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HOW TO INVEST IN RUSSIA

THE AEB GUIDE TO INVESTING IN RUSSIA

Investing in turbulent times

State policy on control over foreign investments

What you need to know about SPIC 2.0

Status of SMEs: benefits and requirements

Strategies and prospects for European companies in Russia

MAXIM RESHETNIKOV
Minister of Economic Development
of the Russian Federation

Dear friends,

Russia is a safe place to create and develop a business of any size. In recent years, the federal government has been constantly working to create a comfortable and profitable environment for foreign businesses in our country. We have accomplished meaningful results in that area.

We have significantly improved our position in the World Bank's Doing Business rating: in 2011, Russia ranked 120th, and in 2019, it ranked 28th. Special administrative regions with flexible tax and currency regulations for international companies have been created. The number of residents in special economic zones is growing. An effective administrative system for supporting investment projects, from concept to launch, is in place. The most important focus area of the Russian government is strengthening trust between authorities and businesses.

New time creates new opportunities. Right now, the Business Climate Transformation mechanism is being reformed and the "regulatory guillotine" is being launched. A new instrument – an agreement on the protection and promotion of capital investments – is being introduced. This instrument is designed to stabilise tax conditions for major investment projects. All of these steps are aimed at carrying out a new strategic task – the launch of a new investment cycle in which foreign companies will be able to take an active part in it.

Thank you for your interest in our country! We believe that the Association of European Businesses' guide will become a useful source of information for everyone who sees great potential for project implementation in our country.

JOHAN VANDERPLAETSE
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STUART LAWSON
AEB Board Member,
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Dear readers,

Welcome to the 2020 edition of the AEB 'How to invest in Russia' guide which is the 12th edition and brings together practical advice from well-known professionals.

2020 has been an extraordinary year for Russia as it has globally with COVID-19 causing massive disruption both socially and economically. It is generally accepted that Russia managed the pandemic relatively well while the country had a relatively low death rate compared to most other countries. At time of writing, there is a second surge in COVID-19 cases and the potential impact is difficult to forecast.

Assuming that the economic impact is controlled, the Russian GDP is now expected to diminish by around 3.5 to 4.5%, lower than the originally forecast 6.5 to 8.5%. Following the reopening of the economy mid-year, consumer spending recovered and although it is as yet unclear how hard the pandemic hit employment in the private sector, the state sector that dominates the economy has been relatively unaffected.

A combination of pressure on the oil price and a discount due to the political environment has meant the rouble has devalued 20% since a year ago. This will cause some pressure on inflation however the expectation is that inflation will remain within the targeted band by the CBR although this will prevent the ability to reduce interest rates further.

A fiscally prudent policy has left Russia with strong foreign exchange reserves, solid sovereign funds and an enviable fiscal position. Of concern however is the medium-term prospects for the country as economic growth is anemic and both domestic and foreign investments weak. The cross-border political environment has continued to worsen and at time of writing there are serious concerns that both Russia and its western interlocutors are facing off on a number of issues and that normal communication channels are not available currently.

The AEB survey of European companies in Russia indicated a decrease in overall optimism caused by both short-term expectations and a continuation of the difficult operating environment, however it is notable that companies remained positive in expectations for medium-term opportunities.

The AEB remains committed to fostering good business relations between Europe and Russia and will continue to provide forums for constructive discussions across all sectors.

This current edition of the 'How to invest in Russia' guide will bring you updates on the investment climate, the legal, financial, IT and other aspects. In addition, it also provides insight into investments by regions and by industries, as well as into the opportunities and challenges when localizing in Russia.

We would like to thank all the authors who helped by making their valuable contributions to this guide, sharing their knowledge of the Russian market and their experience of running a business here. We are also most grateful to the Ministry of Economic Development of Russia and the Federal Antimonopoly Service, who have supported the guide over the years.

We hope this publication will serve its purpose, bringing more investment to Russia and promoting a business environment which is beneficial to all interested parties.

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Part I.

Strategic initiatives

State policy on control over foreign investments and the latest changes in foreign investment legislation

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Head of the FAS Russia

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He is Member of the Government Commission for Control over Foreign Investments in the Russian Federation; Member of the Government Commission for Administrative Reform; Member of the Government Commission for Development of Competition and Support of Small Business.

In 2006-2016 he chaired the Interstate Council for Antimonopoly Policy (ICAP) of the CIS member states.

Mr. Artemiev is the author of 7 monographs, 43 articles and patents. He was awarded with Order for Service for Motherland of the 4th and the 3rd grades.

Foreign investments are one of the most important forms of international movement of capital, helping to develop and attract advanced technologies and know how, implement new business projects, improve the quality of products, works and services, promote competition and improve the quality of life of citizens. For the purpose of protecting the national interests of the Russian Federation and creating a predictable and transparent business climate in the Russian Federation, Federal Law dated 9 July 1999 No. 160-FZ "On Foreign Investments in the Russian Federation" (hereinafter, "Law No. 160-FZ") and Federal Law dated 29 April 2008 No. 57-FZ "On the Procedure for Making Foreign Investments in Business Entities of Strategic Importance to National Defense and State Security" (hereinafter, "Law No. 57-FZ") were passed.

Law No. 57-FZ sets restrictions on the participation of foreign investors or groups of persons that include foreign investors in the authorized capital of entities having strategic importance to national defense and state security (hereinafter, "strategic entities") and regulates relations connected with the performance of other transactions or actions, in which foreign investors take control over strategic entities as defined in Article 5 of Law No. 57-FZ.

The approval process with respect to taking control over strategic entities is clearly regulated by Articles 8 and 14 of Law No. 57-FZ as well as by regulations adopted in pursuance thereof, which regulate the procedure for submitting a request for prior approval of a transaction and/or a request for approval of taking control, the procedure for notifying about transactions with shares (interest) comprising the authorized capital of entities having strategic importance, transactions, and other actions subject to prior approval.

The request for prior approval of a transaction or the notification about a transaction are submitted to a competent authority.

Pursuant to Decree of the Government of the Russian Federation dated 30 June 2004 No. 331 "On Approval of the Regulation on the Federal Antimonopoly Service" and Clause 4 of Decree of the Government of the Russian Federation dated 6 July 2008 No. 510 "On the Government Commission for Control Over Foreign Investments in the Russian Federation", the Federal Antimonopoly Service is a federal executive authority authorized to perform control over foreign investments in the Russian Federation. To ensure the effective performance of this function entrusted to the FAS Russia, a special business unit – the Foreign Investment Control Department – was formed.

A transaction is subject to approval by the Government Commission for Control Over Foreign Investments in the Russian Federation (hereinafter, the "Governmental Commission"), which was established in 2008 and is headed by the Chairman of the Government of the Russian Federation, in the manner established by Law No. 57-FZ. The procedure for reviewing requests by a competent authority and then the Government Commission is established in Articles 9–12 of Law No. 57-FZ.

Over the 11 years that Law No. 57-FZ has been in effect, as of 1 September 2020, the FAS Russia received 640 requests, of which 287 requests were reviewed by the Government Commission (with a positive decision for 259 requests, imposition of obligations for 81 requests and refusal of prior approval for 23 transactions), 272 requests were returned as not requiring approval, 66 requests were withdrawn, and 15 requests are pending.

The value of total investments in strategic companies for transactions approved by the Government Commission amounted to approximately USD 117.25 billion over 11 years. The total value of transactions approved by the Government Commission in 2019 amounted to RUB 1.19 trillion (≈USD 18.63 billion), of which the total volume of estimated foreign investments is RUB 895.5 billion (≈USD 14 billion), which exceeds foreign investments in 2018 by 51%.

This testifies to the Russian Federation's friendly attitude towards foreign investors.

The type of approval procedure depends on the number of acquired shares (interest) in the authorized capital of an entity or other factors suggesting that a foreign investor has control over that entity. Thus, transactions, which result in a foreign investor or a group of persons receiving the right to dispose of over 50% of shares (interest) comprising the authorized capital of a strategic entity, as well as the right to appoint a sole executive body and/or over 50% of the membership of a collegial executive body of a strategic entity and/or unconditional ability to elect over 50% of the membership of the Board of Directors/Supervisory Board or other collegial governing body of that entity are subject to approval.

Transactions that are subject to prior approval also include other transactions/actions resulting in strengthened control of a foreign investor over a strategic entity, as well as transactions providing for acquisition into ownership, possession or use of a property that pertains to the fixed production assets of an entity having strategic importance and whose value amounts to 25% or more of the book value of assets of that entity.

It is worth noting that Law No. 57-FZ sets special thresholds (25%) for foreign investors planning to invest in entities performing geological studies of subsoil and/or exploring and extracting mineral resources at a subsoil site having federal importance (hereinafter, "subsoil users").

The value of total investments in strategic companies for transactions approved by the Government Commission amounted to about USD 117 billion over 11 years.

In addition, special thresholds are set for particular categories of foreign investors, such as foreign states, international organizations and organizations controlled by them (hereinafter, "public investors"). Public investors need to submit a request for prior approval of transactions that will result in acquiring the right to dispose of, directly or indirectly, over 25% but not more than 50% of shares (interest) of a strategic entity, or other opportunity to block the decisions of governing bodies. Slightly different and stricter restrictions are stipulated for public investors with respect to transactions with shares (interest) of subsoil users. Thus, a public investor needs to submit a request if a transaction will result in the acquisition of the right to dispose of, directly or indirectly, over 5% but less than 25% of shares (interest) of a subsoil user.

Public investors are prohibited to acquire control over strategic entities by virtue of Part 2 of Article 2 of Law No. 57-FZ.

Article 6 of Federal Law dated 9 July 1999 No. 160-FZ "On Foreign Investments in the Russian Federation" (hereinafter, "Law No. 160-FZ") contains some exemptions for foreign investments with respect to public investors making transactions, which result in acquisition of the right to dispose of, directly or indirectly, over 25% of shares (interest) comprising the authorized capital of a Russian entity, or other opportunity to block the decision of the governing bodies of that entity. Requests shall be submitted in the manner stipulated by Law No. 57-FZ.

Law No. 160-FZ also provides the Chairman of the Government Commission with the right to submit for the Government Commission's consideration any transaction made by a foreign investor with respect to Russian entities. The procedure for making such a decision is regulated in detail by Decree of the Government of the Russian Federation dated 3 June 2019 No. 711 "On Introducing Amendments to Clause 4 of the Regulation on the Government Commission for Control over Foreign Investments in the Russian Federation".

One shall note that Law No. 57-FZ applies only to entities, which perform types of activity having strategic importance to national defense and state security rather than to all entities operating in the Russian Federation.

Law No. 57-FZ contains a list of 47 types of activities having strategic importance to national defense and security. They include activity types related to nuclear plants and materials, radioactive substances, nuclear power, encryption tools, arms and armaments, military and aviation equipment, aviation and transportation safety, space developments and infectious pathogens. The scope of Law No. 57-FZ covers work on the active influence on hydrometeorological or geophysical processes and phenomena, geological study of subsoils and/or exploring and extracting mineral resources at subsoil sites having federal importance, production/fishing of aquatic biological resources, as well as printing activities, activities of an editorial entity and/or publisher and/or founder of a printed periodical if product output exceeds the standards set by Law No. 57-FZ.

Finally, the activity of entities included in the list of natural monopoly entities in sectors specified in Clause 1 of Article 4 of Federal Law dated 17 August 1995 No. 147-FZ "On Natural Monopolies" (except for natural monopolies providing public telecommunications and public postal services, services for transmission of thermal energy and electricity via distribution networks, services in ports of the Russian Federation), as well as entities occupying a dominant position in the communication services market, providing services in ports of the Russian Federation and serving as operators of an electronic trading platform under the laws of the Russian Federation on a contract system in the purchase of goods, works and services for public and municipal needs is deemed to have strategic importance.

Sometimes, foreign investors do not analyze the types of activity performed by an entity/the object of investment for which they bear legal risks.

The FAS Russia continuously monitors foreign investments in strategic entities, including control over the fulfilment of obligations imposed on foreign investors by decisions of the Government Commission, while at the same time improving Russian laws on foreign investments.

The FAS Russia goes to court with statements of claim if it determines that control was taken without prior approval by the Government Commission as stipulated by Law No. 57-FZ. Failure to comply with the established procedure may entail severe legal consequences, such as recognizing a void transaction to be invalid and depriving foreign investors of the right to vote at general meetings of shareholders (members) of strategic entities.

Thus, in 2018, the FAS Russia determined that Neighbours Maple Acquisition Ltd, a Canadian company (successor: Canrig Drilling Technology Canada Ltd., a Canadian company), took illegal control over an entity performing geological surveys at subsoil sites having federal importance, i.e. lowering of casing into the well (Okset LLC, Moscow) without prior approval by the Government Commission.

The foreign investor was brought to administrative liability. The FAS Russia also went to court to recognize a transaction to be invalid and to deprive a foreign investor of the right to vote at the general meeting of members. Courts of all instances supported the position of the FAS Russia and decided to deprive Drilling Innovation M.E. Ltd., being a part of the Canrig Drilling Technology Canada Ltd. group of companies, of the right to vote at the general meeting of members of Okset LLC.

This position of the FAS Russia was supported by the Constitutional Court of the Russian Federation. Thus, the judicial practice providing for the assignment of entities rendering oil field services at subsoil sites of federal importance to entities having strategic importance to national defense and state security was decisively formed.

It should be noted that work on improving the laws on foreign investments is critically important for improving the investment climate in the Russian Federation.

Thus, while enforcing the laws and revealing legal gaps or the possibility of ambiguous interpretation of statutory regulations of the Russian Federation, the FAS Russia proposes to introduce

additional requirements regarding the need to have transactions approved by the Government Commission, including to prevent the avoidance of Law No. 57-FZ. At the same time, the government is weakening control over foreign investments when such transactions are not associated with threats to national defense and state security.

Thus, in virtue of statutory regulations of the Russian Federation, an owner of shares (interest) comprising the authorized capital of a strategic entity, has the right to transfer them for a certain time to a pledge or a trust to another person, including the right to dispose, at his/her sole discretion, votes attributable to shares (interest) in the authorized capital of a strategic entity.

The version of Law No. 57-FZ in effect until 2020, determining the presence or absence of control of a foreign investor over a strategic entity, proceeded from the concept of primacy of the right of a foreign investor to dispose, directly or indirectly, of votes attributable to the voting shares (interests) of a strategic entity.

When analyzing the application of Law No. 57-FZ, the FAS Russia revealed the possibility of circumventing the requirements of this law by entering into agreements on the temporary transfer of a foreign investor's right to dispose, directly or indirectly, of voting shares (interest) of a strategic entity (such as a property trust agreement, pledge agreement, repurchase agreement, collateral agreement, etc.) in order to acquire additional packages of shares (interest) of a strategic entity without a decision from the Government Commission.

To exclude the potential misuse of that right and eliminate legal ambiguity, the FAS Russia drafted Federal Law No. 255-FZ dated 31 July 2020 "On Introducing Amendments to the Federal Law 'On the Procedure for Making Foreign Investments in Business Entities of Strategic Importance to National Defense and State Security'", which introduced clarifying changes in the definition "control by a foreign investor" (Article 3 of Law No. 57-FZ), features of control (Article 5 of Law No. 57-FZ) and Articles 5 and 7 of Law No. 57-FZ.

We would like to note the openness of the FAS Russia for foreign investors. Thus, a foreign investor or its representative may submit a request to the FAS Russia to provide explanations on a certain matter, as well as a request to provide approval of a transaction in the manner established by Part 6 of Article 8 of Law No. 57-FZ.

In addition, the FAS Russia advocates for competition and has established the Expert Council for Foreign Investments designed to reduce administrative barriers for foreign investors, exchanging experience and discussing the possibilities to implement global best practices in the field of foreign investments. In 2018, a scientific practical commentary on Law No. 57-FZ explaining the fundamental matters of its application was prepared.

A climatic fork in the road for international business in Russia

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Vadim Korsun supervises environmental issues and helps corporates to meet regulatory trends in environmental regulation. Vadim holds government relations projects in chemical and raw materials industries and coordinates corporate climate change strategies.
Prior to TIARCENTER, Vadim served as a Federation Council Member chief of staff. On this position Vadim supervised legislative process on natural resources management, environmental and climate change policy, coordinating regional governments, NGOs and business associations on regulatory issues.
Before that Vadim worked as government relations consultant focusing on regulatory risks management.

International business in Russia faces a choice in the corporate strategy to adopt in the light of the carbon regulation being drafted in Russia. The choice is far from straightforward given that competing on the Russian market needs to be balanced against aligning with global priorities in sustainable development (including climate change) and risks of EU carbon regulation.

Although still in the development stage, state regulation on greenhouse gas emissions in Russia has already set parameters which defines the Russian Government's strategic choice in carbon regulation. First, a choice has been made in favour of climatic "non-ambition", stark testimony to which is paid by the draft Low-Carbon Development Strategy up to 2050, whereby in all scenarios envisaged for the development of the Russian economy, in the medium term at the very least, greenhouse gas emissions will rise. Secondly, government regulation of greenhouse gas emissions will be very lenient towards businesses with high CO2 emission levels (as borne out by the contents of the associated draft statutory regulations).

Such a decision has surprised numerous experts, particularly given an assessment of the risks and financial losses that would ensue from a lack of "climatic ambitiousness" from Russia and Russian business as presented by leading expert organizations (KPMG and BCG). The first estimated the total size of losses to Russian exports due to the EU Carbon Border Tax Adjustment to be in the region of USD 33.5 billion over the first five years; the second predicted a drop in competitiveness of Russian hydrocarbons on the European market compared with those from other countries (although, a no lesser threat is faced by, for example, exports to the EU from the Russian pulp and paper industry).

All the same, high-carbon business in Russia is unlikely to face any significant restrictions of a regulatory nature that would incentivize it to make drastic cuts in greenhouse gas emissions any time soon.

Meanwhile, the overwhelming majority of large international companies have a series of ambitious corporate commitments regarding climate change and sustainable development which they are obliged to achieve. The activity of international companies' Russian subsidiaries, simply by virtue of the significant share of the Russian market in their portfolios, will inevitably play a vital role in achieving company-wide objectives. Aside from which, it is important to bear in mind that for a significant number of international companies, Russian enterprises constitute not only an important platform for supplying the large Russian market, but also an export-oriented hub to the EU market among others, which given the carbon regulation in preparation in the EU makes choosing a corporate climatic strategy in Russia for international companies a truly complex matter.

On the one hand, the top management of international companies' Russian subdivisions will have to institute changes to corporate processes with the aim of ensuring the said subdivision plays its part in meeting the global carbon-reduction targets of the company as a whole (usually an expensive undertaking), and on the other hand, it is essential to remain competitive on the big Russian market where domestic companies lack the incentive to invest in extremely expensive low-carbon development, meaning that, in the short term, their products will gain a competitive advantage.

In the current situation, international business in Russia has several options:

- "Develop an alternative climatic agenda": to come up with their own proposals for further regulatory measures to incentivize carbon efficiency. This will possibly help export-oriented international companies in the current conditions of tightening regulations in the EU, however this is unlikely to resonate with large Russian business which has come out publicly against such measures so pro-active promotion of climate-ambitious agenda is fraught with clashes of business interests at the political level.
- A "wait & see" strategy: not to take any serious steps to increase carbon efficiency until this becomes the position taken up by the regulator in Russia. For international companies in Russia this means postponing steps to increase carbon efficiency for an indefinite time, which hardly fits with such companies' global sustainable development and carbon reduction objectives.
- "Adapt": to opt for a tactical compromise and introduce voluntary measures enabling company carbon efficiency targets to be met, but which are purely voluntary in nature, assuming an absence of regulatory restrictions.

Are such voluntary frameworks available today? Yes, international business has all it needs to create a voluntary carbon market in Russia: the means of trading the results of voluntary carbon-reduction projects which companies participating in the voluntary market launch independently. The results of such projects are traded voluntarily, based on the price of carbon, which is conditional upon the market format: whether it is closed off within a certain jurisdiction or integrated with international carbon market.

The building blocks for this are already in place:

- There are clear calls for the emergence of a "carbon market" in Russia, even if it is voluntary. There are already a significant number of companies in Russia (not only international but domestic companies too) willing to implement projects to reduce CO2 emissions and trade the results. A recent climate change forum by Delovaya Rossiya, where association members aired their aspirations for bigger carbon-reduction ambitions, is further proof of this.
- There are "stricter", internationally recognized, standards of verification for carbon-reduction projects available: the "Verified Climate Standard" and "Gold Standard" (the experience of applying them dates to when the first stage of the Kyoto Protocol). This potentially makes Russian greenhouse gas emissions reduction projects integrable with already existing formats for trading in the results of carbon reduction projects.
- Although carbon regulation in Russia is as tolerant as possible towards high-carbon business, it still leads the concept of the "climatic project"

into the area of law (its formulation is open to question but it is nonetheless regulatory in nature), to which the results of preparation of the draft regulations bear witness. And this means that projects for cutting greenhouse gas emissions are in the process of exiting a legal vacuum and that such projects will become "verifiable" by the government and its results implementable within Russian jurisdiction.

