Investing in Russian Securities: Analysis of Capital Market Development

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Abstract

Russia works hard to create a capitalistic system. Although only established in 1991, Russia’s securities market has already attracted a large number of foreign investors. The American financier George Soros has already invested US $1 billion in the Russian economy. Although experts agree that its potential is enormous, the newborn Russian capital market contains a significant amount of risk. This Essay shows the basic features of the development of the Russian Securities Law, analyzes the present market conditions, and shares some ideas for the near future.
INVESTING IN RUSSIAN SECURITIES: 
ANALYSIS OF CAPITAL 
MARKET DEVELOPMENT

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INTRODUCTION

Russia works hard to create a capitalistic system. Although only established in 1991, Russia’s securities market has already attracted a large number of foreign investors. The American financier George Soros has already invested US$1 billion in the Russian economy.  

Although experts agree that its potential is enormous, the newborn Russian capital market contains a significant amount of risk. This Essay shows the basic features of the development of the Russian Securities Law, analyzes the present market conditions, and shares some ideas for the near future.

I. SECURITIES AND THE FREE MARKET IN RUSSIA

During the first stage in the privatization process, which was completed on July 1, 1994, nearly 100,000 state-owned enterprises changed their form of ownership, about 12,500 of which became private. 

Appraising the results of the first stage of privatization, experts have concluded that the physical transfer of stocks to workers and employees did not, and could not, bring about radical changes in the economy. The real consequences appeared in the second stage of privatization, when those who had money and knew how to invest it bought stocks from the state and private stockholders.

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1. Tatyana Koshkareva & Rustam Narzikulov, Russia Has Become a Klondike for International Fund Speculators, RUSSIAN PRESS DIGEST, Oct. 31, 1997. Russian newspapers have published a list of twenty foreign investment funds operating in Russia. Id. This list does not show all such funds, only the most successful whose profit is 95% or more. Id. The greatest players on the market are the “Hermitage Fund” with a profit of almost 280% from January to August 1997, and the “Templeton-Russia Fund,” an investment group based in Singapore. Id.

2. The unprecedented voucher privatization (“voucherization”) began in December 1992 and has since been completed. Private property has been reborn in Russia: a majority of the companies in all sectors of economy have been privatized.

Pessimists predicted that privatization would result in a fiasco, on the theory that Russian people reject the notion of private property. Indeed, unprepared for such a crucial twist in their lives, a majority of the shareholders have lost a sense of reality. They obtained the vouchers virtually for free, and did not understand what to do with them. The seventy-five year period of communism virtually erased the word "owner" from people's minds. In connection with the psychological status of potential investors, the Russian Government has issued a statement declaring that:

[N]ow that the first, voucher stage of privatization has come to an end, the privatization policy must be aimed at stimulating investment and structural shifts in the economy, securing dynamic advance of the stock market, and improving management of all types of property.

Attempts at revising this policy, giving up the Results of the privatization drive, and editing the President's and Government's decisions, as well as calls to 'nationalize' some privatized enterprises are groundless. The right of ownership, which has emerged as a result of privatization as one of the most important constitutional rights in Russia, will be steadfastly protected by the Government.\textsuperscript{4}

The proliferation of new enterprises created more than forty million shareholders, a prodigious number by Russian standards.\textsuperscript{5} While some of the shareholders tried to sell their shares, the lack of liquidity in the market made this a difficult task. Industries such as oil and gas, non-ferrous metallurgy, automobiles, telecommunications, consumer goods, and media represented the remarkable exceptions. The shares of these companies has reached market price, and sufficient information about them is available. Market insiders believe that the remainder of Russian enterprises will likely catch up as the Russian economy matures.

The Russian market's most highly rated shares belong to the larger energy, communication, and utilities companies. These include Rostelecom, Kamaz, Komineft, and Krasny Oktybr. The most prominent star on the market, and the best performer to


\textsuperscript{5} Karpenko, supra note 3, at 36.
date, is LUKoil, a company that many predict will soon grow to become the largest company in the country. LUKoil’s capitalization constitutes nearly ten percent of the entire Russian stock market.

The commercial companies, banks, and investment funds in Russia began to issue securities in 1991. Unfortunately, this normally routine method of generating funds fell prey to a variety of con artists and swindlers in company management who either disappeared with investors’ money or declared bankruptcy. Consequently, the current liquidity value and reliability of the various private companies’ shares tends to vary widely from company to company.

In contrast, commercial banks are seen as a more solid investment. Shares of many stable Russian commercial banks have greater liquidity, and are reliable and trusted by their investors. Moreover, the dividend yield for most commercial bank stocks has been consistently high, with a considerable number reporting 300% to 400% dividend rates in 1993. In 1994, many banks took advantage of investor interest and increased their share issues. While some market watchers maintain that this resulted in an overvaluation of those shares, the act almost certainly ensured the banks’ stability and ability to maintain high yield rates over the long term. The most reliable and profitable of the commercial bank stocks are Incombank, Tokobank, Toribank, Neftehimbank, Unikombank, and Sberbank of Russia. Second on the list of the most popular Russian stocks in this category are shares of newly formed private trade firms and companies involved in Russia’s emerging service sector. These tend to issue shares with a small nominal value that are not registered to any particular individual and that do not require identification of an owner, but are issued to a bearer who has the authority to collect funds. Known as “street shares,” these stocks are usually issued for short-term operations and therefore carry a high risk.

Under Russian law, these bearer shares are technically illegal, but despite several well-publicized scandals, the shares are still widely circulated. The market price of these shares oscillates around their nominal value, dipping as much as two to three times below nominal value during times of light trading. The
most popular among such companies are Doka-khleb, Sistema Telemarktet, AVVA, Olbi-Diplomat, and Holding-Tsentr. Third on the list of viable stocks in this category are investment funds, which were created during privatization to collect vouchers that were subsequently invested in the shares of privatized enterprises. The largest of these investment funds have up to several million shareholders, although they tend to be low in liquidity and yield small dividends.

