material increase or reduction in ownership involves five percent or more of any class of an issuer's securities.[340] The report must identify the owner of the securities, the issuer, the class and state registration number of the securities, and the number of securities owned. The report must be filed within five days after the occurrence of the event or events triggering the reporting requirement.[341]

The Joint Stock Company Law also includes provisions designed to protect shareholders of widely-held joint stock companies.[342] If a person alone or with its affiliates intends to purchase more than thirty percent of the authorized and issued common stock of a company, such person must notify the company in writing at least thirty days before the acquisition.[343] Once a person has acquired thirty percent or more of authorized and issued common stock of a company, it must offer to purchase all the common stock of the remaining shareholders at an average price per share calculated on the basis of the company's share price for the preceding six months, unless the disinterested shareholders amend the company's charter to provide otherwise.[344] The offer must be made to all holders of common stock in writing[345] and contain the name and address or location of the person making the offer, the quantity and price offered to the shareholders, and the period allowed for the acquisition of the stock.[346] The offerees have thirty days to accept the offer from the date that they receive it.[347] The original transaction and the offer to the shareholders must be completed within 120 days after the acquiring party's written statement to the company.[348] If a person acquires thirty percent or more of the common stock of a company without complying with these provisions, it may exercise its voting rights at shareholders' general meetings with respect to thirty percent of the voting stock of the

339. *Securities Law*, *supra* note 2, art. 30.
340. *Id.*
341. *Id.*
342. *See Joint Stock Company Law*, *supra* note 3, art. 80. These protections apply to companies with more than 1,000 common stockholders. *Id.* art. 80(1).
343. *Id.*
344. *Id.* art. 80(2). The charter amendment must be approved by a majority of the disinterested shareholders present at a duly constituted general meeting. *Id.*
345. *Id.* art. 80(3).
346. *Id.* art. 80(5).
347. *Id.* art. 80(4).
348. *Id.* art. 80(6).

company.[349] Any purchase of more than twenty percent of a company's authorized and issued shares requires the approval of the Anti-Monopoly Committee of the Russian Federation.[350] Additionally, the company is also required to file a current report with respect to acquisitions and dispositions of large blocks of shares.[351]

E. *Disclosure by Securities Market Participants*

Broker-dealers, clearing organizations, asset managers, depositaries, and registrars must disclose certain information to the Federal Securities Commission or registering agency under which they are licensed. Each of these actors are considered securities market participants. Information must be provided quarterly if a securities market participant has concluded transactions concerning all an issuer's outstanding securities of one class or concluded a specific transaction involving at least fifteen percentof all an issuer's outstanding securities of one class.[352] A securities market participant must identify itself and the issuer, report the class and state registration number of the securities, the price of the securities, and the number of securities involved in the transaction or transactions within five days after either the end of the relevant quarter or the specific transaction.[353] In connection with concluding transactions, a broker-dealer must disclose all of the information it possesses that has been disclosed by the issuer. Alternatively, the broker-dealer must indicate that it does not possess such information.[354]

IX. INVESTMENT FUNDS

A. *Investment Funds*

Investment funds were created in the Russian Federation to organize the financing of enterprises by individuals and to secure participation of Russian citizens in the privatization process. Currently, investment funds serve as intermediaries between both Russian and foreign investors and issuers of securities. Although the idea of an investment fund first appeared in Government Resolution #78, the actual growth of the funds began with the voucher privatization process in 1992 pursuant

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349. *Id.* art. 80(7).

350. Zakon "O konkurentsii i ogranichenii monopolisticheskoj deyatelnosti na tovarnukh rynkakh" [Law "On Competition and Prevention of Monopolistic Activities"] (Mar. 22, 1991) (as amended), VEDOMOSTY S'ESDA NARODNYKH DEPUTATOV I VERKHOVNOGO SOVETA ROSSIYSKOI FEDERATSII 1991, No. 16, Doc. 499, *translated in* Economic Law of Russia, "Law of the RSFSR of March 22, 1991 on Competition and Restriction of Monopoly Activity on Commodity Markets" (Garant-Service 1996, Doc. 5108), *available in* LEXIS, Intlaw Library, RFLaw File, art. 18.