In these circumstances, there is one thing missing: an initiative-driven coalition between international business and climate-ambitious Russian business to create a voluntary carbon market as soon as the necessary regulation is approved (it is due to appear in a matter of about half-a-year). However, such initiatives have still not been voiced in public and, as far as the author of this article is aware, there are not any current plans for this to happen.

What are the strategic advantages of such a step?

First, the emergence of a voluntary carbon market will allow the verification and integration into the market process of the results of carbon-reduction projets, which international companies will, in any case, be implementing over the short term: from modernizing energy systems to optimizing logistics. The only question is how "tangible" the results of these projects will be.

Secondly, global regulation of greenhouse gas emissions within national and supranational jurisdictions is at a very active stage of formation. This process is at its most active in the EU; however, it is gathering momentum in other jurisdictions too. Regarding which, having any kind of internationally recognized project results in one's arsenal is better than not having any at all. It is important here to note that the protracted process of ratifying the implementation of Art. 6 of the Paris Agreement (the rules for recognizing the results from projects to reduce greenhouse gas emissions between jurisdictions) will sooner or later be resolved, which will convert investments into opportunities.

Thirdly, the creation of a voluntary carbon market does not require large amounts of investment. According to a report by the World Bank (State and Trends of Carbon Pricing 2020), in 2019, two thirds of "carbon units" (CO2 equivalents in the reduction of greenhouse gases) originated from voluntary mechanisms. For example, the above-mentioned verification standards (the Verified Climate Standard and Gold Standard) are in force in 72 countries, and the average price per tonne of reduced emissions varies from USD 3 to USD 4/tonne of CO2 (compare this with the average price of EUR 25/tonne of CO2 on the European state-based carbon exchange).

The current agenda to change carbon regulation in Russia will undoubtedly throw up a host of challenges for international companies present on the Russian market. However, it is perfectly possible to convert these into opportunities. To do this, international companies need to move beyond declarations of climatic ambitions to the currently available options for meaningful action in Russia, which will undoubtedly yield results in the long term and in the short term too.

Russia slowly enters the pathway towards a "green economy"

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Prior to Creon, Florian used to work in various senior positions for the leading German business publications Handelsblatt and Wirtschaftswoche. His tremendous experience of more than 14 years of businesses in Russia/CIS is coupled with a focus on Corporate Social Responsibility Strategies. For Handelsblatt Group he assessed supply chains of energy and chemical companies, but also those of retailers sourcing textile product in developing countries like Bangladesh.

The European Union attempts to be carbon neutral in 2050. In the meantime, financing will depend on an ever-larger extent on a company's performance in terms of ESG-performance. For businesses in Russia, this is yet a challenge that must be turned into an opportunity by setting the course towards a future energy with hydrogen and zero-emission projects.

Let us be honest: in Russia and other emerging markets, most climate change action has long been dismissed quietly as a philanthropic topic for saturated societies in the West. Although Russia politically supports the Paris Climate Protection Agreement, corporates have so far assumed that Russian gas – cheap as it is produced – will always find its customers anyway. The trend towards renewable energy has been underestimated systematically.

This is now about to change. Climate change is more and more perceived as a factor of financial risks: oil spills such as in the case of Norilsk Nickel show the Russian government's readiness to prosecute companies for environmental hazards instead of imposing symbolic fines. Environmental catastrophes can end up in losing, strategic partners, markets, customers. Large corporates are now forced by law to publish non-commercial reports about environment, social, and governance (ESG) performance, which go beyond the ancient threshold that planting trees is enough commitment to the ecology. Most importantly, the financial market is shifting capital supply globally away from conventional investments toward "green" and ESG-compliant products. This trend is set to become the main driver for this transition.

The importance of all means of "Green Financing" is gaining pace dramatically. Among the ESG-related financial products, the "Green Bonds" reached a market volume of EUR 250 billion in 2019, but this amount is expected to quadruple at least in 2020. Large public investors such as European Investment Bank (EIB) or private fund managers (Blackrock) declared to shut down investments in companies related to carbon emissions. Other fund managers are entirely looking for "clean" opportunities such as energy companies with a focus on renewables, retail chains providing fair working conditions, food processors with a sustainable sourcing approach. Notably not on the paper but proven by facts and figures.

If we anticipate the trends on western financial markets, we can easily assume: companies lacking ESG performance will face increasingly difficulties to receive at least cheap financing from global financial markets as investors are more and more shifting equity, debt or other means of investments towards more attractive directions. Among the ESG concept, the subcategory "environment" will probably be the most relevant one as the pressure of politics, society and competitors grows to decrease GHG emissions and cope with increasingly sophisticated targets to mitigate climate change.

The most obvious victim could be the oil and gas industry. This may cause large difficulties for Russia as still more than 40 percent of the gross domestic product (GDP) are linked with oil and gas producers.

In a worst-case scenario this could mean that an oil and gas producer will be cut off from international corporate financing soon, begging in one queue weapon manufacturers and tobacco companies for investors. Most of the latter are forced by their own investment frameworks to invest only in stocks or obligations of ESG-compliant companies. Even equity partners enter projects only on large discounts. Consequently, the "fossils" face increasing difficulties to raise cheap capital on financial markets. They will increasingly rely on governments support as shrinking profits do not even allow financing even the most necessary maintenance investments in oil and gas fields.

Businesses in Russia must accept this challenge and turn the latter into an opportunity: oil and gas companies are requested by strategic partners and financiers to take a clear stance on ESG, so why not preparing the companies strategically for a time beyond fossil fuels, accompanied with investments.

Italy's Enel did this by installing a wind-park in Murmansk region. Lukoil uses solar power to cover the internal electricity demand for refineries in southern Russia. Severstal made huge efforts to decrease energy consumption in their steel plants. However, the market demands even more disruptive strategies and concrete investments, which show a company is heading towards net-zero.

The market growth stalled this year. Instead, competition in the energy market – primarily with renewables – will increase exponentially, while demand for carbon will gradually decline.

Certainly, it is too early to bury the "traditional" hydrocarbons – oil and gas. Demand for these energy resources will remain for decades to come. But the market growth already stalled this year, which is only to some extent due to the COVID-19 crisis. Instead, competition in the energy market – primarily with renewables – will increase exponentially, while demand for carbon will gradually decline. A horrific scenario for the oil and gas industry as abovementioned might come true not in the 2030s but in the 2040s. And it can be still avoided if oil and gas companies take a clear stance on GHG emission, innovation, and a setup of value-chains for alternative fuels and sources for electricity.

It would be strategically appropriate even for conventional Russian oil and gas companies to offer cleaner alternatives: the production of hydrogen based on the abundance of natural gas for industrial purposes. Several chemical companies and refineries process gray hydrogen from methane, releasing CO2. The separation of carbon or the storage of CO2 are technically possible but would have yet to be rolled out in series.

Corporates can show the financial market to move despite difficulties such as sanctions and political risks in a trajectory towards sustainable development. This might prove a company's strength in the perception of investors, buyers, and strategic partners. Consequently, a company with positive ESG performance can shelter itself to some extent against maintaining political risks and increase their potential for competitive corporate financing on global capital markets.

Apart from the energy sector, Russian Railways (RZD) recently proved that a state-owned Russian corporation can despite sanctions successfully attract capital from European financial markets by having a green framework for a bond in place: their green bond with a maturity of eight years has been placed with a final price of 2,2 percent last year in Europe, raising a volume of more than EUR 500 million for modernization projects. Since RZD is planning to switch diesel-driven locomotives to hydrogen in the next year, the surprisingly effective railway company will for sure find other stories to issue "green" products on the international financial markets.

In Russia there is a brisk trade in "green bonds". Since the Moscow Exchange began listing in August 2019, nine bonds with a volume of more than RUB 70 billion have been issued. This is yet a small amount, but taking into account that the green bond framework has not yet been finally authorized between several ministries, the Central Bank of Russia, and Vneshekonombank as the author or the Russian "taxonomy", these activities should be seen as a good start. The first Vice-President of Sberbank, Aleksander Vedyachin, expects a market volume of three trillion roubles all for "green financing" by 2023.

ESG banking in the transformational economy

VASILY VYSOKOV
Chairman of the Board of Directors, Center-invest Bank

Vasily Vysokov founded Center-invest Bank jointly with a team of university professors in 1992.
Today Center-invest Bank is the biggest regional bank in southern Russia implementing ESG banking business model in practice.
Prof. Vysokov is an author of more than 350 works on the transformation of financial markets, SMEs, ESG banking.
He chairs the Committee on SME of the Association of Banks of Russia.
He is an organizer of the Forum "Positive economy" together with Jacques Attali (positiveforum.ru), participant of EBRD, World Bank forums, winner of FT/IFC competition.

The transformational economy is a new reality that requires managing constant changes in an environment of continuous crises. Russia is a unique arena for elaborating and testing new management methods in times of transformation.

Unlike speculative banking, which is concerned with buying and selling risks, ESG banking manages risks. In a crisis, a speculative bank buys more expensive funding and passes the risks on to customers by increasing loan interest rates. In contrast, an ESG bank will work with customers to find ways to reduce risks in a crisis. This means that an ESG bank can reduce loan interest rates, while its customers gain competitive advantages and can repay their loans on time and in full.

ESG banking implements Environmental, Social and Governance principles. In effect, it combines many complementary ideas about "green", "ethical", "responsible", "sustainable" and "transformational" banking that have been developed as alternatives to speculative banking. Center-invest Bank has successfully implemented an ESG banking business model in the south of Russia.

The ESG banking business model considers a wider range of risks:

- environmental risks (physical – accidents, natural disasters, climate change; and transformational – changes in legislation and standards);
- social risks (inequalities based on income, gender, age and other characteristics, the accessibility of new technologies and resources);
- governance risks (transparency, efficiency, monitoring and reporting on the processes of reproduction of all types of capital: productive, financial, human, social, informational, intellectual and natural).

Each component of ESG risk management is important, and all the components are interconnected.

ESG banking finances real processes of transformation in its customers' lives and businesses. Center-invest Bank has obtained 82% of its income from lending to the real economy and has allocated its income to: the population (interest paid on deposits) – 36%; partners and suppliers – 23%; employees and the state – 19%; and shareholders (dividends and development) – 22%.

Agribusiness

Agribusiness is considered a risky sector to lend to. It is true that if we focus on volatile weather, the risks of agribusiness lending are considerable. But if we consider more stable climates, productive soil and water resources, then the risks diminish. If you lend to agribusiness for a period of three years, two of those years might have poor harvests. But over a five-year period, there will be two good harvests – meaning that all loans can be repaid.

SME lending

Small business is also considered a risky sector for lending. SMEs account for one third of Center-invest Bank's total loan portfolio. To reduce risks, the bank has provided entrepreneurs with non-financial services in addition to loans since 1997. These include consulting, auditing, outsourced bookkeeping, legal support and tax advice. Even modest expenditure on this support reduces the risks from lending to small businesses that operate legally.

Women in business

Lending to female entrepreneurs promotes gender equality and benefits from a generally lower risk profile. As women entrepreneurs tend to manage risks more carefully, we can lend to them at lower rates. At the same time, we can focus more on the quality of bank services and on establishing trusting relationships between the bank and its customers. There has not been one single default in the whole time we have been lending to female entrepreneurs.

Youth enterprise is expected to implement the creative ideas of the younger generation despite the constraints of existing rules and barriers to entrepreneurial activity. To support this, the bank offers new entrepreneurs training, preferential terms for business bank accounts and loans, and free advice and mentoring. The bank actively participates in sociological research into the challenges faced by young entrepreneurs and implements projects with university students.

Social enterprise

It addresses community needs in a given market on the basis of more effective approaches, cost-recovery and financial sustainability; is scalable ("a good programme works even when the developer is absent"); effectively manages risks.

Loans for business transformation

In response to COVID-19, government support for small business has been scaled up. Center-invest Bank is actively participating in government programmes and the post-crisis development programme. In a distance economy, the future of business will depend not on government support, but on the digital transformation of business.

Energy efficiency

Modern energy-efficient technologies reduce energy consumption and cut CO_2 emissions. The comprehensive introduction of new technologies generates labour, creates other resource savings in addition to energy savings, and reduces losses. This results in a 2-3-year payback period for the cost of replacing equipment. When the bank conducts this analysis with the customer, the customer chooses the energy-efficient option. When they learn how their project will reduce CO_2 emissions, they become a proponent of ESG principles.

Financing the renovation of apartment buildings

To fund the renovation of apartment buildings, the government proposes that residents save up money by making monthly contributions to a communal fund. But the best way to keep money for renovations is to take out a loan, do the renovations, and use the monthly contributions to pay back the loan.

Retail lending comprises 62% of the bank's loan portfolio. Center-invest Bank's ESG retail lending focuses on traditional secured consumer loans, mortgages and car loans. ESG banking finances the happiness of ordinary people.

Mortgage loans, which are the most popular and least risky loan product, account for two thirds of the bank's retail loan portfolio. The bank helps customers to find the best option for purchasing a property and helps them to consider incentives under government programmes, the environmental conditions of different locations, and energy-efficiency solutions for their new homes. In particular, the bank actively participates in a government programme for rural mortgages.

ESG banking risk management

ESG risks (grouped by customers, products, transactions, and decision-making processes) and their impact on regulatory compliance and financial indicators can be assessed.

Unlike a business plan, the ESG strategy views the constraints of a mathematical model not as predetermined, but as variables. This allows for a range of growth trajectories that are balanced in terms of assets and liabilities. Taking into account geopolitical, environmental and social factors, as well as oversight and supervisory practice, we select the balanced solutions that are feasible.

ESG banking risk management entails:

- balancing long-term profitability, organic growth and risk;
- knowing the target markets, regional risks and a detailed analysis of borrowers' businesses in lending to the real economy;
- regularly re-assessing risks and covering risks with sufficient provisions and capital;
- minimizing risks by diversifying funding sources and prioritizing lending to local clients;
- a risk-management system combining formal and substantive risk-assessment procedures;
- transparency of deals and transactions;
- improving financial literacy among the population and providing free business advice;
- reducing the level of defaults (whether fraudulent or resulting from social or economic factors);
- continuous innovation to tackle new challenges.

The implementation of the ESG risk-management strategy is underpinned by Bank of Russia recommendations and requirements, Basel Committee recommendations, best international practice, shareholders' recommendations, the bank's 28 years' experience in managing regional risks, and the lessons drawn from the crises of 1998, 2008, 2014 and 2020.

ESG banking risk management is not a "product", but a continuous process. It takes into account changes in the operating environment, innovations in products and services, and regulatory requirements which are continually being updated.

ESG reporting

Thanks to its transparent reporting under Russian and international standards, Center-invest Bank avoids the risks of unreliable reporting and is able to produce timely information about its participation in international programmes and national projects. The bank records the impact of its products on the implementation of the United Nations Sustainable Development Goals and Russia's National Projects. It can readily inform its depositors of how the money they have entrusted to the bank is being used to achieve global and national goals.

By using integrated reporting rather than just financial reporting, the bank has been able to assess in a new light:

- the impact of the bank's income on the interests of other stakeholders: the local population, employees, shareholders, customers and partners;
- the bank's development as a process of reproducing operational, financial, informational, intellectual, human and social capital.

Our independent financial ratings from Moody's (Ba3, stable) and ACRA (A (ru) stable), and our Vigeo Eiris ranking (17/76, Europe) have shown that ESGs bank can remain consistent in any frame of reference.

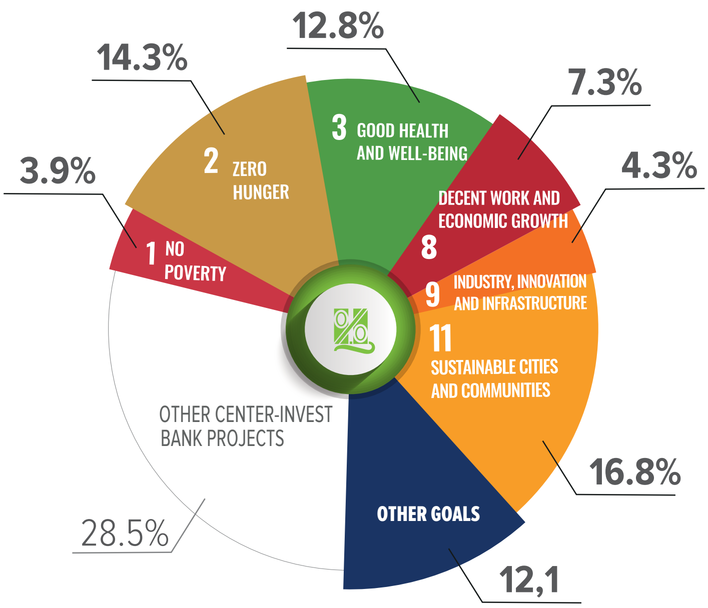
Internal audit and compliance

Internal audit in ESG banking must assess current operations for compliance with internal rules and regulations and national laws, as well as consider global trends in regulation. Regulators are paying increasing attention to ESG banking. The bank's experience clearly shows that having

ESG-investments 2019 - 9M2020 (for every P100 of deposit)

In Sustainable Development Goals

RUB 168.5 bln



In National Projects

RUB 145.9 bln

a more advanced knowledge of best international practice is becoming a competitive advantage when working with customers, employees, partners, the regulator and shareholders.

ESG banking and personnel policy

Speculative banking uses headhunting. In contrast, Center-invest Bank nurtures potential employees. Every year, over 400 students are trained at the Financial Literacy Centres opened by the bank in partnership with universities in Rostov-on-Don, Krasnodar, Taganrog, Volgodonsk and Volgograd. The top students are invited to work placements at the bank, and the top interns are offered jobs with the bank. We also maintain contact with students who go on to work for other companies. A speculative bank trains young employees solely for its own needs.

ESG banking and gender policy

In accordance with Russian legislation, national traditions and established practice, all of the bank's employees have equal rights, equal conditions and equal opportunities for career growth. Our support and respect for motherhood is reflected in the fact that the birth rate among our employees' families is four (!) times higher than the national average for Russia.

ESG banking and communications policy

ESG banking requires regular communication with all stakeholders (regulators, shareholders, employees, customers and partners) not only about official reporting and positive events, but also about risks. There are more positives in the work of an ESG bank, but even this information must be presented to every stakeholder in an accessible and clear format that uses specific messaging, slogans and catchphrases for each group.

ESG digitalization

This is first of all a moral choice between risks and efficiency when using modern financial and digital technologies to support the long-term development of the bank and its customers through the creative use of quantitative assessments and continuous innovations.

ESG banking requires regular communication with all stakeholders not only about official reporting, but also about risks.

ESG banking ensures data protection and safe payments when introducing any new technology. In order to rapidly introduce new digital technologies, an ESG bank will actively collaborate with market leaders as a co-innovation partner. Big data integration and processing is used to create electronic customer profiles and automate product and service management.

Center-invest Bank is: a member of the Global Alliance for Banking on Values (GABV), which unites over 50 banks from around the world whose aim is to use finance to deliver sustainable economic, social and environmental development; a signatory to the Principles of Responsible Banking of the United Nations Environment Programme Finance Initiative (UNEP FI), which unites more than 290 financial market participants.

The bank maintains relationships with participants of the ESG investment market and regularly informs them of its work.

ESG banking against COVID-19

The COVID-19 pandemic is a typical "black swan" event – an unexpected phenomenon of large magnitude and catastrophic consequences. These are exactly the kind of risks that banks applying ESG principles should consider.

Analysis of the various alternatives allowed us to plan, prioritize and implement appropriate measures, including:

- *for retail customers*: enhanced contact centre service, 24/7 response on social networks, remote services, abolition of fees, free delivery of bank cards to customers aged over 65, preferential mortgage rates;
- *for businesses*: loan repayment holidays, interest-free loans to pay salaries, loans for business recovery and transformation (the bank's own loan programmes and government-subsidized programmes);
- *for staff and customers*: hygiene and infection control measures, transition to remote working for two thirds of employees;
- *for shareholders*: regular updates on the financial situation, monitoring of measures taken by government authorities.