A. Establishment of a Federal Securities Commission and Licensing Regime

Probably the most significant measures were taken in Fall 1994 when the Russian President signed Decree No. 2063 of November 4, 1994, entitled Measures for State Regulation of the Securities Market in the Russian Federation.\textsuperscript{7} The decree served five main objectives. First, it forms a new regulatory agency in Russia called the Federal Securities and Stock Market Commission to control the securities industry.\textsuperscript{8} Second, it vests this agency with regulatory authority previously shared by different ministries.\textsuperscript{9} Third, it establishes a licensing regime for securities professionals.\textsuperscript{10} Fourth, it initiates universal registration rules for securities to be traded in the public market,\textsuperscript{11} and, finally, it creates a ground for a legal framework of securities regulation.\textsuperscript{12} These measures mainly represent a political response to the fallout from financial scandals that shook the country throughout 1994, including the fiasco of financial pyramid schemes of Russian investment companies such as MMM and Tibet. Many investments made by individuals in such companies were not even memorialized by certificates that complied with Russian law to qualify them as securities enforceable against the issuer. Many of these investments were also not registered with the Ministry of Finance pursuant to a compulsory requirement.\textsuperscript{13} Millions of Russian citizens lost their investments in high-profile investment

\textsuperscript{7. Measures For State Regulation of the Securities Market, President's Decree No. 2063 (Russ. 1994), available in 1994 WL 9141402.}
\textsuperscript{8. Id. art. 6 § 1, at 3.}
\textsuperscript{9. Id. art. 6 § 9, at 4.}
\textsuperscript{10. Id. art. 1 § 1, at 1.}
\textsuperscript{11. Id. art. 1 § 3, at 1.}
\textsuperscript{12. Id. art. 1-15, at 1-6.}
funds and other securities institutions that lacked proper licenses and were specifically used for large-scale market manipulation and fraud. Some of these companies engaged in illegal securities transactions with the sole purpose of defrauding the public.\textsuperscript{14} The Russian legal system has demonstrated a stark inability to deal with financial crimes.

Such events, covered by the Western media in excruciating detail, did not improve the reputation of the Russian Federation as a desirable host country for foreign investment. As a result of this negative publicity, the Russian Government placed priority on legislation geared to bring order to the securities market. Decree No. 2063\textsuperscript{15} ("Decree 2063") specifically described its purpose as to "ensure state regulation on the financial market and the securities market in the RF, and of relations taking shape in the process of securities trading, and in order to prevent abuses and breaches of rights of citizens."\textsuperscript{16} The Russian government had manifested its intent to regulate financial and securities markets as early as 1992 when, as part of the Decree No. 1186 of October 7, 1992\textsuperscript{17} ("Decree 1186"), the Russian President required that certain securities institutions be licensed.\textsuperscript{18} Decree 1186 also created the Securities and Stock Exchange Commission to oversee the stock market.\textsuperscript{19} Like many Russian government decrees, however, its passing was premature and its implementation slow. The Securities and Stock Exchange Commission barely existed for two years. Decree 2063 strengthened the prior regulations by requiring that "entrepreneurial activity in the securities market in the Russian Federation, including the rendering of services in issuance, purchase and sale of securities, shall be carried out exclusively on the basis of licenses issued to professional securities specialists."\textsuperscript{20} Decree 2063 also empowers the Federal Commission ("Commission"), the successor to the

\begin{itemize}
\item \textsuperscript{14} Thomas A. Dine, \textit{Lessons from a Russian Scandal}, J. COMM., Aug. 25, 1994, at 6a.
\item \textsuperscript{15} Measures for the State Regulation of the Securities Market, President's Decree No. 2063 (Russ. 1994), \textit{available in} 1994 WL 9141402.
\item \textsuperscript{16} \textit{Id.} at pmbl.
\item \textsuperscript{17} Organization of Securities Market as State and Municipal Enterprises are Privatized, President's Decree No. 1186 (Russ. 1992), \textit{available in} 1992 WL 8933201.
\item \textsuperscript{18} \textit{Id.} at annex 1, art. 19, § 2.
\item \textsuperscript{19} \textit{Id.} art. 8 § 1.
\item \textsuperscript{20} Measures For the State Regulation of the Securities Market in the Russian Federation, President's Decree No. 2063 art. 1, § I (Russ. 1994), \textit{available in} 1994 WL 9141402.
\end{itemize}
Securities and Stock Exchange Commission, to stop violations of the securities laws and to prevent unlicensed participants from operating in the market.\textsuperscript{21} In addition, Decree 2063 enumerates business activities and operations that can be legally undertaken in connection with securities\textsuperscript{22} and provides a procedure to stop unlicenced securities institutions from operating before major financial crises develop. Unlawful securities transactions may now be invalidated by legal or administrative actions before investors lose their savings.\textsuperscript{23}

While Decree 2063 defines the types of securities activities subject to its regulatory authority, it also refers to “activity in organization of securities trading, rendering of services, promoting securities transactions between professional participants in the securities market, including the activity of securities exchanges.”\textsuperscript{24} This language is broad enough to include non-securities specialists who may advise institutions or other professional services such as accounting, legal, or insurance services acting in connection with securities activities. Some foreign professionals practicing in Russia, including lawyers, insurance agents, accountants, stock brokers, and bankers, fear that Decree 2063 may require them to obtain licenses despite their remoteness to the securities market. Presumably, each separate securities activity named above would require a separate license.

Decree 2063 also prohibits public securities offerings without a prior registration with the Commission.\textsuperscript{25} It is not clear how the registration requirement applies to non-public offerings —such as private placements and other offerings granted “exemptions” from registration in other securities regimes, including those under the U.S. federal securities laws. Upon a closer reading, Decree 2063 implies that an exemption, once statutorily or administratively defined, will be a narrow one. Article 4 of Decree 2063 enumerates the types of securities for which registration is required in order to lawfully distribute and sell such securities to the Russian public. These include:

—government securities;

\textsuperscript{21} Id. Annex 1, art. 5 §§ 1-16, at 7-9; art. 7 §§ 1-10, at 9-10.
\textsuperscript{22} Id. art. 2 §§ 1-6, at 1-2.
\textsuperscript{23} Id. art. 5, at 3.
\textsuperscript{24} Id. art. 2 § 7, at 2.
\textsuperscript{25} Id. art 5, at 3.
—registered shares of stock issued by stock associations and banks;
—options and warrants;
—bonds, including government bonds;
—certificates of title to residential dwellings; and
—other securities recognized by Russian law or by international treaties to which the Russian Federation is a signatory.  

Decree 2063 empowers the Commission to establish rules and regulations governing registration of securities and offerings. Most importantly, by acting together with the Central Bank, the Commission is authorized to terminate an unlawful distribution or sale of any unregistered securities. The Ministry of Finance traditionally served as the primary source of securities regulations, having concurrent powers with the Central Bank to regulate the securities activities of depository institutions. 

A separate Appendix to Decree 2063 confers broad regulatory and advisory powers to the Commission. The Commission is authorized to promulgate standards for issuing and distributing securities and for carrying out professional activities in the securities market. It is also charged with issuing rules on corporate disclosure to investors. In addition to advisory functions in connection with drafts of new securities legislation, the Commission is empowered to make rulings on disputes brought before it, to issue, suspend and revoke licenses, audit the financial condition of securities issuers, provide information to other law enforcement agencies, and to appear in court as plaintiff in order to invalidate unlawful securities transactions. Decisions of the Commission may be appealed to the Russian president's office or by filing a legal action with a court of law or a court of arbitration. 