351. *See infra* part VIII.B.2.

352. *Securities Law*, *supra* note 2, art. 30.

353. *Id.*

354. *Id.*

to the Presidential Decree #1186 of October 7, 1992, which created the legal framework for the operations of investment funds.[355] Investment funds may exclusively undertake the issuance of shares to mobilize investment capital and the investment of that capital on the fund's behalf.[356] All risks, income, and losses related to such investments are fully reflected in the shareholders' accounts held by an investment fund and are directly tied to the market value of the shares in the particular fund.

Investment funds must be established and registered as Russian open joint stock companies.[357] Russian law recognizes two types of investment funds: common funds which may not accept privatization vouchers from Russian citizens and special funds which may accumulate privatization vouchers. A common investment fund may purchase its own shares from shareholders upon the request of any shareholder. Thus, common investment funds are "open." Special investment funds may not purchase their own shares from shareholders and, therefore, are "closed."[358]

As securities market participants, investment funds must be licensed by an authorized state agency.[359] Prior to adoption of the Securities Law, special funds were licensed by the State Property Committee and common funds were licensed by the Ministry of Finance. Now, the Federal Securities Commission, under the Securities Law, licenses investment funds.[360] The Federal Securities Commission is soon expected to issue new regulations on licensing investment funds.

An investment fund may be managed by an individual or by an entity. The Federal Securities Commission regulates investment funds' management activities. An investment fund, excluding banks, insurance companies, and their subsidiaries, may only appoint a manager that is authorized to purchase shares of Russian companies undergoing privatization.[361]

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355. Ukaz Presidenta #1186 "O merakh po organizatsii rynka tsennykh bumag v protesse privatizatsii gosudarstvennykh i munitsipalnykh predpriyatij" [Presidential Decree #1186 "On Organizational Measures for the Development of the Securities Market in the Privatization Process."] (Oct. 7, 1992), VEDOMOSTI S'EZDA NARODNYKH DEPUTATOV ROSSIYSKOI FEDERATSII I VERKHOVNOGO SOVETA 1992, No. 42, Doc. 2370, *translated in* Economic Law of Russia, "Decree of the President of the RF No. 1186 of October 7, 1992 on Measures to Organize a Stock Market in the Process of Privatization of State-Owned and Municipal Enterprises" (Garant-Services, Doc. 5983), *available in* LEXIS, Intlaw Library, RFLaw File [hereinafter *Decree #1186*].

356. *Government Resolution #78*, *supra* note 85, provision III, art. 19.

357. *Decree #1186*, *supra* note 355, attachment 1, § 2.

358. *Id.* attachment 2, § 9.

359. *Id.* attachment 2, § 4; *Government Resolution #78*, *supra* note 85, provision III, art. 24.

360. *Securities Law*, *supra* note 2. arts. 5, 42(6).

361. *Decree #1186*, *supra* note 343, attachment 1, § 11; attachment 2, § 12.

A depositary authorized by the shareholders at a general meeting must conduct all transactions involving an investment fund's securities and cash.[362] An investment fund may appoint only one depositary. Managers and others affiliated with the fund are excluded from such appointments. This prohibition extends to members of the board of directors and other officers of the fund, founders, or shareholders owning twenty-five percent or more of the fund's shares.[363] Shareholders of an investment fund must be able to transfer their shares without the consent of any other shareholder of the fund.[364] All shares must convey identical rights to the shareholders.[365] An investment fund may not issue preferred stock. Particular investment fund shares can only be purchased with privatization checks, money, securities, or real estate.[366]