Banks are the mirrors of the economy. In times of transformation, banks must not only reflect, but also focus their efforts on managing transformational risks.

National projects as a means of boosting local investment appeal as exemplified by the Lipetsk region

SERGEY KURBATOV

Head of the Department for Economic Development of the Lipetsk region

Sergey Kurbatov has been Head of the Department for Economic Development of the Lipetsk region since 2018.
He is in charge of the national projects implementation in the Lipetsk region; long-term planning, social and economic growth, and SME development.
Since 2004, he used to work in a banking sector and was responsible for investment lending and project finance. He also headed the problem debt department.

Competition for investment flows between Russian regions is becoming ever more intense with each passing year. There is a growing awareness among both regional administrations and residents that investments are the key factor in increasing tax revenues and personal incomes and retaining the most educated and active residents in these regions.

The federal government also places considerable emphasis on investments. For instance, the 15 indicators approved by the Russian President for assessing the performance of regional governors include the volume of fixed capital investments and a number of parameters relating to investment activity (real average monthly wage, number of high-performance jobs, and workforce productivity in key non-extractive industries).

Meanwhile, it is increasingly difficult to compete for investors by providing tax incentives, as tax relief becomes more uniform across all regions and tighter controls are imposed to ensure that such relief is used efficiently.

It is therefore more important than ever for governors and their administrations to remain closely involved in attracting investors to their regions.

Following the first half of 2020, the Lipetsk region ranks second to Moscow in terms of fixed capital investments per capita in the Central Federal District, and third in terms of investment growth rate. The Lipetsk Special Economic Zone has topped the national SEZ ranking in terms of performance to date.

Even though these results are already excellent, Governor Igor Artamonov and his administration continue to search for new ways to enhance the region's investment appeal. The creation of a favourable investment climate is a key strategic priority for the region.

Multiple surveys and interviews with investors suggest that the most important criteria for selecting regions to invest in (excluding tax relief and input from regional administrations) are as follows:

- sufficient transport and utility infrastructure;
- human resources (the availability of a skilled workforce, the flexibility of local training institutions, wage levels);
- quality of products and services from local suppliers;
- market potential of the region.

National projects provide opportunities to broaden the region's investment appeal.

At the moment, national projects fall into three broad categories: "Human Capital", which includes the Healthcare, Education, Demography and Culture national projects; "Comfortable Living Environment", which comprises the Environment, Housing and Urban Environment, and Safe and Quality Roads national projects; and "Economic Growth", which comprises the Science, SMEs and Support for Individual Entrepreneurial Initiative, Digital Economy, Workforce Productivity and Employment Support, International Cooperation and Export, and the Comprehensive Plan for the Modernization and Expansion of Main Infrastructure national projects.

The cost of delivering national projects in the Lipetsk region totals RUB 14,967 million (EUR 168 million) – 19% of the regional budget.

Let us examine how the funds allocated to national projects help to address issues critical to investors.

Transport and utility infrastructure

As part of the Safe and Quality Roads national project, work is rapidly underway to improve local road systems in the Lipetsk region. Over 200 km of roads have been repaired annually, thus providing more convenient transportation routes.

The Lipetsk region keeps regular communication with large companies and investors in order to track their demand for goods and services.

To improve logistics for investors, a large-scale project totalling more than RUB 3 billion (EUR 33.7 million) is underway to construct the second phase of a bypass road to the east of the Lipetsk Special Economic Zone.

The new motorway will ease traffic loads in the urban area of Lipetsk, divert traffic flow to roads outside city limits, link Lipetsk Airport to industrial area, and simplify the transportation of goods to Moscow and to ports by the Black Sea.

There is a large focus on regional special economic zones. In June 2020, a project worth RUB 322.9 billion (EUR 3.6 million) was approved to build water treatment facilities in the Terbuny RSEZ. The corresponding water supply system is already under construction, with the commission of the facilities planned for 2022. Sewage and water treatment facilities are also scheduled for construction in Zadonsk.

It is also important to note that the Comprehensive Plan for the Modernization and Expansion of Main Infrastructure provides for an increase in sea port capacity by over 350 million tons by 2024, and allocates RUB 1,253 billion (EUR 13.87 billion) for an upgrade to the railway system. This will further enhance the investment appeal of the Lipetsk region, which is conveniently situated in the centre of European Russia.

Human resources

The employment centres of the Lipetsk region are heavily involved in implementing the Workforce Productivity and Employment Support national project. In particular, they monitor workforce demand from large companies and investors and offer relevant training for local job seekers. This monitoring data is also used by local professional training institutions to adapt their training programmes.

Staff training efforts are also promoted under the Demography national project to stimulate employment among women and the elderly. Over 2,000 people in the Lipetsk region have been retrained under national projects.

As part of the Education national project, the region is updating its existing training programmes and creating an advanced professional training centre to outstrip workforce demand. The centre will have over 50 workshops fitted with modern equipment. This policy has already yielded good results. In 2019, Vladimir Baboshkin, a 20 year-old fourth-year student at the Lipetsk Industrial and Construction College, was named the world's best welder at the WorldSkills international championship of vocational skills.

Development of local suppliers and contractors

As part of the SMEs and Support for Individual Entrepreneurial Initiative national project and in accordance with the Russian SME Development Strategy, the Lipetsk region is working to implement the Cultivation programme.

The programme is a set of measures aimed at providing small businesses with financial support, information, expert advice and marketing services in order to stimulate their development as suppliers for large companies – including foreign-owned enterprises intending to set up production sites in Russia.

All initiatives related to the Cultivation programme are implemented by the Regional Engineering Centre, which provides prospective suppliers with tailored road maps for development.

The region keeps regular communication with large companies and investors in order to track their demand for goods and services. The Cultivation programme is flexible and can be adjusted to suit the needs of each investor.

Under the Workforce Productivity and Employment Support national project, the Lipetsk region is taking measures to improve workforce productivity at its production sites. Preference is given to lean manufacturing practices, process optimization and skillful inventory management rather than costly technical upgrades. Businesses can take part in the project free of charge. In some cases, soft loans are available to cover the related costs.

Another benefit for companies involved in the project is that they receive subsidies to reimburse their expenses related to retraining, advanced professional training, choice of training organizations and programmes, and advice from employment centre experts.

The programme has sparked great interest among companies. While the project has only been operating in the region for a little over two years, more than 50 companies are already taking part.

It should also be noted that the project is open to foreign-owned companies (if foreign capital accounts for 25% of their equity or less).

Development of the local market

The total cost of implementing national projects in the Lipetsk region makes up over 19% of the regional budget, with most of the funds allocated to capital construction projects. This allows us to conclude that the implementation of national projects can generate considerable demand for goods and services on the internal market. This is especially important given that the region is attracting investors that will manufacture products to satisfy local demand.

National projects provide a wide range of tools to improve the region's investment appeal in many aspects, as well as provide considerable financing to this end. However, almost every Russian region now has access to similar tools. To get the most out of them in the Lipetsk region, it is important to harmonize all relevant projects to the full extent possible.

In addition, we should fine-tune national projects in response to changing external factors. For example, the COVID-19 situation is a good reason to adjust projects and shift focus in the process of delivering them. As we know, these kinds of adjustments are being made at the federal and regional levels.

A major advantage of national projects is that they are based on long-term planning. This makes project operations highly predictable. The current planning horizon of the current national projects is 2024, and is set to be extended to 2030.

Part II.

Localization and investments

What you need to know about SPIC 2.0 and its difference from SPIC 1.0

MICHAEL AKIM

Associated Partner,
Vitus Bering Management Ltd.

Michael Akim has been the founder and Chairman of the AEB Working Group on Modernisation & Innovations since 2013.

Since September 2020, Michael has been Associated Partner with Vitus Bering Management Ltd. and Professor of Graduate School of Business, HSE.

From 2008 to 2020 Michael worked with ABB and since 2014 as Vice President of Strategic Development in Russia.

In 2006 he joined Emerson Process Management as Director of their European Pulp and Paper Business. Prior to that, in 2001 he joined Troy Chemicals as Regional Manager for CIS & Russia.

Michael graduated from the Leningrad Technological Institute in 1986, and in 1991 from Latvian Academy of Science IWC with Ph.D. in Chemical Engineering. In 2000 he graduated from IONA (USA) with an MBA.

MAXIM GRIGORYEV

Head of Special Projects,
VEGAS LEX Law Firm

Maxim Grigoryev is attorney, partner, head of Special Projects at VEGAS LEX Law Firm. His core activities include legal negotiations with government authorities on budget subsidies and other government support measures, turnkey legal support for investment projects, accompanying M&A transactions and establishing joint ventures.

Maxim is actively involved by the RSPP in the development of the regulatory framework for the implementation of SPIC 2.0 mechanism in Russia. Besides, he is a well-known speaker at conferences on supporting business in Russia and stimulating industrial manufacturers.

Maxim is recommended by the Best Lawyers rating and recognized as a leading lawyer in "investments and capital markets" by the Kommersant newspaper in 2019.

BILGEIS MAMEDOVA

Partner,
BEITEN BURKHARDT

Bilgeis Mamedova is Partner in the Commercial Law Practice Group at BEITEN BURKHARDT's Moscow office. Her core activities include consulting on the market entry, set up of production facilities and localization issues.

Ms. Mamedova has extensive experience in the areas of international and Russian contract law, securities and project financing in Russia.

She is the author of numerous publications and regularly lectures at conferences in Russia and abroad.

Bilgeis graduated from Moscow State Law Academy.

She obtained an LL.M. degree at the University of Bremen and a Ph.D. at the Moscow State Institute of International Relations (MGIMO) of the Ministry of Foreign Affairs of Russia.

The AEB Working Group on Modernisation & Innovations made a dedicated effort to diligently analyse SPIC-2 with a focus on the technological and legal aspects of the updated mechanism for special investment contracts (SPIC-2) and to facilitate a number of corresponding events. It served as a platform to discuss key challenges in innovation development and the dispersal of cutting-edge technologies in Russia, as well as the perspectives for implementing high-tech projects with the support of SPIC 2.0 and the advantages and disadvantages of SPIC 2.0 in comparison to SPIC 1.0 in terms of protecting investors.

The special investment contract (SPIC-1) provides the investor with special treatment such as tax benefits and subsidies in exchange for investment activities. The maximum set term of the Federal SPIC is 10 years and the minimum investment amount is 750 million roubles.

Although a SPIC as a type of investment instrument is regarded as a form of production localization that is guaranteed non-discrimination in public tenders and can receive the status of "Sole Supplier", anecdotal evidence suggests that some companies have had difficulty obtaining the benefits promised and fulfilling their obligations under SPIC-1 terms. Most projects under SPIC-1 cover the automotive, pharmaceutical, electronics and oil-and-gas equipment industries.

SPIC-2 represents a significant step in improving the investment climate, particularly in regard to tax benefits and liabilities. Tax benefits are provided both at the federal and regional levels, and liabilities are limited to the amount of fiscal support measures provided by the state.

SPIC-2 was originally developed as a tool for developing innovation, transferring technologies and implementing modern technologies for the production of competitive goods in the world market. Once implemented, it will be possible to obtain related state support measures (tax relief, guarantees of stabile legal conditions for business, localization of industrial products, access to state orders, inclusion as a single supplier and other support measures).

For most foreign investors, "Made in Russia" status may be the most important and attractive part of the new regulations. However, as indicated in the detailed legal analyses below, "access to government purchases as a sole supplier [is] subject to investments of more than 3 billion Russian roubles". This may not be achievable – particularly for small and medium-size companies and new investors.

upset the results of any expert examination and compromise its validity and completeness, particularly in regard to the long-term competitiveness of the technologies proposed. Another possible danger is subjectivism in an expert board that has

SPIC-2 represents a significant step in improving the investment climate, particularly in regard to tax benefits and liabilities.

One of the key objectives of the SPIC-2 is to include SMEs, which is why the entry barrier for the minimum investment amount of 750 million roubles has been eliminated. However, the new format requires extensive documentation and procedures that may be restrictive to foreign SMEs, particularly newcomers. The active participation of pharmaceutical and automotive companies appears natural due to the scale of their market in Russia, the size of their investments and their well-established local presence.

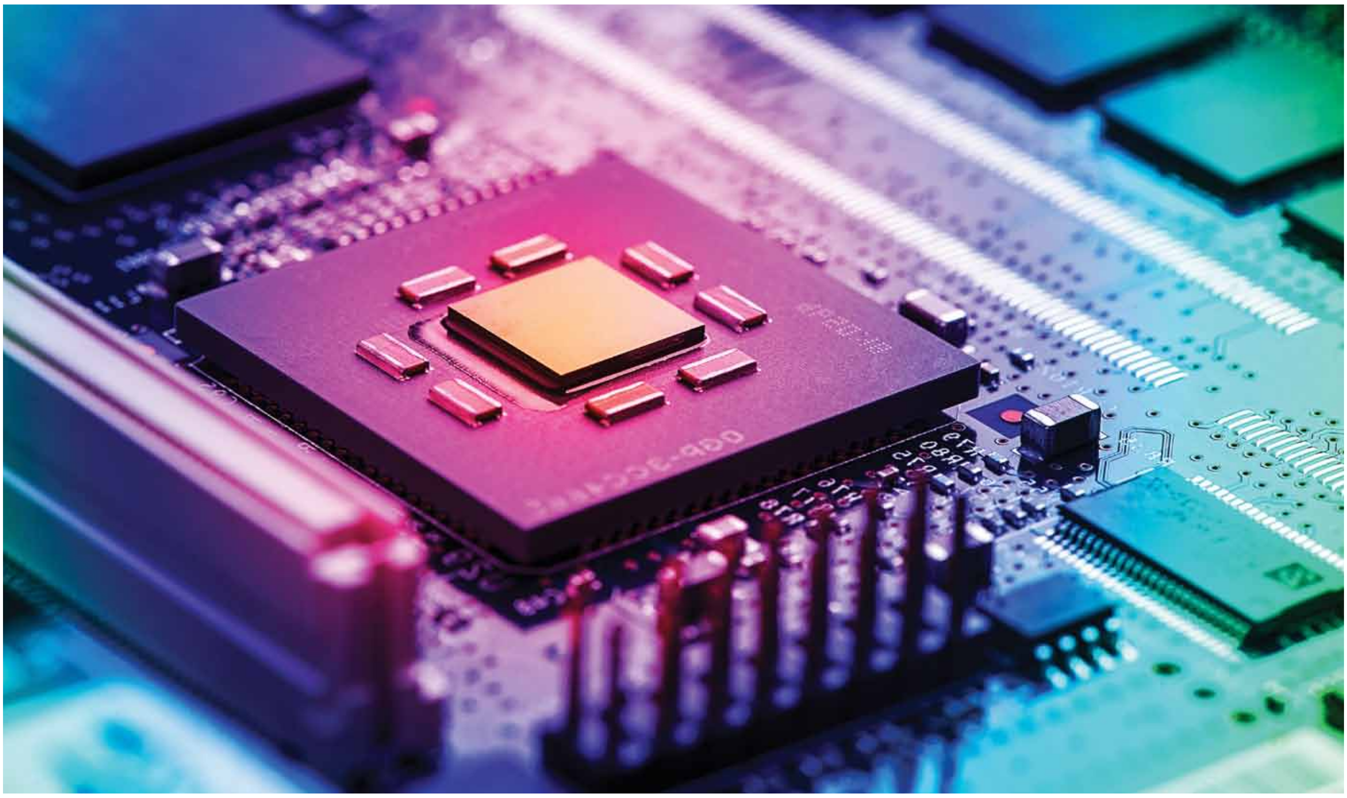
The conclusion of SPIC-2 will operate via tender rather than a simple application procedure. SPIC-2 sets out the procedure for holding a competitive selection process for the development and deployment of technologies included in a government-approved list of advanced modern technologies. Input for this list was collected from Russian businesses and academia. An expert examination procedure for the technology is established to assess applications in order to estimate the competitiveness of the technologies proposed. However, no foreign experts are allowed on the expert board. This may seriously

no international expertise. The long time frames of projects may require extraordinary strategic marketing expertise to ensure the global competitiveness of products and demand for such technologies and corresponding products over the project's lifespan.

In August 2019, the mechanism of a special investment contract to be concluded between the Russian Federation and a private investor to implement a project for the creation or modernization of manufacturing facilities (SPIC 2.0) was completely updated. At that time, only 45 federal SPIC had been concluded since 2016, the majority of which were for the automotive (14) and chemical (8) industries, pharmaceuticals/medicine (7), and mechanical engineering (6).

Key changes:

- The purpose of the updated SPIC mechanism is to increase long-term investments in high-technology projects and introduce advanced technology for local content in manufacturing products that are competitive on the world markets. In return, the government promises to ensure stability in the conditions for the inves-



tor's business activities and offer special incentives to support the project.

- The result of the investment projects supported by the State must involve serial manufacturing utilizing modern technology under a list approved by the Russian Government.
- The entry barrier for the minimum investment amount has been eliminated (it was previously RUB 750 million excluding VAT), with the focus now on the transfer of technology.
- The maximum SPIC term has been extended to 20 years.
- The SPIC conclusion procedure is now more transparent: competitive selection has replaced the filing procedure used to conclude contracts previously. The key criteria for the evaluation of bids will now be the speed of introduction of technology, the volume of serial manufacturing for products and the technology level of local content in manufacturing.
- The rules regarding stabilization clauses relating to both business activity in general and to investors' tax burden have been improved.
- The liabilities of public and private parties to a SPIC have been limited: in the event of a breach of contract by a public party, it will be impossible to recover lost profits. The investor will be liable only for the amount of fiscal support measures provided by the state.

Under current legislation, the following key preferences may apply to investors that are parties to SPIC 2.0:

- The stability of conditions for the investor's business activity at the federal and regional levels if special regulatory acts are adopted regarding this matter.
- The stability of tax burden (except for VAT and insurance contributions).
- Tax benefits (income, property, transport, and land taxes if certain regulatory acts are adopted at the local level).
- "Made in Russia" status for industrial products with a suspensive condition on the local manufacture of such products.
- Access to government purchases as a sole supplier (if investing over RUB 3 billion).

Statements from officials who supervised the SPIC update process were taken into account to expand the list of preferences for investors and make the mechanism more attractive.

In March 2020, the Russian government approved the Rules for Forming and Updating the List of Types of Technologies Recognized as Modern Technologies for the Conclusion of Special Investment Contracts[1].

[1] See Decree of the Government of Russia No. 319 of 21 March 2020.

An expert examination of the technology claimed by the investor to serve as the basis for the manufacture of globally competitive products is conducted by Russian organizations from a list approved by the Russian Government[2]. The fact that there are no foreign experts on this list may seriously affect the results, validity and completeness of such an expert examination due to a lack of relevant competence and experience among Russian experts. They are unlikely to engage any foreign experts, as such organizations are compelled to conduct the relevant expert examination free of charge.

On 28 July 2020, the Rules for the Conclusion, Alteration and Termination of Special Investment Contracts[3] came into force. As a result, in order to actually launch the updated mechanism, the Government must approve a primary list of modern technologies and form a special commission[4], while the Russian Ministry of Industry and Trade must approve exemplary forms for new SPICs.

According to the Minister of Industry and Trade, the first SPIC 2.0 tenders will take place in October. It is planned, first of all, to conclude contracts for technologies for which the Russian economy is critically dependent on foreign suppliers.

At this stage, the new rules are of interest to business in terms of the additional requirements for the project and the procedure for SPIC conclusion initiated by the investor.

The additional requirements for an investment project are:

- The project should provide for manufacturing and process operations that allow for the batch manufacturing of products based on modern technology. This requirement refers to a technical aspect of the project and is intended to block projects that will not result in the release of the claimed products. The project should provide for the achievement of the intended operating profitability within the term of the SPIC. Thus, projects that are potentially unprofitable or extremely adventurous financially are rejected. The term for gaining said profit shall be set from the date of the SPIC to the end of the calendar year in which profit becomes positive for the first time.
- Modern technology should be up-to-date. The period after which it becomes out-of-date is recorded by the Government in the list of modern technologies.
- The project investment schedule should provide for expenses in cer-

Mandatory Costs	Optional Costs
Purchase, construction, manufacturing, delivery of fixed assets, including customs duties and fees, and construction, installation and commissioning works	Purchase or lease of land plots intended for manufacturing facilities located on them
R&D clinical studies, or obtainment of rights to results of intellectual activity (unless such rights are transferred to the investor free of charge or these rights are already owned by such an investor by the beginning of the tender)	Construction, major repair, reconstruction of industrial buildings, mine openings, electric power and heating facilities (including survey works and preparation of design documents)
	Modernization or depreservation of fixed assets (a minimum share of purchased equipment should be at least 25% of the cost of modernized or depreserved equipment)
	Creation, modernization, reconstruction of the infrastructure required for the project

[2] See Order of the Government of Russia No. 994-r of 12 April 2020.