Members of the Commission ("Commissioners") are to be appointed by the Presidential Administration, Ministry of Finance, the State Property Committee, the Federal Property Fund, the Ministry of Justice, the State Anti-monopoly Committee, the State Tax Service, the State Authority for Non-govern-

26. Id. art. 4, at 3.
27. Id. Annex 1, art. 5 § 2, at 7.
28. Id. Annex 1, art. 5 § 5, at 8.
29. Id. Separate Annex, art. 7 § 8, at 10.
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mental Pension Funds, the Federal Insurance Authority, the Central Bank of the Russian Federation, and one representative each from the two chambers of the Russian Parliament. A board of experts from government and the private sector advises the newly appointed Commissioners. Despite many difficulties in the early stages of its operation, the Commission has begun to influence the market and plans to regularly publish information on its decisions, regulatory actions, and Russian securities legislation in conjunction with its regulatory and oversight functions.

Another important legislative development was the adoption of the Decree of the Russian Government No. 336 of April 15, 1995 on Measures for Further Development of the Securities Market in the Russian Federation ("Decree 336"). Decree 336 sets forth the necessary components of a market infrastructure and enumerates the steps necessary for their implementation. These components include clearance and settlement capability, computerized organized trading facilities, informational services, and reliable custodial services.

The new Decrees noted above represent an improvement of the initial basic legislative acts on securities enacted in 1991 and 1992. Decree No. 1769 of October 27, 1993 entitled Measures to Ensure Shareholders' Rights ("Decree 1769") imposed record-keeping requirements on the obligation of publicly-held (open) stock associations to maintain a record of stock transfer procedures. Decree No. 1233 of June 11, 1994, provided additional safeguards with respect to registration of securities transfers and nominee ownership.

B. Struggle Over Regulatory Authority and the Separation of Power Doctrine

The rapid development of Russia’s securities market stands in sharp contrast to the "back-and-forth" power between the Commission and Central Bank for authority to regulate it. At a

30. Id. art. 6 § 4, at 4.
32. Measures to Ensure the Rights of Shareholders, President’s Decree No. 1769 (Russ. 1993), available in 1993 WL 10409648.
34. In 1992, President’s Decree No. 1186 created the Commission with broad pow-
conference on the Russian securities market sponsored by the Harriman Institute, Peter Borenboim, Vice President of the Union of Advocates of the Moscow City Bar Association, defined a protocol signed by the Commission and the Central Bank on May 29, 1997, as "the end of a long-running bureaucratic dispute, which has been causing confusion and frustration in Russia's rapidly growing capital market." The protocol grants the Central Bank authority to license commercial bank activities in the equity market and increases shifts the balance of power between the Central Bank and the Commission to regulate the capital market in favor of the Central Bank.

The regulatory dispute between the Commission and Central Bank hinges on the question of what economic model is best for Russia. While the Central Bank favors bank-centered system similar to the German model, the Federal Commission supports a stock market-based system controlled by an independent regulator, as in the United States and the United Kingdom. The May 29, 1997 Protocol represents the defeat of the Commission's view.

According to Barenboim, the Commission has undermined its own prospects in several ways. First, it opposed compromise with capital market participants and the reformers from the Central Bank. Second, it failed to protect the investors' interests by inadequately policing questionable market participants. Third, it rejected well-capitalized banks from the securities market. Fourth, the Commission unnecessarily burdened the market with detailed and intrusive regulations. Finally, it adopted a

ers to make rules, exercise market oversight, and promote practices consistent with international standards. In practice, however, competing authorities including the Central Bank, the Ministry of Finance, and the State Property Committee regulated the securities market from the beginning.

35. Conference Calendar, Russ. & Comm. Bus. L. Rept., June 4, 1997, at 5. The Conference on Russian Securities on the American and Russian Capital Markets was sponsored by Harriman Institute of Columbia University. Among the participants were Alexander Zaharov, General Director of the Moscow Interbank Currency Exchange, Peter Barenboim, representative of the International Bar Association of the CIS, Thomas Sanford, Vice President of the Bank of New York, and Richard Bernard, Executive Vice President of the New York Stock Exchange.


37. Id.

38. Id.

39. See id. (explaining which exchange should trade which corporate securities).
different legal standard for government and corporate securities.40

Despite its controversial nature, the protocol expresses optimism about the future of the Russian securities market and its regulation. It shows that the parties in dispute can reach some compromise, and raises a question about the necessity of choosing an adequate form of regulatory body. Some experts, including Borenboim, opine that Russian capital market should follow the U.S. example of defending small investors while at the same time avoiding over-regulation.41 One can argue that separation of power among the Central Bank, the Ministry of Finance, and the Commission will eliminate over-regulation, but this would undoubtedly bring confusion to the market. Cherie Loessberg, General Counsel to Brunswick Brokers in Moscow and head of the Subcommittee on Securities of the American Chamber of Commerce in Russia, believes that this protocol will end the conflict among regulators.42

II. CREATING AN INVESTOR-FRIENDLY MARKET

A day before his re-election, Russian President Boris Yeltsin signed two landmark decrees which, together with the new Law on Securities Markets of April 1996,43 bolster the Russian capital markets by increasing their stability and thus their attractiveness to domestic and foreign investors. Decree No. 1008 On the Establishment of the Concept of Development for the Securities Market in the Russian Federation44 (“Framework Decree”) provides a blueprint for the future of regulatory oversight of Russian

40. Id. Borenboim explains that, by instituting a double standard, the Commission intended to separate the market for governmental and corporate securities in terms of licensing. The protocol provides for a single license to sell both types of the securities. The Commission will license securities market participants. It will issue a general license to the Central Bank, and thereafter the Central Bank will license and supervise the securities market activities of credit companies. The rest of the “securities pie” is divided between the Ministry of Finance, which will register the securities of insurance institutions, and the Central Bank, which will register the securities of commercial banks.

41. Id. at 16.
42. Id.
44. On the Establishment of the Concept of Development for the Securities Market, President’s Decree No. 1008 (Russ. 1996) [hereinafter President’s Decree No. 1008] (on file with the Fordham International Law Journal).
capital markets and strengthens the role of self-regulating organizations in securities-related industries.