Investment activities of the funds are subject to numerous limitations under federal law. For instance, Decree #1186 provides that investment funds may not, *inter alia,* (1) make investments other than investments in securities; (2) acquire the voting shares of any joint-stock company, if after the acquisition thereof, the fund and its affiliates will own more than ten percent of such company's voting shares; (3) acquire and own more than ten percent of the securities of an issuer where the percentage is determined by reference to the aggregate par value of such issuer's securities; (4) invest more than five percent of the fund's net assets in the securities of one issuer; (5) invest in securities of its affiliates; (6) contract for the sale of securities that are not owned by the fund or that it has no right to acquire; (7) borrow funds; (8) invest in general partnerships or other enterprises with unlimited liability; (9) issue guaranties of any sort or encumber the fund's assets; (10) act as an agent, intermediary, or seller of privatization facilities, including investment in, and issuance of, debentures (other than government securities); (11) conclude transactions unrelated to its investments; (12) invest in options or futures contracts of any kind; or (13) invest in shares of other investment funds.[367] The foregoing and other restrictions on fund activities limit the ability of funds to compete with other securities market participants.

The Duma is currently considering two draft laws on investment funds to regulate fund activities in the post-privatization period. Both drafts eliminate special voucher funds and allow the option to create either joint stock investment funds which would be registered as legal entities in Russia or open-ended investment funds which would closely approximate open mutual funds as discussed below. The Duma also is debating favorable investment fund taxation legislation. Reportedly, that

362. *Id.* attachment 3, § 43.
363. *Id.* attachment 1, § 4; attachment 3, §§ 41-42, 44.
364. *Id.* attachment 1, § 7; attachment 2, § 7.
365. *Id.* attachment 1, § 9; attachment 2, § 10.
366. *Id.* attachment 1, § 13; attachment 2, § 14.
367. *Id.* attachment 1, §§ 20-22.

tax legislation eliminates an adverse tax regime for investment funds making them more attractive investment vehicles.

B. *Mutual Funds*

The concept of mutual funds is relatively new in the Russian Federation. Originally, the general public invested in government securities and Russian company securities through separate legal entities governed by their own internal corporate structures. In 1995, the Federal Securities Commission began preparing the legal framework for Western-style mutual funds that would be subject to a more favorable investment and tax regime than the previous privatization era. Newly created mutual funds are expected to revive and to encourage investment by the general public.

The legal status of mutual funds is primarily regulated by the Civil Code provisions on trust management,[368] the Securities Law, and the Presidential Decree #765 of July 26, 1995, "On Additional Measures for Improving Investment Policy in the Russian Federation."[369] A mutual fund is not a legal entity; rather, it is a "property complex" managed in trust by a management company.[370] A mutual fund may be established either as an open mutual fund or as an interval mutual fund.[371]

There are several differences between the two types of mutual funds. Shares of an open mutual fund may be offered continuously and may be purchased at any time by prospective investors. Interval mutual fund shares may be sold and purchased only during specific periods. The two types of mutual funds also differ with respect to when fund shares may be redeemed. An open mutual fund must redeem fund shares upon an investor's request which may be made at any time. Interval mutual fund investors, however, may redeem their shares only once a year. There also are differences in the structure of their assets. Open funds may only invest in very liquid securities that are publicly traded, bank deposits, and bank accounts.[372] Conversely, because interval mutual

368. *Civil Code*, *supra* note 1, arts. 209, 1012, 1026.

369. Ukaz Presidenta #765 "O dopolnitelnykh merakh po povysheniyu effectivnosti investitsionnoj politiki Rossiyskoi Federatsii" [Presidential Decree #765 "On Additional Measures for Improving Investment Policy in the Russian Federation"] (July 26, 1995), SOBR. ZAKONOD. R.F. 1995, No. 31, Doc. 3097, *translated in* Economic Law of Russia, "Decree of the President of the Russian Federation No. 765 of July 26, 1995 on Additional Measures for Raising the Efficiency of the Investment Policy of the Russian Federation" (Garant-Service 1996, Doc. 3833), *available in* LEXIS, Intlaw Library, RFLaw File [hereinafter *Decree #765*].