[3] See Decree of the Government of Russia No. 1048 of 16 July 2020.

[4] Commission for the conclusion, alteration and termination of special investment contracts.

tain areas. These areas are subdivided into mandatory and optional investor costs.

At the same time, neither the new version of the Law nor the new Rules mention export volume as a requirement for the project. At the same time, as shown by the conclusion of previous SPICs, export potential was also assessed (along with other indicators for the project). For this reason, the contract included requirements to ensure a certain level of export. We believe that this practice will also be transferred to SPIC 2.0.

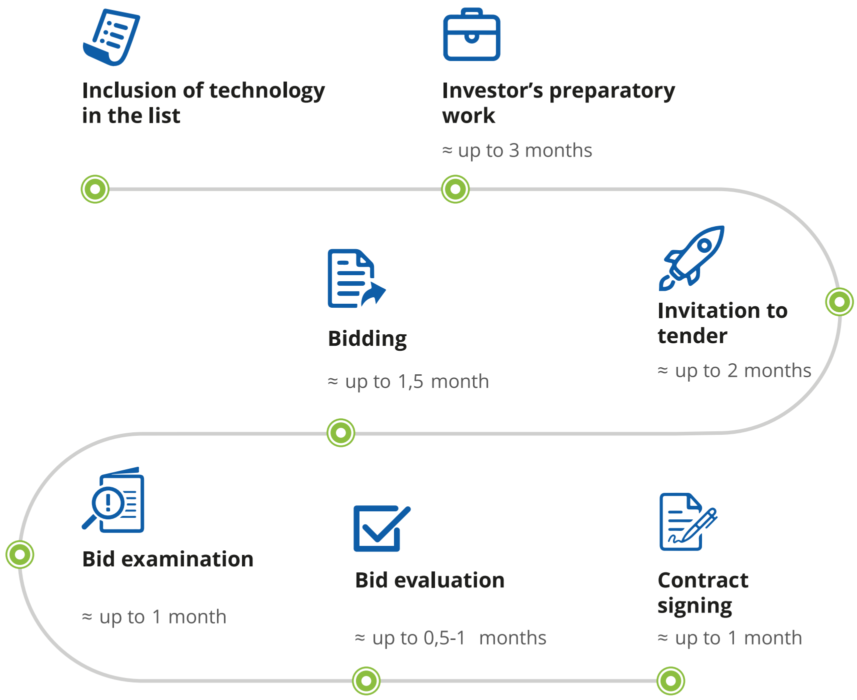
A contract may be concluded at the initiative of both public and private parties.

Meanwhile, taking existing practice in using investment vehicles into account, the most popular option is likely to be the conclusion of a SPIC at the investor's initiative.

Based on our estimates (and taking regulatory time limits and previous experience in the conclusion of contracts into account), the total time from the start of the investor's preparatory work to the signing of SPIC 2.0 may be between 5 months and 1 year. The length of this time period will depend (among other things) on the level of preliminary elaboration of the technical, process, financial, and legal aspects of the project implementation, the current stage the project, the existence and sufficiency of a regional regulatory framework, and the political will of a competent authority currently focused on import phase-out and export.

As a general rule, an investor should be competitively selected for the conclusion of a contract.

Procedure for concluding a contract at the investor's initiative



However, in practice, contracts largely seem to be concluded without a tender. This is acceptable if only one investor submits a bid for a tender. This is due to the fact that industrial projects are usually very customized. This is particularly relevant here, as SPIC 2.0 conclusion requires the use of modern technology whose acceptability and necessity are confirmed by special expert examination and the Government. Often, projects are tied up in manufacturing at a given location. At the same time, the initiator of the contract conclusion should agree on the location of the project before the start of the tender. It is not unusual for a tender to be focused specifically on the agreed-upon territories. In addition, as a rule, the initiator will also be in an advantageous position due to the fact that they will have more time for the preliminarily elaboration of issues in their interest and to prepare the necessary materials. In turn, this considerably narrows the range of parties interested in concluding the relevant contract and reduces the likelihood of competition in this area.

New SPIC 2.0 from the perspective of medium-sized companies

The COVID-19 pandemic has changed the business environment worldwide. In most countries, the hardest hit by COVID-19 and the subsequent lockdown were small and medium-sized businesses operating in the services sector and manufacturing companies. As a result, manufacturers increasingly started to consider a return to the localization and regionalization of production.

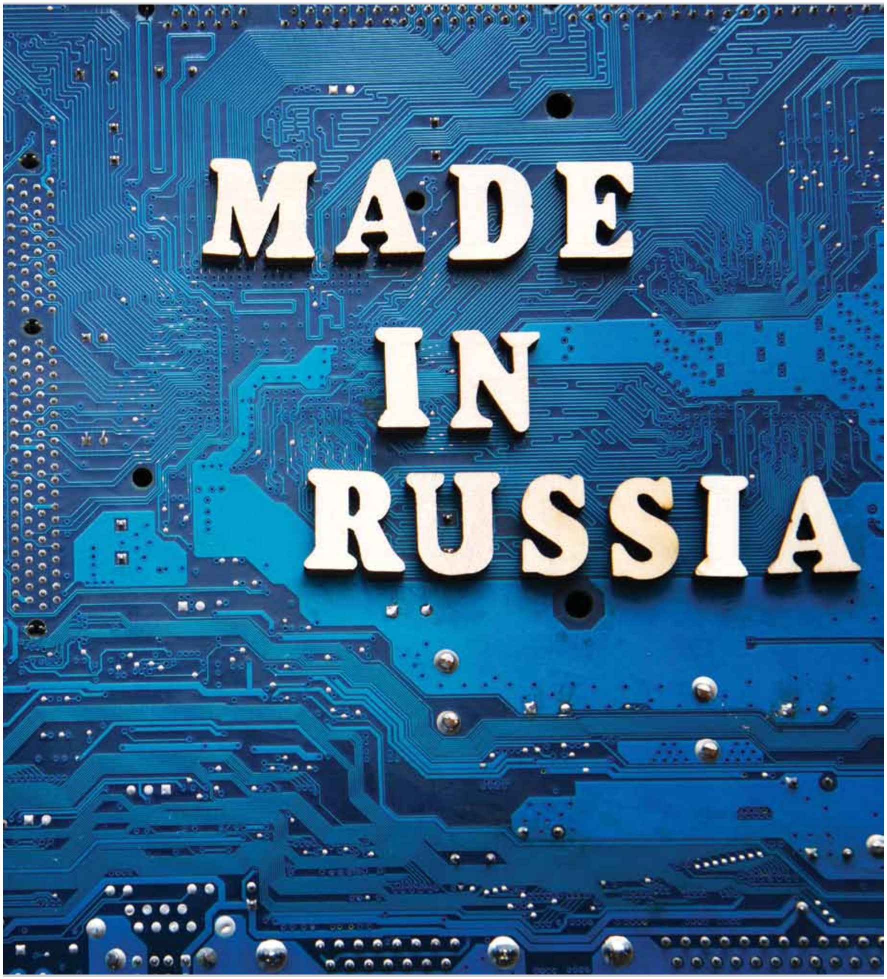
In Russia, this trend for localization was already evident over the past few years even before the pandemic. Against the backdrop of COVID-19, this trend has clearly intensified. In April 2020, the Russian Government adopted Resolution No. 617, which limits access to a wide range of foreign-made industrial goods for state procurements. In July 2020, federal laws approving quotas on state procurements from domestic manufacturers were also adopted.

This has forced manufacturing companies operating in Russia to once again contemplate whether they should establish or expand existing production facilities in Russia, which would allow them to sell their products on the market as Russian products and consequently maintain or increase their presence in Russia.

In turn, the state has also stepped up its activity to attract foreign investments. In this sense, the SPIC 2.0 investment regime has come at the right time. In July 2020, Resolution No. 1048 of the Russian Government "On Approving the Rules for the Conclusion, Amendment, and Termination of Special Investment Contracts" was adopted. This document finally approved the rules for concluding SPIC 2.0, which were long awaited among market participants.

"Made in Russia" confirmation

The conclusion of a special investment contract usually enables access to the "Made in Russia" confirmation for products manufactured in Russia. The "Made in Russia" confirmation allows companies to offer their products without any restrictions for state procurements and large-scale state-financed investment projects.



As a general rule, the requirements to receive the "Made in Russia" confirmation were set forth primarily in Resolution No. 719 of the Russian Government "On Confirmation of the Manufacturing of Industrial Products in the Russian Federation". However, the specified requirements have not always been feasible for companies building production facilities in Russia from scratch.

In this sense, a special investment contract offers an interim solution for companies. For example, a company that has concluded a special investment contract is entitled under the simplified procedure to obtain "Made in Russia" confirmation immediately after concluding a contract and may brand their products as "Made in Russia", as though the products actually were fully manufactured in Russia.

Tax benefits

Tax benefits are another advantage available to companies after the conclusion of a special investment contract. Such benefits are provided both at the federal and regional levels.

At the federal level, a zero corporate income tax rate is applied. For example, Moscow offers a reduced regional corporate income tax rate of 12.5%. A zero corporate income tax rate is in place in the Moscow region until 2025.

To apply the tax benefits, the investor may select the specific tax base to which it will apply the reduced (zero) corporate income tax rates: a) the preferential rates apply to the entire tax base if the income from activity under the special investment contract is ≥90% of all the taxpayer's income; or b) the preferential rates only apply to the tax base formed from activity under the special investment contract (separate accounting must be kept). The selected method for determining the tax base must be formalized in the accounting policy and cannot be changed during the effective term of the special investment contract. The right of the investor to apply the tax benefits arises in the year after the method for determining the tax base has been formalised in the investor's accounting policy.

In addition, the conclusion of a special investment contract provides the investor with an opportunity to apply for regional property tax benefits. In many regions, such a tax is set at 0% for the entire term of the special investment contract.

Subsidies

The conclusion of a special investment contract enables many companies to access state support available to domestic manufacturers. In keeping with the active support shown by the state for industrial production in Russia over the past few years, the state provides support (subsidies) on a regular basis to domestic manufacturers. For instance, in August, the Russian Government adopted a resolution establishing federal budget subsidies for machine tool manufacturers to enable them to offer discounts to customers for the acquisition of their Russian-made machine tools.

Modern technologies

First of all, unlike SPIC 1.0, which as a rule could be concluded in respect of any industrial investment project, SPIC 2.0 may only be concluded for the implementation (development) of a modern technology which has been entered into a government list of technologies in high demand. If the technology is approved and included in the government list, then the investor can expect its investment project to qualify for SPIC 2.0.

Procedure for concluding SPIC 2.0

Unlike SPIC 1.0, where special investment contracts were concluded based on an investor's application, SPIC 2.0 is performed through competitive bidding. Any company registered on the State Information System of Industry Platform (GISP) may participate in competitive bidding (including foreign entities).

To participate in competitive bidding, an investor files a bid that should include, inter alia, an investment project implementation schedule, a schedule for raising funds to finance the project, a schedule for the performance of technological operations, incentives requested by the investor, a description of the product and investment project target indicators, etc. In addition, a Business Plan and Financial Model of the investment project should be attached to the bid.

In practice, the preparation of the required documents is time-consuming. The timeframe for filing bids to participate in competitive bidding, with all the required documents attached, cannot exceed 45 days. Consequently, the applicant will have to prepare documentation within a very challenging time period.

Investments

Unlike SPIC 1.0, the new rules do not stipulate a minimum investment threshold. This new regulation is an advantage for medium-sized businesses, as the previous threshold of RUB 750 million was too steep for some companies, and was frequently artificial and economically unjustified. The investments must involve the acquisition of production equipment, R&D and other assets pursuant to the investment schedule.

Terms and conditions of SPIC 2.0

The draft SPIC 2.0 (the agreement) is submitted by the state as part of the tender documentation. When participating in competitive bidding, the investor is entitled to provide as part of its bid additional terms and conditions (amendments) proposed by the investor for inclusion in the special investment contract. At subsequent stages, the investor will not be able to submit any additional terms and conditions. In view of the aforementioned tight deadlines for the submission of documents, the investor will have to pool its efforts.

Conclusion

The special investment contract mechanism has demonstrated its worth in the past. Major investment projects have been implemented under the SPIC.1.0 regime in the chemical, automobile and pharmaceutical industries and the mechanical engineering and wind power sectors. The state anticipates an even greater return from SPIC 2.0 and is calling on investors to proactively apply this regime. SPIC 2.0 should enhance Russia's investment appeal and guarantee stable terms of business for investors. Practice will show whether this mechanism enjoys demand in the current economic environment and will identify the difficulties that investors must overcome when entering into SPIC 2.0. The implementation of SPIC 2.0 may require further dialogue between the business and the state.

Frequent traps in the post-localization process

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Localization Projects Manager, Merck Russia

Eldar Aleev joined Merck in 2018 to drive several localization projects across Russia.

He has 9 years in the pharmaceutical industry, 5 years in consulting. Eldar has strong experience in project management, business development, portfolio building, marketing, production and launch management in the pharmaceutical industry.

He graduated from Financial University under the Government of RF, has Master's in business marketing and MBA.

PAVEL SAVKIN

Associate Sales Director, BioProcessing, Merck Life Science, Russia and CIS

Pavel Savkin joined Millipore company in 2007 to drive different project across Russia and CIS.

He has 14 years in Life Science industry, and strong expertise in the area of sterilization of medicine liquids, validation of sterilizing grade filters, single-use technologies and design of filtration lines, as well as expertise in the area of excipients for final formulation of medicinal drugs.

Pavel graduated from D. Mendeleev University of Chemical Technology of Russia.

For the last ten years, foreign drug producers have generally dealt with partners and products that require a transfer to Russian industrial facilities. While the questions of what, where, and how to localize used to be the most prominent, other problems have since come to the fore and have been identified based on experience after a period of active commercial production.

For the purposes of this article, we will regard localization as the transfer of a drug produced from a supplied substance to the consumer pack to a local (Russian) factory. We see the post-localization process as a path to commercial production, but before the full industrial capacity of the line or factory has been achieved.

It's commonly believed that experienced companies dealing with a transfer of product manufacturing on a permanent basis may be able to prevent problems during the post-localization period. However, even those companies are rarely successful in doing so. This is due to differences in site preparedness, cultures, project goals, the presence or lack of dedicated project teams, missing error databases, lessons learned and other reasons. Nevertheless, such experiences can provide ready-made solutions (among other things) if problems can be identified.

When outlining the numerous problems that can arise in the post-localization process, the authors used the following main groups: industrial facilities, quality, communications, legal issues, paradigm shifts, and other factors. It is worth noting that the authors do not think it is necessary to make any kind of gradations, as the questions appear in each project to varying degrees of frequency and urgency. Recommendations on the resolution of certain problems are given only as an example. They are not exhaustive and do not provide a multi-purpose tool.

Industrial facilities

When considering the problem of industrial facilities, it is worth noting that (based on the authors' experiences) the following arises in almost all cases: capacity is either deficient or excessive. In both cases, companies often revise their previous forecasts for the localized drugs. However, forecasts for five years or more are always risky, particularly in fast-growing markets in which the changing landscape influence sales both positively and negatively. In addition, forecasts are made on the basis of certain assumptions that can change partly or entirely.

The authors recommend considering the following options for the optimization of industrial facilities:

If industrial capacity is deficient:

- Request a donor factory for temporary production support. During the support period, it is necessary to implement actions to improve production efficiency and validate another line (or part of the line plant).
- It may also make sense to consider purchasing, installing, and commissioning an improved or additional line. So-called "one-off" lines reduce the time required for installation, validation, and maintenance, which can be a substantial support during peak-load periods. Of course, "one-off" lines are expensive, but the cost is negligible for high outputs, especially when considering significant seasonal variabilities and the production of high-cost drugs.
- Engage an additional site, especially if the limitations have an impact on packing while transfer, validation, and registration don't require much time.
- Increase the size of manufacturing companies, thereby eliminating idle time spent on cleaning, adjustments, and part replacements.

If industrial capacity is excessive:

- Expand the output of the drug for other countries, such as those in the EAEU. Notwithstanding extra-low levels (generally, 10–20% compared the current level in Russia), the capacity will be utilized fairly due to the small batches of goods and the periods of time required to make arrangements in between.
- It may be possible to revise the medicinal products portfolio to select drugs with similar production. In this case, however, strong arguments are needed in favour of localizing a candidate at the current capacity.
- Another approach is to engage an external partner either independently or with a contracted manufacturer. Nevertheless, companies are not eager to consider such opportunities, citing high risks such as a potential future deficit in capacity due to the extension of their own plans, the reallocation of industrial capacity in favour of another partner, the risk of cross-contamination resulting from (among other things) the manufacture of different medicinal product groups, the risk of data leaks arising from visits to production lines by other companies, etc.

Quality

Questions regarding quality in the post-localization process are inevitable. It is difficult to invoke a low-quality system in Russian enterprises, as every foreign (and Russian) company undertakes its own audit and validates the enterprise's quality system prior to localization (and often afterwards). However, a common problem is the lack of a so-called "quality mindset", i.e. establishing quality as the governing principle under any circumstances. In other words, not every action is preceded by the question, "will it affect (reduce) the quality?". That said, the good news is that when management send the right message and

new experience is gained, the result is the development of this essential skill.

One solution to quality issues can be extra training for partner personnel (including through visits by corporate professionals) and the assignment of a special officer from the donor company's quality department to work with the partner's employees during regular personal visits. Additional expenditure aside, such investments will help to eliminate issues such as the destruction of a product batches – a solution whose value far exceeds the costs incurred.

Communications

Once localization is over, regular communications reduce in frequency. This is driven in particular by a change in teams, who are now responsible not for the project but for regular production and monitoring. Labouring under the illusion that the localization implemented requires a routine kind of manufacturing, foreign companies often appoint other professionals to take control of it or remove it entirely. At the same time, regular and intense communications during the post-localization period are important and flow into other departments. However, the absence of a project manager (who previously served as a front-end system) creates gaps around issues at the interface of various departments, such as the output of a new pack, the purchase of pharmaceutical aids from another supplier, the validation of new processes, etc.

One recommendation is to assign a project role to an officer to settle such matters. However, employing an attendant manager such as an alliance manager (analogous to a project manager responsible for localization) may be a more expedient option. The candidate should provide insight into local experiences and speak the language of the manufacturer's employees in order to better understand the problem and avoid differences in mentality. Some companies can lure employees away from the manufacturer in the reasonable belief that said employees know all the enterprise's problems and are able to solve them. However, such a move must be considered carefully, as it can undermine relations with the partner and the company may not achieve the desired effect due to communication issues.

Team meetings must take place on a regular basis in order to track the fulfilment of plans and check the status of current issues. In-person meetings can be replaced with conference calls, but a face-to-face meeting must take place at least once per year, including at the enterprise.

Legal issues

It is common knowledge that a signed contract is a key project milestone and, notwithstanding bulky revisions by the legal department to cover every eventuality, the post-localization process will reveal plenty of gaps that were previously imperceptible.

In this case, it is advisable to hold regular meetings, maintain solid relations with the partner and, sometimes, turn a blind eye to their faults (even when they're not in line with the contract). Contracts and relations should be capable of evolving, so amendments to some terms and conditions may be necessary.

Paradigm (goal) shift

When localization is being carried out, the company may change not only its strategy for predetermined segments, but also its development paradigm as a whole. This will inevitably affect the goals and objectives that the localization was designed for. It is not a rare occurrence to conclude that no localization is required and that relations with a manufacturer can be terminated once money has changed hands. Besides being an easy recommendation for reducing losses, it also makes sense to postpone the shutdown and instead close temporarily. This preserves the ability to make modifications and to spend the minimal amount of money and time on maintaining manufacturing capabilities in future.

Mindset can be another problem. Foreign companies often don't understand the logic behind some decisions made by Russian companies, believing that there should be a set decision for one case or another. It is important to remember that Russia has had to frequently change and adapt to the rules of game. This generates uncertainty around opportunities and marks a significant difference from European countries. Given such uncertainty, Russian enterprises often focus on the present and plan for the long-term with reluctance. One recommendation is to keep this attitude in mind and do transparent business with the partner while gradually communicating the importance of long-term cooperation to the donor company, rather than having a hit-and-run strategy.