The Framework Decree lays out the Russian Government's policy and legislative agenda for the securities market, and operates to stimulate domestic and foreign investment in Russian companies. In addition, it aims to balance the need for regulation of securities issues and distribution with the need to create a stable, investor-friendly climate that would allow Russian companies to compete for capital in the international market place. The Framework Decree identifies six main goals for securities market regulators:

1. developing an effective mechanism for attracting investors to the private sector of the Russian economy;
2. financing the federal deficit through non-inflationary means;
3. increasing efficiency in the management of privatized enterprises, particularly enterprises with substantial government participation, by setting up managerial retraining and incentive programs for payment discipline and market-oriented project development;
4. protecting securities market participants against unfair market manipulation;
5. integrating the Russian securities market with international capital markets through primarily depository receipts (GDRs, ADRs)\(^4\) while insuring the independence of the Russian securities market; and
6. closely regulating surrogate securities and derivatives, and policing for fraud and illegal activities in the securities market.\(^5\)

The Framework Decree also provides that the first phase of regulatory review should emphasize elimination of the so-called registrar risk\(^6\) and foster increased scrutiny of quasi-monetary

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4. GDR refers to Global Depository Receipt and ADR refers to American Depository Receipt.

5. President's Decree No. 1008, supra note 44, art. 3.1.

6. The early Russian registrars were completely inexperienced and operated under few controls. They used primitive systems and procedures, determined their own preconditions for transferring ownership on their books, and set their own fees for doing so. Nor was there a regulator imposing standards or auditing registrars' activities in offices dispersed across a vast country usually inside company gates. All of these factors combined to make potential wary of the Russian market. To date, in many instances, a shareholder is faced with a number of difficulties when trying to exercise his rights or transfer his shares.
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instruments and bills of exchange. While these goals are mostly declaratory in nature, the emphasis placed by the Framework Decree on creating a favorable investment climate, integration into international capital markets, modern management practices in state-controlled privatized enterprises, inflation cognizance in financing the federal budget, and eradication of fraud in the market demonstrates that Russia intends to base its securities regulations on the same general principles found in capital markets in the West.

On June 16, 1997 President Yeltsin ordered the creation of a commission to protect investor rights and then appointed Prime Minister Viktor Chernomyrdin to preside. The resulting State Commission on the Protection of Investors on the Russian Securities Market ("State Commission") includes members from the Central Bank, the Interior Ministry, and the Supreme Court. The State Commission controls and investigates violations of investors’ rights and enacts procedures for the administration of lawsuits and enforcement of judgments. The notorious court decisions in favoring Western shareholders over management of Russia’s largest steel plant, AO Novolipetsk Metallurgical Kombinat ("Novolipetsk"), mark the beginning of a new legal era on the untested ground of Russian securities law. In April 1997, Novolipetsk’s domestic investors, including Moscow-based investment bank Renaissance Capital Group and its Sputnik Funds division (whose shareholders include billionaire George Soros), the Harvard University Endowment, Bahamas-based Cambridge Capital Management Ltd. (a hedge fund), and MFK, a Russian investment bank subsidiary of Russia’s Uneximbank, brought four lawsuits against Novolipetsk. These investors, who together held more than fifty percent of the company’s shares, demanded proportional seats on the board of directors and claimed that some stock had been wrongly converted into nonvoting shares. The three-judge panel of the Lipetsk Arbitration Court, a civil court in the city of Lipetsk, ruled for the

48. President’s Decree No. 1008, supra note 44, art. 1 § 3, at 6.
50. Id.
51. Id.
52. Id.
investors in May of 1997, ordering Novolipetsk's management to submit to a shareholder vote at the July 12, 1997 shareholder.

Parties in these disputes agree on the positive fact that the judges remained impartial. According to Vladimir Lisin, a director of the steelmill, the court's decisions were very objective. In addition, several U.S. lawyers agreed that the court's decisions evidenced the improving legal standards for protection of foreign investors in Russia. Brian L. Zimbler, partner at the Moscow office of New York-based law firm LeBoeuf, Lamb, Greene & MacRae L.L.P., has stated that Russian courts have begun to comprehend shareholder rights, and that, despite pressure of negative public opinion, they are willing to bring justice to this delicate area of corporate law by ruling for non-Russian investors. According to Bruce W. Bean, a partner at New York-based Coudert Brothers' seventeen-member Moscow office, "arbitration courts are what count for foreign investors," and, "the decisions have certainly come out the right way. Now the question is one of enforcement."

In July 1996, the Central Bank issued Instruction No. 45 to ease restrictions on foreign investment in the government securities market. Instruction No. 45 provides for type S ruble bank accounts and regulates the procedure for operating such accounts. Pursuant to Instruction No. 45, non-residents must open a type S ruble account to invest in Russian government securities. Any non-resident may open an S account, but may open only one such account at each bank that is licensed by the Central Bank to offer S accounts. The Central Bank has given permission to a number of the largest banks in Russia to conduct operations with S accounts.

Individuals can use S accounts to effect only those catego-

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53. Id.
54. Id.
55. Id.
56. Id.
58. Id. § 1.1, at 1.
59. Id. § 1.2, at 1.
60. Id. § 1.4, at 1.
61. Id. § 1.3, at 1. The list of authorized banks includes Sberbank of Russia, UNEXIM Bank, Bank Menatep, JSB Inkombank, Russian Credit Bank, Alfa-Bank, MJSB "Vozrozdeniye", Avtobank, SBS-AGRO, and Promstroybank of Russia. Id.
ris of transactions that Instruction No. 45 permits. Thus, for example, a non-resident can not deposit ruble revenues from the sale of goods or services in Russia into an S account. Non-residents also cannot invest S account funds in privatized Russian enterprises. Instruction No. 45 permits non-residents to withdraw S account rubles in order to acquire GKO's and OFZs, pay expenses in connection with the purchase of GKO's and OFZs, purchase hard currency for "conversion operations," and conduct all other transactions permitted by legislation, including payment of tax obligations arising from the purchase or sale of GKO's and OFZs. As a general matter, therefore, a non-resident may withdraw rubles from an S account to purchase government securities, and to pay corresponding expenses and taxes. Apart from S accounts, a non-resident may use a type I account to transfer hard currency abroad. The amendments to Instruction No. 16 permit non-residents to transfer funds from a type T account, which is principally used to deposit rubles from sales of goods and services, to a type I account.

In December 1995, Arthur Levitt, Chairman of the U.S. Securities and Exchange Commission ("SEC"), and Anatoly Chubais, the First Deputy Prime Minister of the Russian Federation and Chairman of the Commission, signed a Memorandum of Understanding and Protocol. This document defined the bilateral relationships and constructive efforts that experts consider as fundamental to driving the improvement of law enforcement and regulation in the Russian securities market. In Levitt's opinion, the Memorandum of Understanding "is a prime example of enforcement cooperation between securities regulators." The Memorandum of Understanding emphasizes the vital im-

62. Id. § 1.5, at 1.
63. Id. § 3.1 (b), at 3. GKO's are short-term, zero coupon, ruble-denominated treasury bills. OFZs are long-term, floating rate, ruble-denominated Federal loan bonds.
64. Id. §§ 3.2 (a)-(d), at 3.
portance of forming markets with integrity and creating enforcement mechanisms to eliminate fraud. In addition, it expresses the popular belief that in order to secure markets from criminals, law enforcement authorities must have access to information on matters relating to possible violations of the securities law. Significantly, Yuriy Kotler, a spokesman for the Commission, stated that "raising the confidence of the Russian public is a problem."