370. *Id.* § 4.

371. *Id.* § 8.

372. Postanovlenie Federalnoj Komissii po Tsennum Bumagam #12 "Ob utverzhdenii vremennogo polozheniya o sostave i structure aktivov paevykh investitsionnykh fondov" [Resolution of the Federal Securities Commission #12 "On Approval of Temporary Procedures for Composition and Structure of Assets of Mutual Funds"] (Oct. 10, 1995), ROSSIYSKAYA GAZETA, Nov. 18, 1995, *translated in* Economic Law of Russia, "Decree

funds are regulated less stringently, they may invest up to fifty percent of their assets in securities that are not liquid and in securities of closed joint stock companies.[373]

A mutual fund may begin operation once its rules and fund prospectus are registered with the Federal Securities Commission or applicable registering agency. The model rules and stock prospectus, developed by the Federal Securities Commission mandates, mutual funds to include particular rules and provisions in its prospectus.[374] Decree #765 and instructions of the Federal Securities Commission contain requirements for registration of the fund's prospectus, provide general principles for share redemption, and define the rights of investors.[375] Instructions of the Federal Securities Commission also describe the procedure for issuing fund shares, placing shares, trading shares, and maintaining a share register.

Shares in mutual funds certify the rights of an investor to demand redemption of its shares upon presentation in exchange for an amount determined on basis of the value of the fund's assets as of the date of redemption. By acquiring investment shares of mutual funds, investors enter into a trust management agreement with the fund's management company. Thus, the investors participate in the mutual fund's investment activities[376] as conducted by the management company in compliance with rules of the mutual fund and fund prospectus. Subscription time for open mutual fund shares is not limited. Generally, a tax is levied on a company's initial public offering. However, the issuance of open mutual fund shares is not subject to a securities transaction tax.[377]

A mutual fund's management company must manage the fund's assets solely for the benefit of its investors.[378] The activities and responsibilities of the management company are regulated by the Resolution of the Federal Securities Commission #11 of "Temporary Regulations on Management Companies of Mutual Funds, Trust management Activities

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of the Federal Commission on Securities and the Capital Market of the Government of the Russian Federation No. 12 of October 10, 1995 as Interim Regulations on the Composition and Structure of Assets of Unit Investment Funds" (Garant-Service 1996, Doc. 5499), *available in* LEXIS, Intlaw, RFLaw File, § 4.

373. *Id.* § 8.

374. *See Resolution #13*, *supra* note 92; *see also Resolution #15*, *supra* note 92.

375. *Decree #765*, *supra* note 357, §§ 7-21.

376. *Id.* §§ 1, 5.

377. Pismo Gosudarstvennoj Nalogovoj Sluzhby #NP-2-01/8ON "O nekotorykh voprosakh nalooblozheniya, voznikayushchikh b svyuzi s obrazovaniem i funktsionirovaniem paevykh investitsionnykh fondov" [State Tax Service Letter # NP-2-01/8ON] (Dec. 15, 1995), ROSSIYSKIE VESTI, Feb. 8, 1996, *translated in* Economic Law of Russia, "Letter of the State Tax Service of the Russian Federation No. NP-2-01/8ON of December 15, 1995 on Certain Issues of Taxation, Arising in Connection with Farming and Functioning of Share Investment Funds" (Garant-Service 1996, Doc. 5972), *available in* LEXIS, Intlaw Library, RFLaw File.

378. *Decree #765*, *supra* note 369, § 5.

and Licensing" of October 10, 1995.[379] Management companies must be licensed by the Federal Securities Commission to perform trust management activities for mutual funds.[380] Although one management company may manage several mutual funds, it is limited to mutual fund management with the exception of trust management of non-governmental pension funds and other investment funds.[381] A management company must be capitalized with at least one billion rubles (approximately U.S. $200,000).