While other problems may arise during the post-localization period, relying upon the principles of trust, mutual support, and critical thinking makes all these matters resolvable.

Continuous investment in Russia: being resident of the Lipetsk Industrial Special Economic Zone

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General Manager,

Bekaert Russia

Erwin Lokere has been working for Bekaert company for 20 years. His background centres around technology and operations. He used to work in several countries. Prior to his assignment in the Russian Federation, Erwin led a company-wide behavioral safety programme.

JULIA BARANOVA

Human Resources Manager,

Bekaert Russia

Julia Baranova has been working for Bekaert company for 11 years. Along with her focus on the Lipetsk team, she has been executing several projects for Bekaert company worldwide, and has led the Human Resources Department of Bekaert in Romania.

Investment articles often focus on the initial investment of a new factory, the arguments in favour of doing so, and the challenges to overcome when starting up in a new country.

This article is devoted to the experience of Bekaert, which recently celebrated its 10th anniversary as resident of the Special Economic Zone in Lipetsk, with continuous investment and expansion over these first 10 years.

The article will share experiences on utilizing local knowledge built up during the initial years, how to maximize localization within expansion projects, and how the development of your local team contributes to efficient "continuous" investment.

As we consider the COVID situation to be a temporary phenomenon, this article does not reflect the events of 2020.

Bekaert

Bekaert is a Belgium-based global market and technology leader in steel wire transformation and coating technologies. The company has a strong presence in diverse sectors such as automotive, construction, energy & utilities, agriculture and consumer goods. Bekaert serves customers in 120 countries and has 30,000 employees worldwide.

Bekaert Lipetsk, the company's only production site, was officially inaugurated by President Medvedev on January 2010 and produces metal cord used for tire reinforcement and dramix steel fibre in construction.

Continuous investment in Russia

Bekaert Lipetsk is growing annually. Rapid development in the automotive industry has led to an increase in the tire market and a resulting expansion in steel cord production. Therefore, continuous investment is key to sustaining and extending our market share.

We can optimize costs while maintaining pace with the market by going GLOCAL: using the benefits of our global company in concert with the local team.

We have outlined three main phases in the GLOCAL investment approach:

Pre-start-up investment preparation

The selection of the location of our plant was based on many criteria, such as proximity to (all our) customers, business-minded administration support, infrastructure, long-term vision on labour availability, etc. However, one of the key factors in further investment is the ability to recruit the right people and form a skilled labour force. Combined with the other above criteria, we were able to select a site for our company in a city with excellent metallurgical education, an industrial approach and a skilled workforce: Lipetsk. Due to the wide availability of expertise, we were able to select people based on their (potential) leadership skills. Once the right local people were hired, several of them were sent for extensive training at our global sister companies to learn about Bekaert's specific skillset and company culture.

Start-up investment
During start-up investment, there is intensive co-working between local staff (who had already spent time at a sister plant abroad) and global company experts. Significant time (extra time) is devoted to transferring knowledge to the local team and putting them fully in charge of the processes. The fact that part of the local staff had already received training abroad allowed us to keep team of foreign experts smaller. This means that the local team "owns" the building-up of their company alongside the expert global team, instead of simply following the global team's lead. This is a key step in future engagement and the success of future investments by the local team. Due to the critical relationship between process and machine in terms of the quality of our products, Bekaert makes 90% of its equipment in-house (though installation and infrastructure are outsourced). This is done (as much as possible) with well-established local suppliers, which ensures that future expansion can be secured locally. We found 95% of the required skills among local suppliers and contractors in the Lipetsk region.

Last but not least, in this start-up investment we decided to first bring over the final step in the process and insource half of the product in the first year. This allowed us to take a phased approach and not lose sight of the local team during the exciting start-up period.

Values bring an identity to the company. They create a strong foundation for maximizing results in good times and withstanding any kinds of crises.

Continuous investment
Our local team reacts to market developments quickly, strives to achieve benchmark KPIs and has bottom-line responsibility for the overall performance of the plant.

It will be the local team that initiates an investment proposal for global headquarters – though as world leader in steel wire transformation, our "competitor" is often a Bekaert plant in another region. This means that a sustainable, cost-competitive investment climate is required to continue investing. Regardless of what was sufficient in the "start-up-investment" phase, continuous improvement is key in all critical facets of business.

To date, this has been (very) successful for our site in Lipetsk, and we have a passion and ambition to continue this journey with all our stakeholders.

It's no surprise that we're continuing to focus on the development of our local people during this ongoing phase. Regular topical meetings and video sessions allow local experts to interact with their global colleagues around the world. As part of the Bekaert Manufacturing System, actively supporting the invention, sharing and implementation of good ideas all over the Bekaert world is a good practice-sharing tool.

When new process technologies or manufacturing systems (e.g. digitalization of the MES) are made available in the global company, the local team will go to study it abroad and ensure the efficient implementation of the new systems in our plants (with assistance from the global team if required). This is preferential to a global expert team rolling the new system out.

As we have made clear, the focus of all three phases is the development of the local team and on making them truly engaged and part of the global organization. We have identified four key areas in the success of our local team.

Development of the local team to ensure future growth

Foster a culture. Define your values clearly before building the plant
Values bring an identity to the company and to the team. They explain our raison d'etre and create a strong foundation for maximizing results in good times and (more importantly) withstanding any kinds of crises. Values may seem a vague and blurry concept, one that can't be calculated or shown on a graph, but they penetrate

every sphere of the business. They are what makes a team resilient and gives it ownership of its performance. Our three global company values – trust, integrity and irrepressibility – are deeply integrated with everything we do in our Lipetsk facility.

Recruitment: search for a cultural match

Technical skills can be taught and trained and language proficiency can be achieved with six months of classes. But if you need dynamic and creative people, you can't just train them to be that way. If your team requires flexible and fast members, a world expert who prefers to work at their own pace won't integrate well into that team. In interviews, we supplement traditional questions aimed at highlighting and demonstrating ability with freer conversations on various topics. "Which famous people would you like to talk to and why?", "What's the best strategy to win a game of ice hockey?", "What does your best friend really think about you?". These questions may not be a part of the standard interview procedure, but they encourage people to open their hearts and minds to demonstrate their authenticity and values.

Use the full power of the team

We widely practice working in mixed cross-departmental and cross-level teams. An annual must-win battle can be led by a white-collar employee instead of a relevant manager, an accountant can join a project to improve working conditions, a warehouse supervisor can contribute to a problem-solving team. We believe your contribution to the business is not limited by your role or position. We let people learn by joining various project teams and occupying different positions that don't always match their educational background or previous work experience, and we actively promote and rotate people.

It's not uncommon for an operator to become a technical manager or for a management assistant to try out various positions before growing into a quality manager. Others still will find themselves working far away from their home country, contributing to the company from other countries and continents.

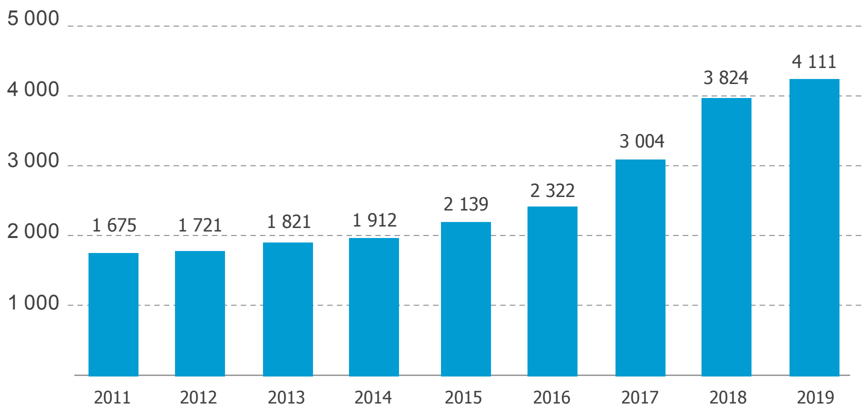
Glocal: go local and utilize the scale of the global company

Local team players have some obvious advantages: they know the environment, understand the local culture and know how to utilize its strengths, can better predict the reactions and behaviour of the locals and can find unique alternatives. At the same time, it would be a crime not to fully utilize the global scale of the company. We have created a solid worldwide network that tremendously broadens our horizons, accelerates staff development, improves business agility and greatly helps with learning English.

We understand that we can be great, unstoppable and unbeatable when everyone on the team can proudly say "I am Bekaert".

With this level of engagement, trust to continue investing from year to year remains high.

▶ Cumulative investments (2011–2019), mln roubles



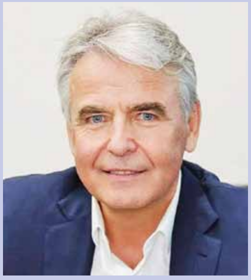
Summary

The Bekaert Lipetsk team has been actively focusing on the development of local talents, providing them with company-specific skills and establishing true ownership of the company's performance.

This combination of the crucial "people factor", the localization of processes in controlled steps, integration with regional suppliers and cooperation with administrative bodies will produce an engaged team that can grow together with customers and continue to invest in a successful and sustainable business.

"Localization" is the magic word for investment in the Russian Federation. We believe that after equipment and purchased products, the key focus of localization should be on embedding local talents in your global organization: go GLOCAL.

The Tula region: potential for doing business



ANDREY SHESTAKOV

General Director, "Tula Region Development Corporation" JSC

Andrey Shestakov has been General Director of the "Tula Region Development Corporation" JSC since April 2019.
He is a candidate of psychological sciences, a corresponding member of the Academy of Imageology, a corresponding member of the Russian Academy of Natural Sciences, an Honored Economist of the Russian Federation, and also Investment Commissioner of the Government of the Tula region.

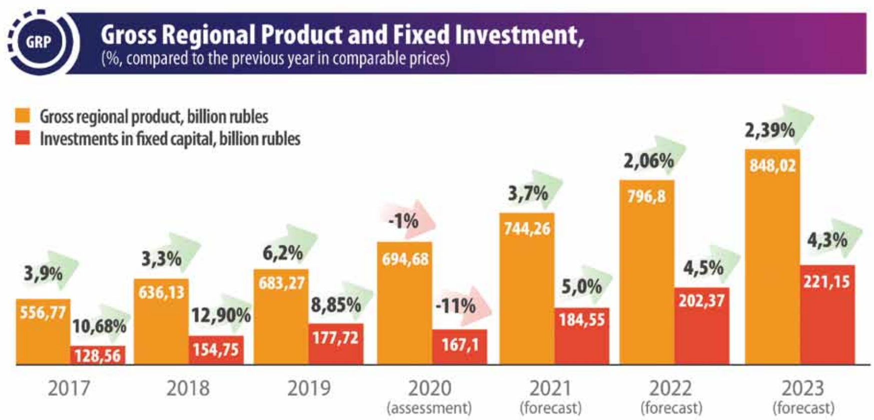
The Tula Region is a dynamically developing region of Central Russia with an active position in attracting investments.

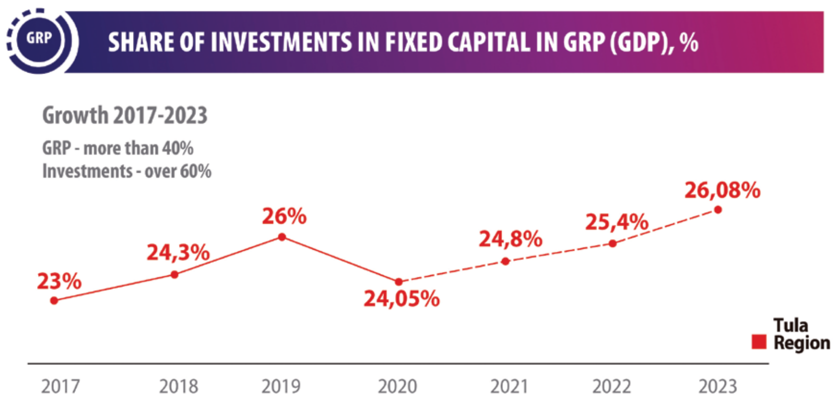
With the volume of fixed capital investments amounting to more than 177 billion roubles in 2019, the region has become a leader in industrial growth in the Central Federal District. The gross regional product of the Tula region in 2019 amounted to 683,27 billion roubles. Industry, trade, agriculture, transportation and storage, construction, and other industries are prominent in the structure of the region's GRP. These figures speak to the stability of the region's economic development.

The Tula region ranks third among Russian regions in terms of investment attractiveness. Special conditions allow residents to implement daring large-scale projects.

The investment strategy of the Tula region is aimed at the integrated development of territories by attracting Russian and foreign investment and enhancing innovation, primarily in industries traditional for the region such as mechanical engineering, metalworking, chemistry, electronics, and the processing of agricultural products.

Main investment priorities include chemical products of organic synthesis, machine tools, industrial equipment, the production of auto components, composite materials, biotechnology and deep processing of agricultural products, agro-industrial production, mineral mining and processing, tourist and recreational areas (the construction of hotels and campgrounds, the reconstruction of sanatoriums), logistics (warehousing and logistics hubs).





A progressive legislative base has been created in the Tula region. Investor companies implementing projects in the region are provided with a wide range of preferences, including a reduction in the income tax rate and property tax, and financing for infrastructure construction.

The "Tula Region Development Corporation" JSC also acts as a management company for the Uzlovaya Industrial Park and Uzlovaya Special Economic Zone. This makes it possible to promptly provide potential investors with options for relevant tax and customs regulations, as well as options for providing sites with infrastructure.

The government of the Tula region and the Tula Region Development Corporation work with development institutions such as Vnesheconombank, the Industrial Development Fund of the Russian Federation, the Russian Direct Investment Fund, the Federal Corporation for the Development of Medium and Small-sized Business (SMB Corporation), the Russian Agency for Export Credit and Investment Insurance (EXIAR), the Agency for Strategic Initiatives (ASI), and the Russian Export Center (REC).

The "Tula Region Development Corporation" JSC is a "single-window" service provider for investors. The corporation provides a full range of services to support investment projects, including the selection of land plots with the required infrastructure, as well as administrative and technical project support. All consulting services are provided free of charge, which allows investors to focus on their business.

That's why more than 5,000 industrial enterprises supplying products to 139 countries, and more than 200 companies with foreign capital, including Procter & Gamble, Cargill, Unilever, Knauf Group, Heidelberg Cement Group, SCA, HAVAL, IKEA, Leroy Merlin have already chosen the Tula region as a platform for future business development.

Monotowns and PSEDAs

The Tula region comprises over 100 greenfields, more than 75 brownfields, 6 monotowns, 5 industrial parks, 2 priority social and economic development areas (PSEDAs): the Aleksin PSEDA and the Yefremov PSEDA, and the Uzlovaya Special Economic Zone for industrial production.

There are 6 municipal entities in the Tula region included in the list of monotowns by order of the Russian government. They are Aleksin, Yefremov, Belyov, Suvorov, Kimovsk, and the Pervomaysky workers' township.

The advantages of implementing investment projects in monotowns include new opportunities for doing business, support and promotion for investment projects, the removal of administrative barriers, the attraction of financing, and infrastructure construction.

As part of the implementation of investment projects in monotowns, it is possible to obtain a concessional loan and co-financing for the construction and reconstruction of infrastructure facilities from the Foundation for the Development of Monotowns.

In order to promote the development of single-industry municipal entities in the Tula region, an important area of activity for the region's government has been the creation of territories of advanced socio-economic development (PSEDAs).

In 2018, Yefremov, a town with a population of 55,000 people, was granted PSEDA status – becoming the first monotown in the region to do so. Yefremov's industry mainly comprises large and medium-sized enterprises in the chemical and food industries. 64% of the economy of the Yefremov district comes from food production, with 7% from chemical production and 4% from agriculture. To date, the residents of Yefremov PSEDA are: Yefremov-Pharma LLC, Lister LLC, Astra LLC, Prombiotechnology LLC, Tula Vegetable Oil Plant LLC, Zdorovyj vybor LLC, Mir detstva LLC, and BVK-Techno LLC.

During the St. Petersburg International Economic Forum in May 2018, a cooperation agreement was signed with Cargill LLC to create a biotechnology cluster in Yefremov in the Tula region. Several investment projects in the agricultural production sector are already being implemented as part of

Investor companies are provided with preferences, including a reduction in the income tax rate and property tax, and financing for infrastructure construction.

the cluster's creation. Promising areas for the development of the bio-cluster in Yefremov include the biopolymer industry, agrobiotechnology, industrial biological products, biopharmaceuticals, and biologically active additives.

Aleksin obtained the status of PSEDA in 2019. The population of the Aleksin district is more than 66,000 people. The sectoral structure of the Aleksin PSEDA economy is the production of machinery and equipment (38%), the production of non-metallic mineral products (18%), goods and services (16%), energy (9%), chemical production (8%), cardboard production (7%) and others. To date, the residents of Aleksin PSEDA are Tri A Plus LLC, Aleksinskij Meat Plant OJSC, ZGPM Lactoprom LLC, Technocompost LLC. Three more residents will join the Aleksin PSEDA soon: Cheroka CJSC, Innovative enterprise NOVA LLC, Egnyshevskie sady LLC. Their applications were approved by the regional investment committee.

Companies implementing investment projects in the PSEDA can take advantage of additional tax preferences, utilize investment project financing from the Monotown Development Fund and receive support from SMEs.

Uzlovaya SEZ and Uzlovaya IP

Uzlovaya Special Economic Zone for industrial production and the Uzlovaya Industrial Park are situated in the Tula region. They boast convenient logistics and developed infrastructure. Residents have full access to electricity, gas, water disposal and supply, and telecommunications.

Infrastructure development is carried out by the "Tula Region Development Corporation" JSC management company, which carefully considers the needs of investors.

Today, the Uzlovaya Special Economic Zone is one of the top five special economic zones in terms of investment activity and information transparency. The SEZ ranks third in terms of the average annual number of residents attracted, and the Ministry of Economic Development of the Russian Federation consistently awards it the highest operational efficiency rating of 100%.

> Companies implementing investment projects in the PSEDA can take advantage of additional tax preferences, receive support from SMEs.

To date, 13 companies have become residents of the Uzlovaya Special Economic Zone: Engelsspectrubmash LLC, Agrogrib LLC, Arnest MetallPack LLC, StalPolimer LLC, Tula Aluminum Plant LLC, Tenzograf LLC, Evraz Uzlovaya LLC, Innovative Polymer Coatings LLC, Mistral-Tuls LLC, Promet SEZ LLC, Ard-Polimer LLC, Nikton LLC, and Kliks LLC.

Three enterprises are already operational, with Engelsspectrubmash (ESTM) being the first SEZ resident to launch an enterprise. The company specializes in the production of flexible tubing. Coiled tubing is used in the oil and gas industry, and ESTM is the only producer of such pipes in Russia. Agrogrib is a mushroom producer that grows traditional white champignons, large brown portobello mushrooms and mini champignons. Arnest MetallPack is a plant for the production of tin aerosol cans, and was the third enterprise to launch production in the Uzlovaya Special Economic Zone. A number of productions are expected to launch this year.

There are four companies resident at the Industrial Park: GreatWallMotors, GK Quality LLC, Gorodskoj Kommunal'nyj Servis LLC, and NanoPolimerArm LLC.

The largest resident of the Industrial Park is GreatWallMotors, which built a full-cycle Haval automobile plant, as well as stamping, welding, painting and assembly workshops and a component manufacturing workshop.

The construction of a railway hub, station and customs terminal is planned for the near future in order to improve the provision of gas, water and power to residents of the Special Economic Zone and the Industrial Park. Work is also under way to expand the SEZ to an area of 1,000 hectares.

Overall, we would like to say that the Tula region is developing day by day and attracting large international companies interested in operating here. We are confident that our relations and interactions with European companies will only improve in this regard. We're creating a favourable environment for foreign companies to do business in the region, which is why we'll be happy to see you in Tula – the Workshop of Russia.

Software localization in Russia: challenges and opportunities

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Denis has provided legal help to clients engaged in such sectors as e-commerce, oil and gas, manufacturing, pharma, FMCG, trade, transport, TMT, IT, etc.

IT is one of the most dynamically growing sectors in Russia. A 2001 meeting with IT business representatives marked the first time the President raised the issue of the need to develop a national IT sector to create healthy competition with foreign IT developers.

In 2015, a law was passed in the Russian Federation establishing the Russian Software Register and excluding foreign software from state procurements, followed by a government resolution specifying the main requirements for inclusion in the register.

In September 2018, Russia's Ministry of Digital Development issued an Order approving a plan to transition government agencies and major state-owned companies to prioritise the use of Russian software. In December 2018, the Russian government passed a number of directives confirming the requirements for this transition. Half of the applicable companies' software must be Russian by 2022. The only exceptions are if companies can prove that there is no suitable Russian equivalent to the software they require.