The Russian Government has great expectations for the concept of share investment funds which it believes will tap the savings of the Russian public (that currently amount to US$30 billion according to estimates by the Commission) and finance Russian businesses (which are currently in extreme need of capital investment). Having suffered huge losses in pyramid investing schemes, such as MMM and Tibet, the Russian public has some reservations about investing in the stock market. Fund managers thus ask the question whether average Russians can be persuaded to invest in share investment funds the way Westerners have invested in mutual funds. Some Western fund managers answer this question in the affirmative, and enter the Russian market either to work for Russian asset management companies or to set up their own.

President's Decree No. 765 of July 26, 1995 laid the groundwork for the creation of share investment funds "in order to create proper conditions for the effective use of the savings of citizens, to attract investors for investment activities, and to increase the effectiveness of investment policy of Russian Federation." According to Charles Mallory, general director of Credis Moscow AO, a wholly owned subsidiary of Credit Suisse that manages a share investment fund under licence from the Commission, getting the license was not easy. By imposing the licensing hurdle, the Commission ensures that only highly-qualified and well-capitalized experts manage the funds.

69. Id.
72. Id. at pmbl.
73. Western Companies are setting up Share Investment Funds in Russia, 7 Russ. & Comm. Bus. L. Rept. 13 (1996).
Nency Herring, the new chief investment manager at Troika Dialogue, a recently-licensed fund asset management company, stated that Troika intends to address the confidence problem through marketing and stressing to the public that the original fund is government-backed and, therefore, quite safe. Herrig is confident that average Russians who cannot protect their savings from inflation will find that Troika’s financial products offer the perfect means to do so. Foreigners can buy into the share investment fund through I accounts.  

A. The Problems and Solutions in Trading Russian Securities

The 1991 Russian privatization law transformed Soviet economic units into joint stock companies by issuing stock and distributing it to private owners pursuant to the privatization program. Because the stock of Russian firms is not memorialized in certificates, the primary evidence of one’s ownership share is an entry in the firm’s shareholder register. Regulations issued in 1993 provided that companies with more than 1,000 shareholders must maintain such registers with independent registrars. Russian companies have chosen to ignore the independent registrar requirement and instead choose to maintain the register themselves. Developing an industry of independent registrars takes time. Moreover, because companies could still receive state credits in 1994 and early 1995, market discipline that derives from the need to raise capital was largely missing.

Because many firms did not establish a register for shareholders at all, investors often found that they purchased an undocumented and, therefore, illegal block of shares. Investors who experienced problems with a company or the shares issued had no legal recourse. To date, notwithstanding the substantial development of the legal standards governing security transactions over the last few years, title registration procedures applicable to shareholders remain legally and technically cumbersome, particularly for non-Russian shareholders. These problems, along with Russia’s political and macroeconomic instability,

74. Id.
76. Measures to Ensure the Rights of Shareholders, President’s Decree No. 1769 art. 4. § 1, at 3 (Russ. 1993), available in 1993 WL 10409648.
posed a great disincentive for investment in the Russian securities market.

By mid-1995, organizations engaged in maintaining registries fell into six categories:

—Joint stock companies maintaining their own share registries;
—Organizations established by an issuer (also known as “pocket registrars,” usually companies set up as specialized registrars, depositories and investment companies);
—Specialized-Independent registrars;
—Banks;
—Investment firms (including broker-dealers); and
—Depositories (primarily organizations having the word “depository” in their name, but whose major line of activity is maintaining registers).

Joint stock companies maintained more than fifty percent of the registers in Russia in 1995. About eighty percent of the companies maintaining their own registers had fewer than 10,000 shareholders. These companies have chosen to maintain their own registers in order to preserve control of the company and its shareholders, and because either other alternatives did not exist in the region where the company was located, or the company could not afford to retain a professional registrar. The Commission’s registrar audit team cites noncompliance with the independent registrar requirement as the most common violation. Many companies with 500 or more shareholders continue to maintain their own registries due to the high costs of independent registry services and the limited trading volume of their shares. Audits conducted by the Commission often uncover conflicts of interest among registry service providers, including findings that registrars also perform brokerage services, that employees of the registrar actively trade shares, and that the registrar is a shareholder of the issuer. Other problems encountered by the Commission include refusal by the registrar to register share transactions without legal cause, failure to register transactions within the statutory time period, incomplete information maintained in personal accounts, and incomplete or otherwise deficient share extracts.

In July 1995, the Commission issued regulations on the pro-
The regulations also define the rights and responsibilities of registrars, transfer agents, shareholders, and nominee shareholders in detail, and require that registers exist in either paper or electronic form. In addition, the regulations set forth what information must be included in the register, including all registered pledges and encumbrances affecting the securities. Furthermore, the regulations provide that entries relating to transfers of securities must be made within three days of the date of submission to the registrar of the documents required by the regulations for transfer of ownership. Finally, registrars are prohibited from imposing additional requirements to conduct transfers and may not perform other types of professional activities in the securities market.

Most analysts expect a significant consolidation of registrars by the end of 1998. Consolidation should reduce the number of small and medium-sized registrars and/or increase the size of other registrars. Greater use of nominee ownership in the future will dramatically reduce the volume of transactions processed by registrars. The Commission’s prohibition against a registrar’s pursuit of joint activities in the capital market will also force certain registrars out of the business. In the future, the registrar business will most likely merge with bank affiliates, specialized registrars, and depositories. Depositories may specialize as registrars or provide nominal holding and custodial services. A main cause for this consolidation, other than the operation of ordinary market forces, is the fact that main business centers such as Moscow and St. Petersburg already have an adequate number of registrars. Moscow currently has the highest concentration of large registrars.