The management company of a fund has fiduciary obligations to the fund's investors and must act in their best interests. In that respect the Civil Code and Decree #765 create certain investor favorable statutory liabilities for harm resulting from a management company's "guilty actions" or conflicts of interest.[382] Unfortunately, neither Decree #765 nor subsequent regulations of the Federal Securities Commission define the term "guilty actions." In addition to its liability to the investors, the management company also is responsible to the Federal Securities Commission for ensuring that its mutual fund management complies with the applicable regulations of the Federal Securities Commission. This includes portfolio structure, redemption of investment shares, and other issues. The management company may be paid for its services out of the assets of the mutual fund with consideration for payment set out in the rules of the mutual fund.[383]

X. INSIDER TRADING

The Securities Law contains provisions designed to prevent trading on the basis of inside information. Inside information is defined as any information about an issuer and its securities that is not available and gives the persons that possess it an advantage over other persons actively involved in the securities market, because of their employment, their responsibilities at work, or a contract.[384] Persons in possession of insider information may not use it to conclude transactions or tip third parties.[385]

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379. Postanovlenie Federalnoj Komissi po Tsennym Bumagam #11 [Resolution of the Federal Securities Commission #11] (Oct. 10, 1995), ROSSIYSKAYA GAZETA, Nov. 18, 1995, *translated in* Economic Law of Russia, "Decision of the Federal Commission on Securities and the Capital Market No. 11 of October 10, 1995 Interim Regulations as Management Companies of Unit Investment Funds on Activities of Trust Management of the Property of Unit Investment Funds and its Licensing" (Garant-Service 1996, Doc. 5517), *available in* LEXIS, Intlaw Library, RFLaw File, §§ 4, 19 [hereinafter *Management Company Regulation*].

380. *Decree # 765*, *supra* note 369, § 6.

381. *Management Company Regulation*, *supra* note 367, §§ 4, 19.

382. *Civil Code*, *supra* note 1, art. 1022; *Decree #765*, *supra* note 357, § 11.

383. *Decree #765*, *supra* note 369, § 16.

384. *Securities Law*, *supra* note 2, art. 31.

385. *Id.* art. 33.

XI. ENFORCEMENT OF SECURITIES LEGISLATION

The Securities Law, the Criminal Code, and the Civil Code provide a general framework for enforcement of securities legislation. This legislation contemplates administrative and civil actions against violators of securities legislation by various government agencies, including the Federal Securities Commission. The legislation allows criminal actions as well as private remedies. Potential liability for violations of securities legislation extends to all securities market participants, issuers, and issuers' officers and directors.[386]

A so-called "dishonest issue" of securities, *i.e.*, one that violates the procedures for an issuance under Section III of Securities Law,[387] may result in the issue being declared invalid or the issuer being stopped from completing the placement of the issue.[388] Violation of the issuance procedures also is grounds for refusing to register an issue.[389] The Securities Law limits the remedies depending on the character of the violation in question. Thus, if procedural violations are discovered, the registering agency may stop the placement of the issue until the procedural violations are remedied and then may decide to resume the placement.[390] According to the broad definition found in Article 26 of the Securities Law, an issue is invalid if the issuer violates any Russian law during the issue or if the issuer's registration materials are inaccurate.[391] However, Article 51 follows a narrower approach. Thus, if in connection with a dishonest issue the offerees are significantly misled or if the objectives of the issue conflict with a fundamental principle of law or are immoral, the Federal Securities Commission may apply to a court for the issue to be declared invalid.[392] When an issue is declared invalid, the issuer must refund all the proceeds received from the offering.[393]

If the registering agency discovers a dishonest issue of securities, it must inform the Federal Securities Commission or one of its regional agencies within seven days.[394] The Federal Securities Commission may

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386. *Id.* art. 51(3) (officer liability in connection with dishonest issues); *Id.* art. 51(4) ("[t]he officials of the issuer who have taken a decision on the issue of securities that have not passed state registration shall bear administrative or criminal responsibility in accordance with the legislation of the Russian Federation.").