As a result of these state activities, the share of Russian software in state procurements had reached 65% by the end of 2019 (compared to 20% in 2015). According to calculations by the Ministry of Digital Development, by 2024, this figure will reach 90% in procurements by state authorities and up to 70% in those by state-owned companies.

Legal requirements for localization

The key requirements for software to be included in the Russian Software Register are: (i) exclusive rights to the software throughout the world, and that the rights must belong to a Russian person or entity in which the total direct share of and/or indirect participation by the Russian Federation or a citizen thereof exceeds 50% for the duration of the term of validity; (ii) the software must be a separate subject of exclusive rights; (iii) the software must not be subject to mandatory updates or management from abroad; (iv) the total payments under licencing and other agreements that grant rights to intellectual products, the performance of works or the provision of services in connection with the development, adaptation or modification of software for foreign parties must not exceed 30% of the software owner's proceeds from its sale during the calendar year; (v) guaranteed maintenance, technical support and modernisation of the software must performed by an entity without predominantly foreign participation or by a citizen of the Russian Federation.

Point (ii) (the software must be a separate subject of exclusive rights) means that the Russian owner may obtain the software either by: (a) acquiring the full rights to existing software from a Russian or foreign person; (b) developing new software, or (c) technically modifying existing software, thereby creating independent derivative software.

An important aspect of the modification (point (c)) of existing software is that the derivative software must be created by real technical (rather than "cosmetic") processing. For instance, the following changes may not be deemed modifications resulting in the creation of independent derivative software: (i) translation of foreign software into Russian; (ii) changes to the software interface; (iii) changes to the name of the software; (iv) the addition to foreign software of modules that do not fundamentally affect the functioning of the basic software as a whole, and which make no changes to the software's source code. In contrast, modification of basic software by amending its code and adding modules that expand or improve the software overall is highly likely to be deemed a modification of the software resulting in the creation of independent derivative software.

So, if software is created for localization purposes through the modification of foreign software, this must involve real technical and not just "cosmetic" changes; in practice, the addition of individual modules to foreign software or a merger with a Russian product is not recognized as a reworking that creates independent derivative software.

While legislative restrictions are quite stringent, the market suggests that they allow foreign developers to implement (with certain specific features) business models for distributing software. One example is to establish a joint venture with a Russian partner that owns 51% of the shares in the venture, then develop or modify foreign software to be recognized as independent and owned by the joint venture, which is then localized.

IT tax manoeuvre: another step in localization policy?

The following is an explanation of the current tax regime adopted for IT companies in Russia. One of the main tax benefits established for IT businesses is a reduced rate of social security contributions – 14% instead of the basic 30%. The 14% rate is available to Russian legal entities only. It may not be applied by foreign companies operating in Russia through branches or otherwise.

In addition, VAT exemption is granted to IT companies with respect to software supplies made under either an exclusive rights transfer agreement or a licencing agreement. A VAT exemption is also available to foreign companies making cross-border software supplies to Russian customers. Considering that payroll is a major element in an IT business's cost structure, these two tax preferences add high value to an IT business operating in Russia and increase its overall tax efficiency.

Profits derived by Russian companies are normally taxed at the 20% profit tax rate. That said, in some Russian regions (e.g. Novosibirsk, Chelyabinsk, Penza), a reduced profit tax rate may be available to IT companies before 1 January 2023.

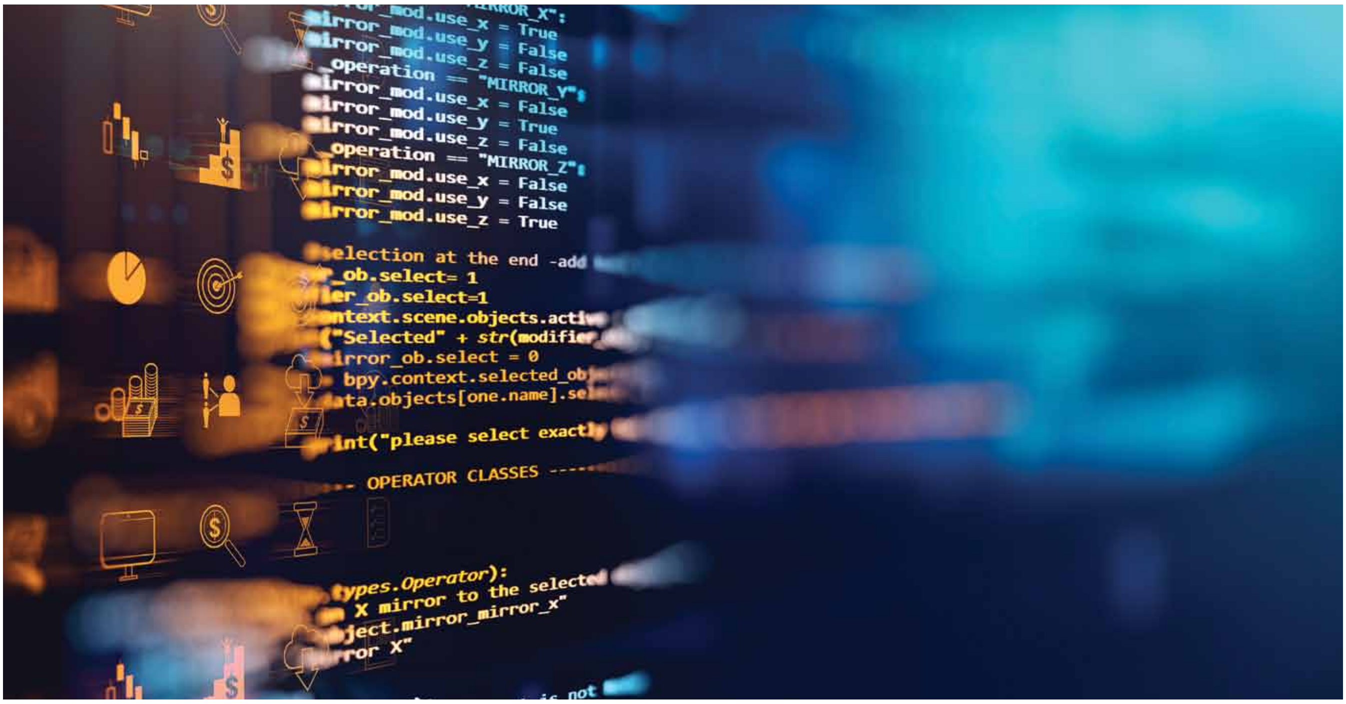
Following the introduction of restrictive measures and the digitalization of the global economy in response to COVID-19, the Russian President announced a tax manoeuvre in the IT sector aimed at making tax legislation in Russia more IT friendly. The law introducing a new tax environment for Russian IT businesses was drafted by the Russian government and passed by Parliament soon after its announcement. It will come into force on 1 January 2021.

The new tax regime for the IT industry stipulates that the following tax benefits will be granted to IT businesses:

- a reduction in the social security contribution rate from the 14% down to 7.6%;
- a cut in profit tax from 20% to just 3%.

No time limits have been established for applying these tax benefits. Under the new regime, the eligibility criteria for tax benefits will remain almost the same for applying the reduced 14% social security contribution rate. The criteria are as follows:

- the company should be accredited with the Russian Ministry of Digital Development as an IT company;
- over 90% of the company's revenue should come from IT operations related to the development and sale of software or the provision of services related to software development, adaptation, modifi-



cation, maintenance, testing or installation;
- the company's average headcount in a given tax (reporting) period should be at least seven.

The major difference from the current tax regime is the disqualification of certain types of IT operation-related income for the purposes of the 90% revenue test. Income derived from the following activities of an IT company shall be disregarded:

- the dissemination of and access to advertising information on the internet;
- the posting of sale or purchase offers for goods, works, services or property rights on the internet;
- the search for information about prospective buyers or sellers and/or entry into transactions.

In an attempt to compensate for the loss in state revenues caused by the introduction of such extensive tax benefits, the Russian government has restricted the application of the VAT exemption on software sales. It will now only be available if the following conditions are all met:

- the software has been entered into the Russian Software Register;
- the software is not used for the operation of aggregator (trading platform) business models or for advertising purposes (please see the specific disqualification conditions established for the 90% revenue test above).

Considering the criteria established for the localization of software in Russia, the fulfilment of condition (i) above is impossible not only for foreign IT companies, but also for their Russian subsidiaries involved in the supply chain of software distributed on the Russian market. In practice, this means that the VAT exemption on software sales will become unavailable to such market players from 1 January 2021. In our opinion, this is a clear sign that the tax manoeuvre in the IT sector could be seen as a continuation of the existing trend in the state's localization policy.

Following on from the letter of the law, IT companies that operate under aggregator (trading platform) business models or sell software used for advertising purposes will be unable to enjoy the new tax regime preferences. For this reason, foreign investors who fail to qualify for IT tax manoeuvre benefits may consider the tax-saving opportunities provided by other tax regimes available to IT businesses in Russia.

The Skolkovo Innovation Centre (the so-called "Russian Silicon Valley") is one such preferential regime. The Centre was established in 2010 by the Russian government to encourage R&D and the commercialization of its products, including in the IT sector of the economy. The following tax benefits are granted to Skolkovo residents:

- 14% social security contribution rate;
- VAT and profit tax exemption;
- refund of customs payments (including import VAT) for goods used for R&D and product commercialisation;
- property tax exemption.

The above tax benefits are granted to Skolkovo residents for a period of up to ten years. Skolkovo residents also have the opportunity to seek financial aid from the Skolkovo Foundation for their R&D projects.

In addition to Skolkovo, Technology & Innovation Special Economic Zones (SEZs) have been established in some Russian regions (i.e. Innopolis in the Republic of Tatarstan, Tomsk, St. Petersburg, Zelenograd and Dubna in the Moscow region). The residents of such SEZs are also entitled to various tax incentives such as a reduced profit tax rate, a 14% social security contribution rate, property tax exemption, etc.

In our view, Skolkovo and SEZ residents should be able to combine the advantages of IT tax manoeuvre benefits with the tax preferences of the Skolkovo and SEZ special tax regimes. In particular, we believe it should be possible for a Skolkovo resident to enjoy the full profit tax and VAT exemption available to Skolkovo residents and, at the same time, the reduced 7.6% social security contribution rate established as a result of the tax manoeuvre in the IT sector.

Conclusion

For foreign IT companies that supply software to Russian government agencies and state-owned companies, software localization in Russia may be the only possible solution for maintaining their market share or gaining access to such a large segment of the Russian market. In light of the upcoming IT tax manoeuvre, such localization may also be seen as an option for ensuring the application of the VAT exemption to software sales and, thus, competitiveness in terms of pricing conditions with domestic market players.

Foreign investors who fail to qualify for IT tax manoeuvre benefits may also be encouraged to have a closer look at the tax advantages available to residents of the Skolkovo Innovation Centre and Technology & Innovation Special Economic Zones. They may present another opportunity to increase the overall tax and operational efficiency of an IT business in Russia.

Investment in the IT and e-commerce sectors: assessing the impact of regulatory requirements

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Anastasia's practice focuses on mergers and acquisitions and technology transfer transactions, as well as licensing, outsourcing, and professional services deals. Anastasia also advises clients on various regulatory aspects of mass media, IT business, e-commerce, and data transfers.

Anastasia's experience is highly recognized by the leading legal ranking agencies such as The Best Lawyers, The Legal 500, Chambers & Partners and others.

Investment in the Russian IT and e-commerce sectors is growing despite the COVID-19 crisis. Recognizing the importance of these industries for its future success, Russia continues its efforts to keep IT and e-commerce (which is still predominantly private) under control. New technologies emerge quickly, as do legislative initiatives from the Russian government and Duma members. Businesses continue to experience regulatory pressure and must keep track of legal updates on a daily basis in order to assess their impact on overall performance and to develop compliance strategies.

This article will cover the following regulatory trends that companies in the IT and e-commerce sectors (as well as their existing and prospective investors) should take into account in 2020:

- the localization of data processing, including domestic air travel data;
- the push to use software and hardware of Russian origin;
- restrictions on foreign ownership in the IT and e-commerce sectors.

Localization of data

Data localization has been an ongoing trend in Russia since 2014. It began with personal data localization in 2015, expanded to telecommunications in 2016, and now continues to grow into other areas such as air travel.

Fuelled by Russia's concerns over new US and EU sanctions that may disrupt key sectors of the economy, the localization trend will likely remain for as long as the sanctions regime keeps strengthening.

Data-heavy businesses, especially in strategic areas such as life sciences and healthcare, transport, telecommunications, energy, banking and finance, space, mining and chemicals, should be on the lookout for new localization initiatives.

Personal data

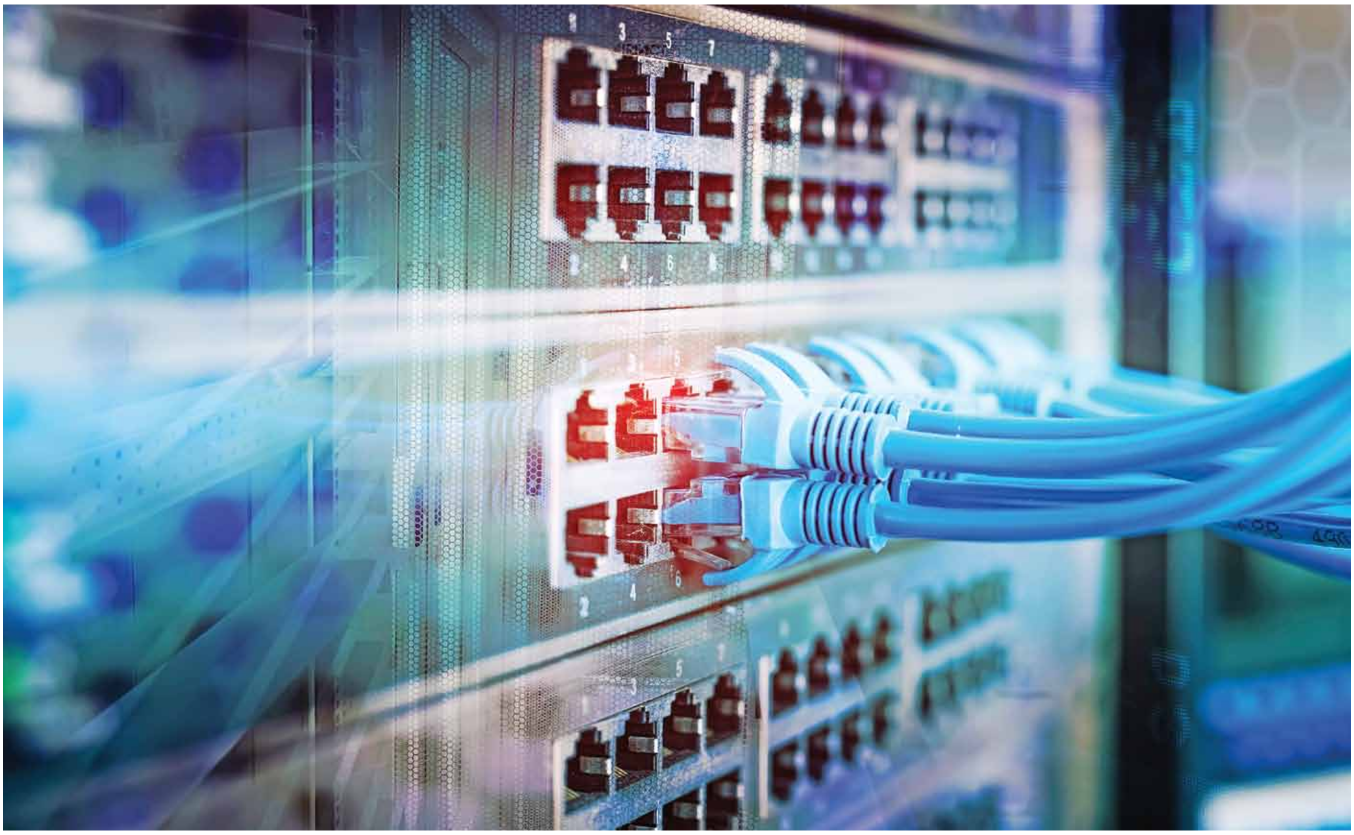
Since 2015, the Russian Law on Personal Data requires data operators to process Russian citizens' personal data (broadly defined as "any information referring directly or indirectly to an identified or identifiable individual") using databases physically located in Russia.

In 2019, the Russian privacy regulator Roskomnadzor lobbied for an increase in the penalties for non-compliance with the localization rule, and is likely to actively enforce it in 2020 and 2021.

Communications data

In 2016, Russia amended its Communications Law to introduce a requirement for telecom operators to store the contents and metadata of users' communications in databases located in Russia. These amendments are sometimes referred to as the "Yarovaya Law".

Telecom operators strongly opposed the move, and the implications of the law were widely discussed. As a result, the government first agreed to postpone the implementation of the law, then effectively replaced the requirement to store the content of communications for six months for telecommunication operators that provide telematics and data transfer services. Instead, a requirement was included to store content using existing



capacity and to increase storage capacity by 15% per year for the next five years. The government is currently discussing the possibility of further relaxing regulations to help telecom companies fight the COVID-19 crisis.

Similar localization rules apply to so-called "information dissemination organizers" (IDOs), an umbrella term for email service providers, social networks, messaging services and, generally speaking, any companies that operate information systems, websites, webpages, or software that allow users to communicate with each other. Russian law requires IDOs to store the content and metadata of Russian users' communications in databases physically located in Russia.

Unlike telecom operators, IDOs do not need a license from the regulator to provide their services. As a result, the regulator has limited enforcement tools for controlling IDOs' compliance with the localization requirement. In practice, this means that for IDOs with no Russian presence, the only measure available to the regulator is to block the website operated by the IDO.

Air travel data

In July 2019, the Russian government introduced a localization requirement for operators of air travel information systems. Under Government Regulation No. 955, databases and servers used to process domestic flight documentation must be located in Russia from 31 October 2021.

The implementation of the air travel data localization requirement requires a significant amount of time and investment. Airlines and service providers are now trying to lobby to postpone the deadline until at least October 2022.

Payment data

As of July 2020, electronic payment operators may not transfer data regarding domestic payments outside Russia. Under new amendments to the Law on the National Payment System, all domestic e-money payments must be processed in Russia and e-money operators cannot provide access to this information from abroad.

A similar requirement applies to payment infrastructure service operators (such as the National Payment Cards System) from July 2016.

The use of software and hardware of Russian origin

Another trend affecting both software and hardware manufacturers is continuing pressure from the government to use products of Russian origin. Originating in the context of state procurement, this trend quickly expanded into strategic sectors such as telecommunications and media, and also affected private businesses. For example, in May 2019 the government required telecom operators to use Russian-made means of information storage for the purposes of compliance with the Yarovaya Law.

In this article, we would like to focus on the proposed requirement for the use of software and hardware of Russian origin by the owners of critical information infrastructure.

Critical information infrastructure law

To recap, in 2017 Russia adopted the Law on Critical Information Infrastructure, which applies to IT systems in the healthcare, science, transport, telecommunications, energy, banking and finance, oil and gas, nuclear, military, space, mining, steel and chemicals sectors. Among other things, the law requires the owners and operators of critical information infrastructure (CII) to comply with the mandatory cybersecurity requirements imposed by the Federal Security Service and the Federal Service for Technical and Export Control (FSTEK).

In May 2020, the Russian Ministry of Communications published a draft decree that, if adopted, will introduce the obligation for CII owners to use Russian software and equipment in critical information infrastructure. In particular, the draft requires CII owners to initiate the transition to predominantly using Russian-origin software (to be completed by 1 January 2021), and Russian-origin equipment (to be completed by 1 January 2022).

Registers of Russian software and electronics

The draft further suggests that CII owners must use software in their CII facilities that is included either in the Uniform Register of Russian Software ("URRS") or in the Uniform Register of Eurasian Software ("URES"). CII owners would only be allowed to use foreign software if there are no analogues in the URRS or the URES.

Similar to the requirements regarding the use of software, CII owners are required to use equipment included in the Uniform Register of Russian Electronics ("URRE"). If there is no analogue with the necessary functions in the URRE, or if the technical characteristics of the Russian analogue do not allow the CII owner to achieve the goals and objectives prescribed by the law, then the CII owner is permitted to use foreign equipment.