Depositories operate differently than a registrars, although the two systems have much in common. Like a registry, the depository places accepted share certificates in open or closed storage. These two types of storage vary in their record-keeping

78. Id. art. 3 § 1.2.
79. Id. art. 3 § 1.4.
80. Id. art. 4 § 1.2.
81. Id. art. 3 § 1.5.
82. Id. art. 3 § 1.8.
methods. In closed storage, each security certificate is numbered and registered to a specific owner. In open storage, securities within a certain category are not designated to particular owners. Securities are inventoried in a depository through a system of deposit accounts. These accounts are divided into active accounts, which record the quantity of securities kept in the given place, and passive accounts, which list the securities belonging to specific clients. In order to open an account, a client must execute a deposit agreement with the depository. The client may include in the deposit agreement provisions assigning certain rights to the depository. These may include the right to use the client's dividends to purchase more securities, or the right to engage in other operations of nominee holders.

To execute a transaction involving securities held in a deposit account, a client must present the depository with a transfer instruction. An account holder wishing to transfer shares has the option of transferring the shares into an escrow account. While in such an account, the transferor holds title to the securities but cannot access them in any way. Upon receipt of payment confirmation, the depository transfers the securities into the deposit account of the transferee, at which point the transferor loses all rights to the transferred securities. When presenting a client with information on the client's deposit account, the depository furnishes information on the storage status of its securities. This information is of particular importance to a client who conducts a large volume of transactions on the securities market.

Trade settling and clearing has developed relatively sluggishly in Russia. The original vision for settlement and clearing espoused by market participants and government officials in late 1993 and early 1994 involved a national network of clearing and settlement organizations which would provide nominee ownership trading and bookkeeping for customers of participating banks and brokers within a centralized system. Maintained by technical assistance funds, settlement institutions were created in Moscow, St. Petersburg, Yekaterinburg, Novosibirsk, and Vladivostok. These had unified technical support systems and were to provide inter-regional settlement accommodations.

Although these settlement facilities continue to exist and function today, their trade settlement activities remain insufficient, and payment on delivery does not yet exist. Most transac-
tions continue to be settled by brokers via telephone and fax, and the vast majority of funds settlement takes place offshore. Although each of the settlement organizations had start-up difficulties, the most significant reason for their limited development to date is the lack of demand for such services by market participants, including brokers and registrars. As the Russian market progresses, and market participants gain experience, settlement and clearing systems will develop along with the securities industry infrastructure.

The Moscow settlement organization, known as the Depository Clearing Company ("DCC"), was founded in November 1993. Initially established as the centralized depository and settlement facility for the country, the DCC has been the most active of the organizations originally formed to clear the overwhelming majority of securities transactions conducted in Moscow. The lack of an unambiguous legal foundation and clear determination of the tax treatment of nominee ownership relegated the DCC to acting as a re-registration agent for the first eighteen months of its existence. The DCC operated as a courier service, providing collection services, transmitting documents for re-registration, and delivering extracts and other types of paperwork from the registrar to the shareholders or brokers.

The DCC is linked electronically to the Russian Trading System ("RTS"), although the use of this process has been narrowed to a limited number of pilot trials. In the fall of 1995, the RTS and the DCC established a procedure to download electronic files from RTS to the DCC once each business day. To notify the DCC of a trade for settlement, a broker can mark the trade for the batch downloaded to the DCC at the time when the broker registers the trade with the RTS. The broker must also send trade documents along with the written confirmation to the DCC in order to request settlement. In order for DCC to settle a trade, each of the brokers for the buyer and seller will generate its written communication with the DCC. This communication is then entered into the DCC's system, matched, and the trade is entered on the specified date. Thus, although electronic clearing is possible, it has proven a time-consuming, labor-intensive process and thus has rarely been used.

An alternative trade settlement concept being discussed in Russia is a nationwide "umbrella" network of regional settlement organizations. In this scheme, the DCC would not operate as a
central depository with regional branches, but rather as the regional subsidiary of the main network for settling trades in the Moscow region. A newly-created "umbrella" database would be formed as the centralized main computer where inter-regional settlement is dispatched through the network of regional depositories. There has also been discussion of developing certain bank depositories for securities settlement in Russia, but brokers are likely to reject a settlement system that is wholly owned and controlled by a third party and that sets its own fees and procedures.

Payment on delivery has not yet been achieved in Russia, although the DCC is currently working to achieve this by developing a funds settlement system with a specialized settlement bank. Problems such as costly currency conversion, expensive custody service, poor information supply, specific market practices, confusing tax conventions, and unpredictable investment policies have driven most settlement procedures offshore. The complexity and instability of the Russian Central Bank's clearing system has encouraged financial organizations to avoid it and set up a separate system for clearing transactions within Russia. For example, commercial banks have established a system of correspondent accounts among them in order to escape the Central Bank system. This system, however, lacks a centralized hub. Most analysts and market participants today feel that payment on delivery could be implemented rapidly in Russia as soon as the economic and political environment permits. Before domestic market demand for settlement can result in its implementation, however, significant improvement in the Russian tax laws governing securities transactions, further market development, and macroeconomic stabilization must occur.

Domestic custodial services are developing in Russia. Several large non-Russian banks holding Russian banking licenses have provided limited custody services to their international affiliates or customers investing in Russian equities. Most notably, Chase Manhattan Bank's Moscow affiliate has provided these services to some customers of its London-based global custodian, including Templeton Funds. Credit Suisse, ING Bank Eurasia, and Citibank have also provided custodial services for their clients. Custodial services generally include the following:
—registration and confirmation of ownership with company registrars;
—clearance of a securities purchase;
—custody of certificates and extracts;
—representation at shareholder meetings; and
—collection of income.

Additional services, such as proxy solicitation, tabulation, and tax reclamation, may soon be available from these custodians. Many Russian banks have also developed “custody” departments during recent years, but act only as depositories for registration with company registrars, safekeeping of certificates and registrar extracts, and the receipt of dividend income.

The legal infrastructure for custodial or depository services in Russia needs further development. The State Property Committee first regulated depositories in 1994. Its regulations defined depository activity as the safekeeping of securities and/or keeping a record of the rights of individuals using such services. Four types of organizations were allowed to perform depository activities. These included investment institutions, stock exchanges, special depositories performing exclusively depository activities, and specialized settlement-depository organizations.

Under the regulations, depository activity could only be conducted pursuant to a license from the Securities Committee (a predecessor of the Russian Securities Commission). No licenses were ever issued. The regulations prohibited depositories from conducting the following activities:

—conducting transactions on their own behalf in the securities they held;
—transferring securities to the management of a third party;
—representing the shareholder at general meetings of the company; and
—giving security over the shares for their own obligations.