387. *Securities Law*, *supra* note 2, arts. 16-29 (section III of the Securities Law describing the manner in which an issue of securities must be effected by a company, including registration, prospectus content requirements, procedures for the disclosure of information about an issue, continuous reporting requirements, and requirements affecting placement).

388. *Id.* art. 26.

389. *Id. See also supra* note 256.

390. *Securities Law*, *supra* note 2, art. 26.

391. *Id.*

392. *Id.*

393. *Id.* arts. 26, 51(5).

394. *Id.* art. 26.

seek an injunctive order to compel refund if an issue is declared invalid.[395] It may, on its own initiative, take various measures to stop the placement of an issue, publish notices warning the general public, investigate the violations, and seek administrative remedies against the issuer and its officers.[396] Where the violations are criminal in nature, the matter must be forwarded to the procurator.[397]

In addition to issuers, securities market participants are subject to sanctions for violations of securities legislation. It is unlawful for securities market participants to engage in activities requiring a license if they have no license.[398] The Federal Securities Commission has several remedies available, including administrative actions against the participant and compulsory liquidation of the participant if it fails to obtain a license within a prescribed time period.[399] If a securities market participant manipulates prices of securities by providing false or inaccurate information and such price manipulation is established by appropriate legal proceedings, its license may be suspended or revoked.[400] Securities market participants also are subject to sanctions of SROs of which they are members.[401]

The new Criminal Code, which will go into effect on January 1, 1997,[402] provides criminal sanctions for specific violations of securities legislation.[403] These violations and related sanctions include: (1) unlicensed activities on the securities market authorizing penalties up to 500 times the minimum wage;[404] (2) willful misrepresentation in a prospectus subjecting the issuer and its officers and directors to penalties up to 500 times the minimum wage;[405] (3) fraud during share issues allowing penalties of fines or compulsory labor;[406] and (4) forgery of securities, which is punishable by imprisonment from five to eight years.[407]

Private remedies are available under the Civil Code. The Securities Law also expressly recognizes the possibility of civil liability for violations of securities legislation in the cases and to the extent allowed by the Civil Code.[408] Under Chapter 1 of the Civil Code, a person whose

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395. *Id.*
396. *Id.* art. 51(3).
397. *Id.*
398. *Id.* art. 51(6).
399. *Id.*
400. *Id.* art. 51(2).
401. *Id.*
402. *Criminal Code*, *supra* note 18, art. 1.
403. The existing Criminal Code of 1964 does not have any such provisions since at the time of its adoption Russia did not have (and did not expect to have) any securities market.
404. *Criminal Code*, *supra* note 18, art. 171.
405. *Id.* art. 177.
406. *Id.* art. 185.
407. *Id.* art. 186.
408. *Securities Law*, *supra* note 2, art. 51(1).

rights have been violated is entitled to fully recover his losses, unless provided otherwise by contract or law.[409] A person is entitled to be indemnified for expenses incurred in enforcing his rights as well as losses and damages to his property and lost profits.[410] In determining the affected person's lost profits, courts are to consider the profit made by the alleged violator as a result of the alleged violation.[411] Chapter 59 of Part Two of the Civil Code concerns liability for damages.[412]

XII. CONCLUSION

The Russian Federation has stimulated the development of financial markets as it moves towards the establishment of a free market economy. Many steps have already been taken to regulate securities transactions. This article shows that the current framework is a leap forward from the preceding period, although forthcoming directions from the regulations will expectedly advance and clarify existing law.

409. *Civil Code*, *supra* note 1, art. 15(1).
410. *Id.* art. 15(2).
411. *Id.*
412. *See id.* art. 1064.