Upgrade and maintenance of foreign software and equipment by Russian entities

If the CII owner uses foreign software or equipment (to the extent allowed by the draft decree), it must have an opportunity to make a contract with a Russian service provider to upgrade such software and equipment and to perform warranty and technical maintenance. Such provider must not be under direct or indirect foreign control.

Obligations of CII owners

The draft decree sets forth a number of steps for CII owners to take in order to ensure the transition to predominantly using Russian software and equipment:

- an audit of the CII and the determination of the necessary software and equipment for it;
- an analysis of the requirements applicable to the software and equipment and, in particular, a search for analogues (substitutes of Russian origin) in the URRS, URES and URRE, and an analysis of existing contracts on the use of foreign software and equipment;
- submission to the authorities of: (1) an application with a list of the foreign software and equipment still necessary to the CII owner and that has no analogues; and (2) a transition plan to ensure the predominant use of Russian software and equipment in the CII.

The draft decree is currently undergoing public discussion. As evident from the above, if adopted, these new regulations would impose significant additional burdens on the owners of CII.

> Over the past few years, Russia has introduced a number of foreign ownership restrictions that relate to the IT and e-commerce sectors.

Foreign ownership restrictions

Over the past few years, Russia has introduced a number of foreign ownership restrictions that relate to the

IT and e-commerce sectors. These must be kept in mind not only in the context of acquisitions and divestitures, but also in connection with routine intra-group restructurings. A summary of the key relevant rules appears below.

Foreign Strategic Investment Law
The Foreign Strategic Investment Law applies to companies engaged in strategic activities, for example, certain encryption and cybersecurity activities.

Under the general rule of the Russian Foreign Strategic Investments Law, any entity that acquires more than 50% of the shares or control over a strategic entity must obtain approval from the Government Commission on Monitoring Foreign Investment.

Mass media
Since 2016, the Russian Law on Mass Media prohibits foreign persons from holding more than 20% of the shares in, or establishing any form of control over, a Russian mass media entity or a broadcasting license holder.

The ban also applies to online mass media, provided that they are registered as a mass media entity (though the registration process for online mass media is currently optional).

Joint efforts by industry players to defend their positions should allow IT and e-commerce businesses to prosper in the current challenging environment.

Audiovisual services
Under 2017 amendments to the Information Law introducing a set of rules covering online video services, only Russian legal entities and Russian citizens may operate an audiovisual service with more than 100,000 Russian users per day.

Furthermore, foreign ownership of online video services is restricted as follows: a company that operates international audiovisual services with at least half of its users outside of Russia is not allowed to own more than 20% of a Russian legal entity operating an online video service without first obtaining special permission from the Government commission. This rule effectively bans major international players from operating their services in Russia without a Russian partner, unless they obtain a permit from the Russian authorities.

Conclusion
Navigating the Russian regulatory landscape is a challenging task for many businesses, as Russia is still subject to the risk of being an "emerging market". In other words, laws and regulations in Russia are often unclear, and their application by government authorities may be subject to political considerations, changing policies, and other factors.

IT and e-commerce companies (and their investors) should be prepared for the continuation of this trend in data localization and the push to use Russian software and hardware. At the same time, as evidenced by the Yarovaya Law, joint efforts by industry players to argue and defend their positions should allow IT and e-commerce businesses to prosper in the current challenging environment.

The China syndrome: how China and Russia can collaborate on digital issues

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With a degree in global economics, Elena is focusing on e-commerce development in Russia and China.

According to some economists, China was the world's largest economy from at least 1500 to 1870. In 1820, China accounted for an estimated 33% of global GDP on a PPP basis. In 1979, after years of economic and political instability, China undertook comprehensive economic reforms and promoted efficient innovation practices that lifted some 500 million people out of poverty and resulted in millions of people moving from rural to urban areas. These trends were supported by many years of double-digit GDP growth.

Efficient innovation, or the "China effect", can be boiled down to three ideas: cheaper, faster, and more globally connected. All of these factors were drivers for China's leadership in globalization with its lean manufacturing and modularization. Another result was the development of China's e-commerce and telecommunications industries, as exemplified by Alibaba and Huawei.

For the last 20 years, China has been able to build a complex eco-system of e-commerce that is now interconnected at a national and global level through major Chinese marketplace platforms (Alibaba, Taobao, Tmall, AliExpress, JingDong, Pingduoduo and others), messaging and social media apps (WeChat, Weibo), fast delivery services (Shunfeng, Yunda, etc.), financial services (Alipay, WeChat Pay), video hosting platforms (DouYin, KuaiShou), digital marketing and cloud solutions (Alibaba Cloud). Today, China represents the biggest e-commerce market in the world and is a leader in continuous development though the integration of new technologies and solutions in e-commerce that impact consumer behaviour and enhance the customer experience on a global level.

Main drivers of the fast development of e-commerce in China

China officially gained access to the internet in April 1994, and has leapfrogged into the digital world within a very short period. China automatically benefits from having the biggest domestic market – with a 64.5% internet penetration rate, the country has more than 900 million internet users (897 million of whom, or 99.3%, are mobile users). Mobile penetration gives equal marketplace access to consumers from lower-tier cities, so internet users from rural areas (28.2% of total internet users) can enjoy a shopping experience with more product choices online. Today, rural areas represent new market opportunities for e-commerce players experiencing a slowdown in business growth in the country's first-tier cities. There's a Chinese saying that goes: "要想富先修路 – "if you want to get rich, build roads first". Most rural areas in China have developed logistics infrastructure, which makes the delivery experience very fast and smooth.

Establishing a trustworthy relationship between consumers and merchants was one of the bases that helped to facilitate the development of e-commerce, and was successfully realized through Alibaba's Alipay payment system. The escrow online payment platform secures transactions between buyers and suppliers by retaining the money until delivery is confirmed by the buyer, after which Alipay releases the funds to the seller.

In the past, one obstacle to the development of e-commerce in Russia was the tendency among Russian buyers to pay cash on delivery. If Russia adopts Alipay's payment system, this trust could be established between buyers and sellers, thus supporting e-commerce.

In addition, easy entry to Alibaba's platform provided many Chinese merchants with direct access to a huge online market. Alibaba's Taobao and Tmall now dominate the Chinese market with 742 million annual active users. The company operates not only in the domestic market, but also in Russia, Europe and the USA through its AliExpress platform and the Lazada platform, which is popular in South-East Asia.

The parcel-delivery market in China

Over 60 billion parcels were delivered in 2019 (more than half of the world's total). The average delivery cost was 11.94 rmb (1.47 euro) and the average delivery time was two to four days (in Russia, the average cost of next-day delivery is 3 euros). Express delivery has become an essential part of life for Chinese citizens, with more than 100 million packages handled daily in China. The two biggest players on the market are Alibaba and JingDong, which has built a huge logistics network. Alibaba operates its last mile deliveries through the logistics operator Cainiao, which depends on carriers such as Shunfeng, ZTO and YTO. JingDong operates independently, with more than 500 warehouses and its own transportation network. Over 90% of JD's orders are delivered the same or next day. In addition, the 150,000+ parcel lockers across the country are seen as a key component of same-day deliveries. Since consumer expectations of delivery speed keep increasing, companies have a strong incentive to constantly improve their logistics infrastructure both locally and globally.

In Russia, fragmented logistics infrastructure and the delivery of 50% of parcels by a marginally reliable postal system have created severe inefficiencies in the logistics system. Some of these problems can be ameliorated by partnering with B&M retailers. JD has signed an agreement with Alfa Group's X5, which has a network of various retail outlets. X5 has established a collaborative logistics model that includes lockers in its stores. A click-and-collect model has also been suggested whereby online orders placed through JD.com could be delivered to X5 stores. Russia needs to improve its warehouse infrastructure and last mile delivery if it is to develop a marketplace model like China's. In a marketplace model, inventory is not held. Instead, customers are connected directly to third party sellers. Additionally, Russia could consider the Chinese model and acquire some B&M retailers.

Establishing a trustworthy relationship between consumers and merchants was one of the bases that helped to facilitate the development of e-commerce.

Alibaba in Russia

AliExpress was established in 2010, and Russia was the first international destination for the expansion of the Chinese e-commerce market. The main challenges for the platform were revealed in the low level of trust in online purchases among local customers, as well as the poor logistics infrastructure, speed and efficiency of online business in Russia, which result in long delivery times. Overcoming these challenges and initially promoting only Chinese products has resulted in Russia now becoming the largest market for AliExpress in terms of transaction volumes, number of orders, and number of customers. At the same time, the platform

provides vast opportunities for local merchants, with over 10,000 Russian companies and individual entrepreneurs conducting business through AliExpress in every market where the platform is available.

In 2019, AliExpress, Mail.ru Group, Megafon and the Russian Direct Investment Fund agreed to set up a joint venture to focus on the development of digital payment services for Russian users, which will help to increase the marketplace share in the Russian e-commerce market.

Studying the development of Chinese e-commerce and the adoption of current trends and practices in the Chinese market as a global commerce leader form an important basis for the successful development of the industry in Russia.

Ren Zhengfei is a former PLA engineer who founded Huawei in 1987 in the city of Shenzhen, which was in a Special Economic Area where individuals could start private high-tech companies. The company started out by reselling imported telecom equipment from Hong Kong in rural areas of China. Government support, China's efficient innovation policy and Huawei's "wolf culture" (supported by Ren) enabled Huawei to achieve USD 123 billion in sales revenue in 2019 and to operate in 170 countries. As a private entity, Huawei is wholly owned by Ren and his employees through a structure known as an employee stock ownership programme (ESOP), which grants non-transferable virtual shares to tens of thousands of employees. This structure has provided Huawei with an internal source of financing and discourages external investors from meddling with Ren's wish to prioritize R&D resource allocation.

Fifth-generation (5G) wireless technology is expected to be critical in the IoT (Internet of Things) due to its increased capability to handle massive volumes of data. 5G networks can process 1000 times more data at 100 times the speed of a 4G system. This creates the possibility of connecting many more devices, e.g. sensors and smart devices. It is estimated that the United States will lead in 5G adoption by 2025, followed by Europe and Asia Pacific. Huawei is the world leader in developing at 20 to 30% lower cost

than Ericson and Nokia, its main competitors. Due to the recent COVID-19 contraction, Xi Jinping has entrusted Huawei to galvanize 5G tech as the cornerstone of a "new infrastructure". This blueprint covers nascent technologies from the Internet of Things, autonomous vehicles, surveillance, and factory automation. The upgrade to 5G is estimated to create USD 13.2 trillion in global economic output by 2035, as well as support 22 million jobs and generate lucrative contracts for network equipment vendors. 5G will be the central nervous system of the 21st century economy, and China and Huawei are placed to be the world leader in this regard.

Following its successful approach in China by starting in rural areas before urban areas, Huawei prioritized developing markets over developed markets, with initial targets including Russia, Africa, and Latin America. Russia in particular presented vast opportunities to Ren, as other businesses operating in Russia were exiting due to concerns over currency depreciation and turmoil in its financial markets in 1998. Unlike in developed countries, the market threshold in Russia was low enough for Huawei to enter by replicating its Chinese business model. It began by assembling switches with a local partner domestically. It wasn't easy, however. Ren said, "We got our first contract in Russia after going through four general managers." According to Ren, the first contract was worth only USD 36. After six years of operations, Huawei's sales in the former Soviet state exceeded USD 100 million in 2003.

President Putin has spent several years promoting the domestic tech industry in a bid to insulate the country from having to rely on Western technological infrastructure. But with Russia still in need of foreign technologies, many companies are stepping up their cooperation with Huawei. In April, Huawei announced a partnership with Sberbank to launch a cloud platform in Russia's fast-growing market for cloud services. Huawei also pledged to "build a digital community with a shared future in Russia", saying it would boost its purchases in Russia from USD 392 million to USD 800 million, train 35,000 IT specialists, and build a new research and development centre in the country. Russia's cloud services are rapidly expanding. According to preliminary estimates from the Russian analytical agency IKS consulting, the market had grown by 20% by 2020, reaching USD 1.32 billion.

It is estimated that Huawei's market in Russia has grown by 51% every year since 2014, and it now has a share of 37%. Huawei's management is prioritizing the development of 5G, a field in which Huawei is providing better and cheaper equipment by investing USD 7.8 billion and training 10,000 specialists over the next five years. Huawei's relationship with Moscow provides much needed foreign investment and fuels entrepreneurship in Russia's IT industry.

The US recently imposed rules that prohibit non-US companies from selling chips made using US technology to Huawei without a special license. Some analysts consider these rules a "death sentence for Huawei", as it may longer be able to produce handsets and 5G equipment. These new rules are part of an ongoing tech war over the last two years between the US, its allies and the rest of the world. Deutsche Bank estimates that this tech war could cost the world economy USD 3.5 trillion over the next 5 years.

Ultimately, a resilient Huawei and China may overcome US sanctions. As Nietzsche said: "what does not kill me makes me stronger".

Part III.

Business in Russia after COVID-19

Status of small and medium enterprises: benefits and requirements

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Zhanna Khozheva has 12 years of experience in legal expertise and advising in various types of Russian and foreign companies. Having successful experience in both internal and consulting practice she understands fully the business' needs and develops practically working solutions.
The main activity is concentrated on corporate law, including structuring and registration of commercial and non-commercial entities, M&A procedures and constantly expanding experience in various projects related with real estate, antimonopoly issues and intellectual property.

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Arina Filippova is studying at the Master's degree programme "Corporate Lawyer" at the Higher School of Economics. Her professional and academic interests lie in legal support of doing business – corporate law, administrative and registration actions.
Starting her work experience less than 2 years ago, she has already managed to participate in a variety of projects from representing the registrar of joint stock companies during the season of annual general meetings of shareholders 2019 to several setting-up and liquidation procedures.

In the Russian Federation there are 5.6 million small and medium enterprises (SMEs), which provide jobs for 18 million citizens. However, according to the information provided by the Federal Service of State Statistics only about 1/5 of Russia's gross domestic product (GDP) is created by such organizations.

To stimulate the development of SMEs, the Russian government created a system of business support.

Small and medium enterprises: who are they?

In accordance with the Federal Law of July 24, 2007 No. 209-FZ "On the Development of Small and Medium Enterprises in the Russian Federation", small and medium enterprises are the legal entities, information about which is included into the Russian State Register of Small and Medium Enterprises (SME Register).

Unfortunately, the legal definition has no practical meaning, apart from establishing a formal feature – being in the SME Register. To understand the essence of this concept, it is necessary to refer to the requirements stated by law and normative acts.

Requirements for the ownership structure

For a company to be recognized as a SME the ownership share of 1) the state and 2) non-SME Russian and foreign legal entities in its authorized capital shall not exceed 25% and 49%, respectively.

Nevertheless, there is an exception for foreign legal entities – their subsidiaries may qualify for the status if the parent company meets the quantitative criteria discussed below, even in cases of 100% ownership of the foreign company in the authorized capital of the Russian company. This exception is not applicable for companies which are registered in offshore zones.

The requirements for the ownership structure are not applied if:

- the company is a joint-stock company and its shares are traded on the organized securities market and classified as shares in the high-tech (innovative) sector of the economy;
- the activity of the legal entity consists in the implementation of the results of intellectual activity, the exclusive rights to which belong to the founders of such entities – budgetary, autonomous scientific institutions or educational institutions;
- the company is a participant of the Skolkovo project provided for by Federal Law No. 244-FZ "On the Skolkovo Innovation Center";
- the participants of the company are legal entities included in the list of companies providing state support for innovative activities;
- a sole participant of the company is a public association of disabled people.

Number of employees and the amount of income

This is the aspect when the entities are divided into micro, small, and medium enterprises, which is important for the benefits provided – most of them are available only to the first two categories:

The individual entrepreneurs can be considered as SME and can be included into the SME Register with all the requirements for the criteria as well.

The income and average headcount should be counted for the previous calendar year.

Benefits granted to small and medium enterprises

Benefits available for SMEs in Russia may be divided into several categories:

Tax benefits

One of the most significant benefits of the SME status is an access to different tax regimes. For instance, there are special taxation systems with low tax rates in Russia, which can only be used by small and micro-business entities. Moreover, for small and micro enterprises which have been operating for less than two years, there is an opportunity to be exempted from paying taxes for two years.

Administrative benefits

In this case, SMEs benefit from the simplification of procedures (e.g. micro enterprises may not keep personnel records). Small and micro enterprises other annexes to the reporting do not need to be submitted.

The simplified procedure also applies to cashier operations. Small enterprises may not set a limit on the balance of cash.

With regard to small and micro businesses, there are benefits in the implementation of state controls – the duration of inspections for the former cannot exceed 50 hours, for the latter – 15 hours.

Benefits in public procurement

The state also provides support to SMEs through quotas in public procurement and procurement by state-owned companies. In particular, the latter are obliged to give 20% of the annual volume of their purchases to small and medium businesses, of which 18% should be distributed based on the results of purchases in which only small and medium businesses participate. Moreover, state and municipal institutions are also required to make at least 15% of the total annual procurement volume from such companies.

CATEGORY	AMOUNT OF INCOME	NUMBER OF EMPLOYEES
Micro enterprise	Up to 120 million roubles	Up to 15 employees
Small enterprise	Up to 800 million roubles	Up to 100 employees
Medium enterprise	Up to 2 billion roubles	Up to 250 employees

The category of the enterprise is determined in accordance with the maximum criteria which the entity has met for 3 years in a row. For newly established companies the criteria will be counted from the date of establishment.

have the opportunity to maintain accounting records and prepare accounting and statistical reports in a simplified form. Simplified accounting reporting consists of only two reduced forms – balance sheet and financial results statement. Explanations and

Property and financial support

The property support SME businesses may claim includes the opportunity to conclude lease agreements with regional authorities on preferential terms. In addition, the preemptive right to buy out the leased property

> During the global pandemic, SMEs, as the most vulnerable, were provided with special benefits. Thus, for all SMEs insurance contributions were halved.

and the possibility of using land plots with preferences is established.

Further, the Russian Federation has developed a programme to stimulate lending to small and medium enterprises, which fixes the interest rate at up to 8.5% per annum for loans in the amount of at least 3 million rubles. More than 60 authorized banks participate in the programme, and an independent guarantee is provided by the Federal Corporation for the Development of Small and Medium Enterprises.

In addition, targeted subsidies are allocated on a competitive basis for this category of business. The amount of subsidies depends on the region and the specific state support programme.

Support measures during the pandemic

During the global pandemic, small and medium-sized businesses, as the most vulnerable, were provided with special benefits. Thus, for all SMEs insurance contributions were halved. State control was also limited – only unscheduled inspections on certain grounds shall be carried out.

In particularly affected sectors of the economy, small and medium enterprises may apply for deferred payment of most taxes, receiving additional subsidies (while retaining 90% of the workforce), and deferral of rental payments. Also, a moratorium on bankruptcy was established. In the lending sector, this category of companies is entitled to receive credit holidays (for 6 months max), deferred loan payments, preferential lending rates for business expenses (>2%), and payment of salaries.

Requirements for receiving the status, terms, and procedure

The current legislation provides benefits for SMEs not just when the business meets the criteria, but when the individual entrepreneur or the company is included on the SME Register. The grants for SMEs with respect to the global pandemic can be provided only to businesses which had already been included on the SME Register before March 1, 2020.

The SME Register has been maintained by the Federal Tax Service from August 1, 2016.

Businesses complying with the SME requirements may be registered in the SME Register only with effect on August 10.

The information on the SME Register is open and can be reached at the link https://rmsp.nalog.ru. The Register is updated every tenth day of the month.

In order to include or exclude a company or individual entrepreneur on the SME Register, the Federal Tax Service makes the decision based on:

- the information of the Unified State Register of Legal Entities and Individual Entrepreneurs provided that the company or the individual entrepreneur have submitted the information on the average number of employees for the previous calendar year;
- the information contained in documents related to the use of special tax regimes in the previous calendar year.

Also, during the period from 1 to 5 of July of every year, the information regarding other companies should be provided to the Federal Tax Services electronically by the following suppliers:

- the stock exchanges submit the list of joint-stocks companies, whose shares are traded on the organized securities market and classified as shares in the high-tech (innovative) sector of the economy;
- the Ministry of Education and Science of the Russian Federation submits the list of legal entities, whose activity consists in the implementation of the results of intellectual activity, the exclusive rights to which belong to the founders of such entities – budgetary, autonomous scientific institutions or educational institutions;
- the Skolkovo Foundation submits the register of project participants provided for by Federal Law No. 244-FZ "On the Skolkovo Innovation Center";
- the Ministry of Industry and Trade of Russia submits the list of companies with the activity in light industry as the main type of activity (Section C "Manufacturing" of the Russian Classifier of Economic Activities) and the average number of employees, if it exceeded the limits described above, but did not exceed the special exceptional limits established by the Government of the Russian Federation;
- the Ministry of Justice submits the information on the limited liability companies where the sole participant is the public association of disabled people;
- the holders of registers of shareholders of joint-stock companies submit the list of joint-stock companies that meet the abovementioned criteria;
- audit organizations submit the list of limited liability companies that have been established by December 1 of the previous year, and whose participants are foreign legal entities. The auditor confirms that, as of January 1 of the current calendar year, the foreign legal entities – the participants of the Russian limited liability companies, meet the criteria.