Two market developments have increased the demand for custody services in Russia, thus accelerating the growth of custodians. The first development is the increasing interest of foreign

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84. Id. art. 1.1 § 2, at 1.
85. Id. art. 2.1 §§ 1-4, at 4.
86. Id. art. 3.1 §§ 1-4, at 6.
institutional investors in investing in Russian securities. The regulations of these investors' domestic regulators, however, require that they invest through local qualified custodians, which did not exist until recent years. In April 1995, the Division of Investment Management of the U.S. Securities and Exchange Commission ("SEC") assured the newly-created closed-end Templeton Russia Fund in a no-action letter, that so long as certain conditions were met, the Fund could invest in the equity securities of Russian issuers without risking an enforcement action pursuant to Section 17(f) and Rule 17f-5 of the U.S. Investment Company Act of 1940.87

The custodial arrangement set up by the Templeton Fund and Chase Manhattan Bank, NA to address potential risks in the Russian share registration system, and which provided the basis for the SEC's no-action letter, included several important qualifications. First, Chase Manhattan was to act as custodian, and enter into a subcustodial arrangement with its wholly-owned affiliate, Chase Moscow. Chase Moscow was to personally register the transfer of share ownership, and to pay for the transfer only after a register extract was issued. Chase agreed to sign a contract with the registrar of each registered issuer. The contract gave the custodian the right to conduct regular share confirmations, hold shares in its name as nominee, and have its independent auditors periodically verify the share register. Also under the agreement, the U.S. parent bank would incur liability for the negligence or misconduct of the subcustodian. Finally, the Templeton Fund's directors were periodically required to examine the custodial arrangements and review the suitability of Russian equity investments owned by the fund.

Subsequently, the SEC's Division of Investment Management issued another no-action letter with respect to custodial arrangements set up with ING Bank and Uneximbank, which announced at the beginning of May 1996 that their custodial arrangements for holding Russian equities had been approved. These no-action letters by the SEC have effectively opened up the Russian equities market to funds based in the United States. Credit Suisse and Vneshtorgbank have also applied to the SEC

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87. 15 U.S.C. § 80a-17 (1994). The Investment Company Act of 1940 permits an investment company to maintain foreign securities held by an eligible custodian in order to effect its foreign securities transactions. Id.
for no-action letters with respect to their custodial arrangements. These banks have announced that they will begin to offer full custodian services by the end of 1997, including settlement services, safekeeping, corporate actions, income collection, customer reporting, tax support services, and foreign exchange services.

The second market development is the emerging mutual fund market that has stimulated the demand for and the development of local custodians. The regulatory framework for Russian mutual funds, adopted by the Russian President, requires that domestic fund managers have in place a contract with a special depository in order to receive a license to establish a fund.

C. Raising Capital Abroad

Russian businesses are currently using several methods to raise capital abroad. These include establishing investment funds, soliciting investments, offering of shares of offshore companies which own Russian securities, and offering depository receipts. Each of these alternatives enable investors to invest in Russian securities without direct contact with Russian tax authorities and without requirements to comply with Russian currency laws. The most popular of these methods is the offering of securities of a non-Russian company that owns or has the right to acquire an interest in a Russian company or project. Several foreign companies have followed this route in Russia, including the Petersburg-based Long Distance, Inc., whose offering was registered in the United States with the SEC and raised nearly US$100 million. Typically, however, an offering is privately placed with a limited group of investors to avoid the cost of complying with regulations applicable to public offerings.

Another very productive means to raise capital for Russian companies is by offering American Depository Receipts ("ADRs"). A depository receipt is a negotiable certificate issued by a Western bank, representing company shares that are on de-
posit with the bank (or, in this case, a local Russian bank) that acts as custodian on the Western bank's behalf. ADRs were invented in 1927 in response to a law enacted in Great Britain prohibiting British companies from registering shares abroad without a British transfer agent. UK shares were not allowed to leave the UK physically, and, in order to accommodate U.S. investor's demand, the American Depositary Receipt was created. ADRs exist in five forms.

1. Un赞助 ADRs

An unsponsored ADR program may be set up by U.S. banks on their own initiative, without the involvement of the non-U.S. issuer. The U.S. bank establishing an unsponsored ADR program offers the ADRs to the public in exchange for shares of the non-U.S. company. Registration with the SEC is made on Form F-6, which does not require disclosure concerning the non-U.S. issuer or any authorization from the company. In addition, this registration does not give rise to any reporting obligation for the non-U.S. company. The U.S. depositary bank retains total discretion over the conduct of the ADR program, including the option to terminate it.

2. Level I ADRs

Level I ADRs trade in the over the counter ("OTC") public markets under the registration and reporting exception in Rule 12(g)(3)-(2)(b) of the U.S. Securities Exchange Act of 1934. Level I ADRs provide issuers with a simple and efficient means of building a core group of investors with minimal regulatory and reporting requirements. A Level-I program is generally viewed as the first step into the U.S. public equity market.

3. Level II ADRs

Level II ADRs trade on NASDAQ or on an exchange in compliance with the U.S. Securities Exchange Act of 1934 registration and reporting requirements. The issuer does not register a public offering at the time of listing. Companies that want to list their securities on a U.S. exchange use sponsored Level-II ADRs.

92. 17 C.F.R. § 240.12(g)(3)-(2)(b).
Level II programs require more SEC filings and involve greater compliance with exchange rules.

4. Level III ADRs

Level III ADRs can be used by companies listed on a major exchange that wish to raise capital in the United States. Level III Depositary Receipts are sold to the public in a public offering. The issuer registers the offering under the U.S. 1933 Securities Act and reports under the U.S. Securities Act of 1933. Spon-
sored Level-III ADRs are listed on an exchange.

5. Rule 144A Private Placement ADR

Rule 144A Depository Receipts trade on portal in the United States. Because no reporting or registration is required, investors must rely on less information. Portal is a very restricted system, and thus Rule 144A ADRs lack the liquidity of registered issues.

Depository receipts allow a company to reach a wider mar-
ket than its home country. The largest ADRs market is in the United States, where the trading volume of ADRs is now over ten percent of the NYSE volume. ADRs are widely recognized as
the optimal method for domestic U.S. investors to invest in non-
U.S. securities.

According to information at the Russian exchange, fourteen Russian companies trade ADRs or are themselves listed at New York Stock Exchange and the American Stock Exchange. Among these, the biggest are AO Mosenergo, LUKoil, Vimpelcom, and JSC Rosneftegazstroy. Information about others is available from the Bank of New York, Merrill Lynch,

93. 17 C.F.R. § 240.144A.
94. Proposed Rule Change by the National Association of Securities Dealers, Inc., Relating to the Operation of the PORTAL Market, 54 Fed. Reg. 49164 (Nov. 24, 1989). Developed by the NASD to facilitate private placement transactions, portal is the acro-
nym for "private offerings, resales, and trading through automated linkages." Id.
96. Russian Exchange information page at Web-site, A few useful references on Rus-
97. Id.
and Smith Barney.\textsuperscript{98} The total amount of ADRs invested in the Russian economy in 1997 was US$15 billion.\textsuperscript{99}

D. Tax Regulations for Foreign Investors

According to the provisions of the Russian Federation Tax Service Instruction 34\textsuperscript{100} ("Instruction 34"), foreign investors must pay taxes on capital gains and dividends. Three issues arise concerning the source of income: liability, withholding requirements, and treaty exemptions. Unless a treaty provides otherwise, shareholders must pay Russian taxes on dividends earned from Russian shares and on capital gains from the sale of such shares.\textsuperscript{101} A Russian company is required to withhold tax on paid dividends,\textsuperscript{102} and a Russian purchaser of shares is obliged to withhold capital gains tax at the time of payment unless evidence is provided that the recipient of the money is registered with the Russian tax authorities.\textsuperscript{103} Russian tax regulations do not require foreign purchasers to withhold capital gains tax unless they are located in Russia or are registered with Russian tax authorities. However, Russian law does set forth a clear method for calculating capital gains. For example, under the current law, Russian purchasers cannot deduct the seller’s basis from the purchase price. Because the regulations provide that the Russian purchaser is liable for any shortfall in withholding,\textsuperscript{104} Russian purchasers often apply the withholding to the full purchase price of the shares, regardless of the seller’s basis or treaty protections.

Even assuming that the purchaser was willing to withhold Russian tax on the gain alone, it is not clear how the seller’s basis would be calculated. For instance, assuming the initial purchase was in rubles (the only lawful arrangement between a foreign buyer and a Russian seller in the absence of a Central Bank license), it is not clear whether the basis would be the number of

\textsuperscript{98} Id.
\textsuperscript{100} Taxation of Foreign Legal Persons’ Profit and Income, State Tax Service Instruction No. 34 (Russ. 1995), available in 1995 WL 9700106.
\textsuperscript{101} Id. art. 5.3, at 20.
\textsuperscript{102} Id. art. 5.3 § 2, at 20.
\textsuperscript{103} Id. art. 6.4, at 21.
\textsuperscript{104} Id. art. 5.4, at 20.
rubles then paid or the number of rubles which today are the equivalent of the amount of hard currency which was converted to rubles to pay for the shares. Given the vast ruble inflation over the past few years, the former could obviously result in a far higher gain, and therefore in a far higher tax. Because Russian law contains no provisions for the indexing of capital gains, and in view of the tax authorities' desire to maximize tax revenues, it seems likely that a higher tax will be demanded.

As mentioned above, under certain double taxation treaties, Russian taxes due on capital gains and dividends are reduced or entirely eliminated. A foreign investor may claim an exemption to get a prior exemption from the tax authorities, at least for the payment of dividends. Because a Russian purchaser is liable for failure to withhold, many Russian purchasers have insisted on withholding tax on the full purchase price in the absence of a clear exemption, thus forcing the foreign seller to apply for a refund. Because investors will ordinarily pay for the shares they purchase in rubles, the withholding and the refund should also be in rubles, placing the currency risk on the seller.

In general, the procedure for obtaining treaty relief is still developing in Russia. In order to claim treaty relief, a valid treaty clearance must be obtained by completing the form specified by the Russian tax authorities, providing proof of tax residency in the foreign country (confirmed by the appropriate authority in the foreign country), and submitting the proof to the Russian tax authorities at the location where the income arises. The paperwork required is cumbersome. Instruction 34 provides that under existing international treaties establishing lower tax rates or a full exemption from taxation in the Russian Federation, the excess amount of tax withheld at the source will be refunded provided application for the refund is made within one year.105 Because treaties take precedence over regulations, it is unclear whether the requirement to apply for the refund within one year is legal as applied to countries whose tax treaties with Russia do not contain this requirement.

Two regulatory bodies—the Ministry of Finance and the Anti-Monopoly Committee—must be notified of certain share acquisitions. Notice to the Ministry of Finance is required upon the acquisition of fifteen percent or more of the shares of a Rus-

105. Id. art. 6.2, at 21.
sian company. Notice needs not be given in advance but rather within five days after the acquisition. The Federal Anti-Monopoly Committee must be notified if the assets either as buyer or seller exceed 750 million rubles, or in the event of:

- acquisition of more than 20 percent of the voting shares of a company (this does not apply to establishment of a company);
- acquisition of ownership or use of fixed or intangible assets along with the securities of a company where the book value of the acquired assets exceeds 10 percent of the book value of all assets of the company; and
- acquisition of rights which permit control of the company or which permit the acquiror to carry out the functions of the company's executive body.

In addition, the Antitrust Committee must consent to the above transactions if the acquiror has a market share of more than thirty-five percent in certain specified industries.

**CONCLUSION**

The Russian securities market is still in its infancy, with 1997 as only the sixth year of market reforms in this huge country. Despite problems with privatization, dependence upon IMF loans and private foreign investments, an undeveloped taxation system, and political instability, the Russian Government has managed to control the economy. Improvement of Russian securities legislation is a primary goal of industry regulators under the supervision of the Russian President and the Parliament. Conflicts in the adopted progressive laws and underdeveloped enforcement mechanisms stand in the way of effective securities transactions and discourages foreign investment in the Russian economy.

Recently-enacted laws have improved the situation with re-

107. Id.
108. Instruction on Rules for Control of Acquisition of Stakes and Holdings in Partnerships and Ordinary inscribed Shares of Joint Stock Companies, State Committee for Management of State Properties, Order No. 5 art. 3, § 9 (Russ. 1994), available in 1994 WL 9141277.
109. Id. art. 1-3, at 1-4.
110. Id. § 10, at 3.
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Regarding securities regulation and protection of the investors' rights. Thanks to these positive changes, the level of foreign investment in Russia has increased from eighteen percent in 1996 to thirty percent in 1997 in the GKO and OFZ markets,\(^\text{111}\) and from US$5.2 billion to US$15 billion for the ADRs market.\(^\text{112}\) As a result of Russia's efforts to liberalize the economy and enhance its international credit rating, Russia was accepted to the Paris and London credit clubs.\(^\text{113}\)

The Russian capital market features a variety of financial products, including promissory notes\(^\text{114}\) and agricultural bonds.\(^\text{115}\) According to Alexander Livshits, deputy head of the presidential staff and the former minister of finance, Russia expects to raise about US$3 billion through placement of convertible bonds of Gazprom, UES, and other major companies, and to place Federal Eurobonds of US$3.4 billion, regional Eurobonds of US$1 billion, and T-bills of US$1 billion in 1998.\(^\text{116}\) Regardless of the Russian market's infancy and problems, it appears that the "Russian Bear" woke up and started its way onto the rough road toward a free market.

\(^\text{112}\) Id.