The current legislation provides benefits for small and medium-sized enetrprises when the individual entrepreneur or the company is included on the SME Register.

For the latter case, Russian limited liability companies should conclude an agreement with the audit organization and provide the documents regarding the company itself and its foreign participant(s) as well. The main tricky issue usually is providing the financial statement for the foreign company for the previous year if the legislation of the respective jurisdiction sets different time frames for submitting the information to the local tax authorities. However, the auditors have some options to solve this issue which should be discussed in the agreement.

As a result, the companies to use the benefits shall be included in the SME Register. Otherwise, even full compliance with the criteria will not reach the desired effect.

Concluding a lease agreement after the pandemic. What should a tenant pay attention to?

EKATERINA SIDENKO

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Her core activities include the preparation of legal opinions on various issues related to real estate, performance of comprehensive legal due diligence on real estate assets (including land plots for the construction of commercial real estate), contractual work and litigation.

Ekaterina's work experience includes advice to companies and private individuals on issues related to the construction of commercial real estate on land plots, sale and purchase transactions and lease of real estate, interaction with the state authorities regarding the registration of title to real estate and real estate transactions, the preparation of draft lease agreements and construction contracting agreements, and representation of clients' interests in court.

The pandemic and the restrictive measures that came in its wake hit all market participants hard. The first to suffer, naturally, were tenants, who attempted (often fruitlessly) to win a discount on rent from the landlord or the possibility of vacating leased premises without penalty. This resulted in headlines in the media about how a considerable number of small and medium enterprises had not survived the lockdown, shuttered windows on cafés and stores, and also friends' photos of home offices or brand-new co-working setups on social media. Obviously, the landlords were the next in line: more and more premises stood empty. When both sides of a legal relationship are suffering losses, it becomes reasonable to cooperate rather than compete, in order to save the business. As there could potentially be a "second wave" of the pandemic, this should both be reflected in contracts. Let's take a look at the conditions that a tenant should look to put in a lease agreement.

The problem of defining the purpose of the premises

As a rule, the purpose of leased premises is frequently specified in the most general terms: "as office space", "for public catering", etc. This works if various types of activity are carried out on the premises – for example, a shop and a café. However, when the government restricted certain types of activities during the pandemic (remember, restaurants were only allowed to offer takeaway service), many tenants found themselves in a difficult negotiating position: how could they prove that the premises were unusable if in fact part of the activity could not be performed, and the premises were not used for this activity, whereas at the same time no one was prohibiting another activity that was being performed? In the end, if the café was forced to close, but the shop was not, the landlord would argue that the tenant could use the entire floor space as a shop and thus would decide not to compromise.

This problem can be resolved by making sure that the lease agreement describes in as much detail as possible the intended use of the premises, taking all parameters into account (for example, how much floor space is to be used for each activity).

It is also important that the purpose of the leased premises does not violate the permitted use of the building and land plot as a whole according to the urban planning regulations. Otherwise, the owners of the building could be subject to administrative liability[1],

[1] 308-ES19-10562 of the Russian Supreme Court dated 21 October 2019.

which, generally speaking, rebounds on the tenants as well, through the obligation to reimburse penalties.

How to reduce the amount of space leased

From the start of the pandemic, most tenants probably began to think about cutting the amount of space they leased: how to "scale down" the office to the right size? From a legal standpoint, this condition was the tenant's right to partially withdraw from the lease agreement. Of course, this is of no benefit to the landlord, but it is possible under certain conditions.

Firstly, taking into consideration the worsening economy, it is better for the landlord if the tenant keeps leasing at least part of the premises, rather than the landlord letting them go entirely and looking for a new tenant, probably on less attractive commercial terms, or trying and collect debt from the current tenant through the courts. Secondly, it is possible to stipulate a provision that the amount of space leased may be reduced in certain circumstances (restrictive measures imposed by the government, a drop in revenues to a certain level, etc.) in return for a reasonable penalty or compensation of losses paid by the tenant.

As a commercial alternative, the tenant can also be given rights to sublet part of the premises, on the provision that the landlord cannot refuse to approve the sublease without significant cause.

Provision on repudiation of the lease agreement in full – a double-edged sword

The lease agreement may stipulate the right of unilateral repudiation on the basis of notification, whether due to breach of contract or at the will of the tenant[2]. Such a right is a very strong weapon in the hands of the tenant and consequently is used in limited cases.

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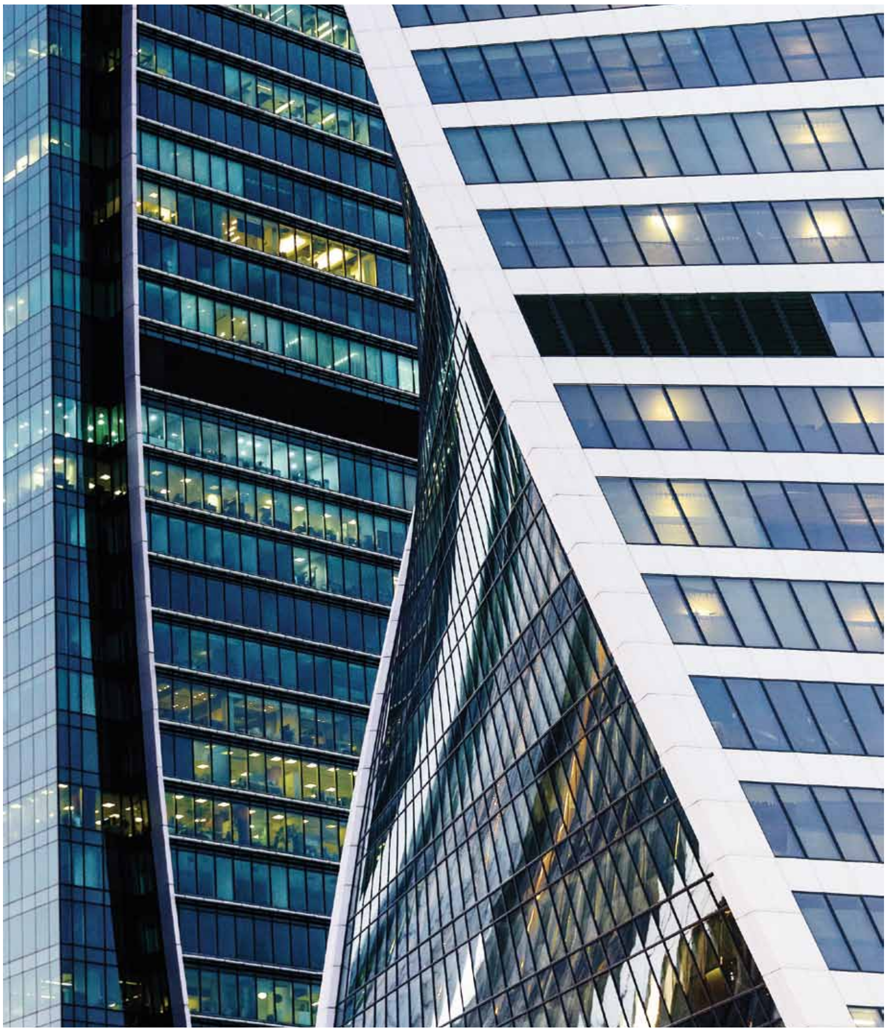
[2] Article 450.1 of the RF Civil Code, the positions of the higher courts.

One such case could arise if the restrictive measures impeding the use of the premises last longer than a set period of time. Another possible option for the lessee would be to agree on so-called "windows of opportunity" – periods during which the tenant may unilaterally repudiate the agreement without incurring any penalties, for example, once every three years.

How to revise the terms on the lease payment

The main issue of concern for tenants during the pandemic is how and to what extent the lease payment can be reduced during the period when the premises are not being used. Landlords have either not made any concessions whatsoever or have forwarded counter arguments on the partial use of the premises (some employees were still coming to the premises, the servers and equipment were still working, etc.) and on the expenses on the upkeep of the premises (cleaning, for example) and utility expenses.



Tenants that paid for utilities based on metre readings, but for everything else based on a lump-sum payment (a so-called base or fixed lease payment) have found it particularly hard to reach an agreement. While everything is clear as concerns the utility payments, how does one separate the payment for parking, for example, which was definitely not used, from the lump-sum payment?

For this reason, we recommend that the lease payment be as detailed as possible so that the parties can agree on a waiver of payment for property and premises (e.g. parking spaces) or services of the landlord (e.g. weekly wet cleaning) that are clearly not being used.

A separate provision on a waiver of part of the lease payment for unused premises and services if these premises could not actually be used for their designated purpose over a certain period in connection with the introduction of the restrictive measures could help to smooth out the process of waiving this part of the payment.

Clause 4 of Article 614 of the RF Civil Code allows the tenant to demand a reduction in the lease payment if the terms of use stipulated by the lease agreement or the condition of the property deteriorated considerably for reasons beyond their control, is as a rule applied in a fairly limited number of cases, such as building repairs[3], a power outage[4], etc. Therefore, it makes sense for the tenant to agree with the landlord on the list of cases when it does not have to make the lease payment because it is unable to use the premises for their designated purpose and to include state-imposed restrictions in this list.

Re-evaluation of the force-majeure clause

It would appear that no one expected the pandemic, in other words, it could be considered a classic force-majeure circumstance (extraordinary and unavoid-

[3] Judgment No. F06-20323/2017 of the Commercial Court of Volga District dated 12 May 2017 in case No. A65-25310/2016.

[4] Judgment No. F05-8666/2016 of the Commercial Court of Moscow District dated 5 July 2016 in case No. A40-115211/15.

able). However, in practice the standard force-majeure provisions were effectively of no help to the parties. Why?

The classic concept of force majeure – a party is unable to perform its obligations as a result of extraordinary and unavoidable circumstances – was not applicable, as neither party found itself in this situation. On the one hand, tenants could have performed their obligations to make lease payments, as the banks were open. On the other hand, it was not advantageous for landlords to close access to the premises, as they did not want to miss out on lease payments.

However, the Supreme Court of the Russian Federation issued clarifications that make it possible to consider the situation from a different angle.

According to the clarifications, "As a general rule, the fact that a debtor does not have the necessary funds does not serve as grounds for releasing the debtor from liability for default on its obligations. However, if the lack of funds was caused by the restrictive measures, then this may be declared as grounds for release from liability. Release from liability is admissible if a reasonable and prudent party to a business transaction could not have avoided the adverse financial consequences caused by the restrictive measures[5]."

Consequently, dire financial straits may now potentially serve as grounds for the release of a tenant from liability in connection with force majeure.

If both parties incur losses, it is logical to agree on sharing the burden than to end up without premises or without a tenant and thus with no incoming lease payments.

Effective cooperation: we establish the negotiating procedure

The government's controversial attempt to regulate landlord–tenant relations during the pandemic by adopting and subsequently amending Article 19 of Federal Law No. 98-FZ dated 1 April 2020[6] merely underlies the need for the parties to cooperate. If both parties incur losses, it is more logical for them to agree on sharing the burden than to put endless pressure on their counterparty, and as a result end up without premises (the tenant) or without a tenant and thus with no incoming lease payments (the landlord).

Here Article 434.1 of the RF Civil Code on the procedure for holding negotiations offers some help. To use the norms of this article as effectively as possible, it is advisable to include a separate section in the lease agreement on the rules for negotiations.

These rules are well developed in court practice[7]. They can stipulate the general negotiating procedures: who is responsible for the negotiations, communications methods (including online), the deadlines for approving proposals, the document signing procedure, and also liability for the violation of this procedure. It is also important to stipulate a convenient end to negotiations – the ability to terminate them if the parties fail to find common ground. Otherwise, there is a risk that a party's conduct will be considered to be in bad faith, and accordingly that damages will be recovered. In practice, this means preventing the sudden and unjustified termination of negotiations, the provision of inaccurate information, the holding of parallel negotiations in violation of the provisions on exclusive negotiations, etc.

[5] "Overview No. 1 of Certain Issues Related to Court Practice on the Application of Legislation and Measures to Prevent the Spread of the Novel Coronavirus Infection (COVID-19) in the Russian Federation" (approved by the Presidium of the Supreme Court of the Russian Federation on 21 April 2020).

[6] Federal Law No. 98-FZ dated 1 April 2020 "On Amending Certain Legislative Acts of the Russian Federation on Preventing Emergencies and Emergency Response".

[7] See, for example, the Judgments of the Commercial Court of Moscow District, No. F05-16349/2017 dated 29 November 2017 in case No. A41-90214/2016, the Commercial Court of North Caucasus District, No. F08-10035/2017 dated 18 January 2018 in case No. A32-41814/2016, and Ruling No. 305-ES19-19395 of the Judicial Panel for Economic Disputes of the Russian Supreme Court dated 29 January 2020 in case No. A40-98757/2018.

How the COVID-19 pandemic is driving e-commerce in Russia

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The pandemic is rapidly changing our behaviour towards online channels, and these shifts are likely to stick post-pandemic. While many companies are struggling to survive in the short-term, the crisis also presents opportunities: bold companies that invest in their online business ambitiously and at the right time are likely to emerge as market leaders.

The Russian e-commerce market has seen rapid growth in the last five years after a sluggish early adoption rate based on low consumer trust, a preference for cash payments and lack of delivery and return services. Millennials in St. Petersburg and Moscow were the group most likely to shop online in Russia in 2018–19 according to research by PwC. Now, COVID-19 has accelerated e-commerce growth more broadly, boosting penetration among sceptical older consumers and outside luxury clusters in the main two cities.

Outlook on a crisis

The COVID-19 crisis is unlike anything the world has ever seen. National, institutional, and business leaders face tough choices with unprecedented levels of uncertainty. While short-term orientation is key, it is becoming increasingly clear that the crisis will permanently shape the societal and economic order of the future, as has been the case with other historical crises. Societal trends in how we work, learn, shop, and use technology are changing rapidly. While these trends were already developing before the crisis, we are now seeing an acceleration that will bring about a new normal after the crisis. While a short-term reaction is needed to survive, a long-term view will make winners. Companies that invest in courageously pivoting their businesses towards these behavioural changes at the right time can gain market shares and emerge as market leaders post-pandemic.

Now is the time to launch that digital marketplace, click-and-collect universe or acquire the critical digital talent you've been considering to ensure that your business is ready for the post-pandemic fight.

Exceptional online demand for essentials and entertainment

Across the globe, the COVID-19 outbreak has led to a major change in business conditions for B2B and B2C companies alike. Developments in China serve as an indicator of what's to come as we prepare to reopen society in Russia. The nationwide effort to contain the outbreak in China has changed consumers' daily habits, consumption patterns, and ways of thinking. This has resulted in a boost to the "home economy" and a further improvement in online services that were already world-leading. Online demand has increased in multiple categories, including entertainment and food-and-beverage delivery using innovative non-contact formats.

Coronavirus revolutionizes Russia's retail scene

Russia is no exception. Between March and April, e-commerce turnover in Russia increased by 30–35 percent according to data from the Committee for the Development of Electronic Commerce of the Chamber of Commerce and Industry (CCI) of the Russian Federation.

The most significant results are in Food Tech – services for the delivery of groceries and ready-to-eat food. There has been an influx of the new users to Yandex.Eda app since the end of March (a growth of approximately four times). These new customers make up about 20% of all orders.

The pandemic has stimulated the expansion of Food Tech into Russia's regions.

The e-grocery industry has also experienced the positive impact of the lockdown period. In an environment of self-isolation, demand for various food products has sharply increased. By the end of the first quarter, food product sales on Ozon had increased by 170%. Turnover at Sbermarket grew by 500%. Ozon and Wildberries doubled their user base in the spring. The main driver was the appearance of new clients from small settlements and the over-55s audience.It is likely that consumers will continue to approach their purchases carefully in the near future, giving preference to main goods and reducing the cost of expensive items. And it is clear that Russian e-commerce as a whole will continue to grow from the involvement of new categories of online users.

The introduction of pick-up points helps brands to capitalize on increasing penetration across smaller cities in Russia.

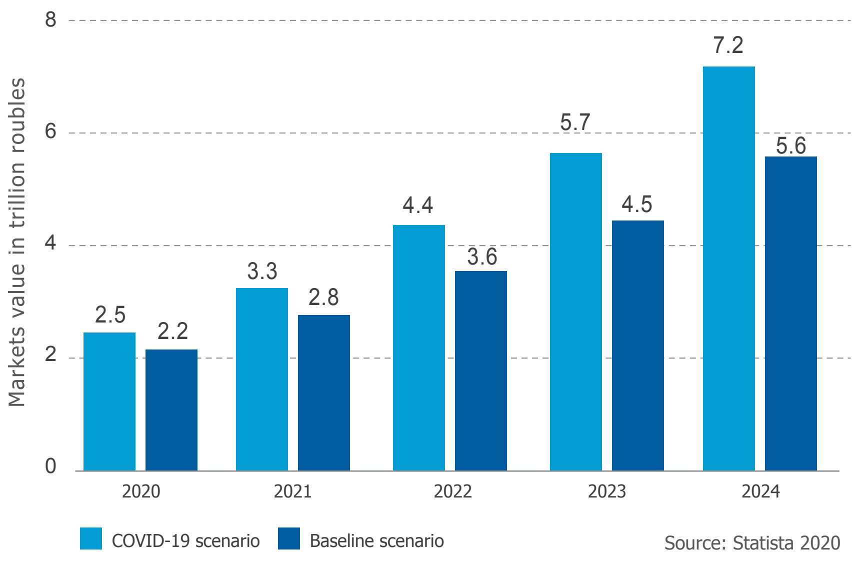
In response to the threat of COVID-19, the flexibility of e-commerce has made the delivery of goods virtually contactless and adapted to the end user. It may well go on to become completely contactless, both in Russia and worldwide. Various retailers, including Dunelm and Domino's Pizza, have introduced contactless delivery services since the coronavirus outbreak.

Try-on and returns are the main obstacle to online fashion shopping today. That's why in addition to courier services, Russian platforms have established pick-up points across the country that allow customers to try on clothing and return it free of charge.

The introduction of pick-up points helps brands to capitalize on increasing penetration across smaller cities in Russia. For those consumers, the focus is availability, rather than delivery speed. Giving them the ability to try on premium or international brands they wouldn't be able to find outside of St. Petersburg or Moscow – without delivery costs and via a pick-up point where they can try items on at any time – is a huge plus.

While crisis-induced shifts in demand are temporary, the question is whether the underlying shifts in consumer behaviour will stick? Will categories such as food and beverages remain partly online? And will purely online e-commerce players

Projected e-commerce market value in Russia influenced by the COVID-19 pandemic 2020–2024 (in trillion roubles)



be able to protect the market shares they've acquired?

A persistent gear change in Russian e-commerce

The SARS crisis in 2003 is widely known for kickstarting the e-commerce success of Alibaba and other Chinese companies in Asia. Alibaba launched its online marketplace for consumers during the SARS crisis, when many people in China were quarantined at home. Likewise, China's JD Multimedia (now JD.com) migrated its business from offline to online channels in response to SARS and is now one of the country's largest retailers. The SARS pandemic accelerated the behavioural change of the internet becoming a mass medium in China. The COVID-19 crisis will cause permanent changes to our shopping behaviour and ways of doing business in Russia. While some businesses have experienced a temporary short-term peak in demand, other categories will be moving online for good. Why?

There are several factors:

Convenience beats price as the #1 reason for online shopping
People are getting used to online convenience, and new habits stick quickly. Last year, convenience topped the list of reasons for online shopping. Essential product categories such as beverages and fresh food may be particularly susceptible to the convenience wave.

Continued social distancing due to the risk of a pandemic resurgence
There is an underlying concern in society about a larger return of the pandemic in the mid-term, and the increased focus on personal hygiene and social distancing will encourage continued online shopping and reinforce behavioural change in the longer term.

Intensified online competition
E-commerce players who see a surge in volume will do everything in their power to retain their newly acquired customers through loyalty programmes, subscription models, promotions, and expanded product ranges. Competition only intensifies with consumers using price engines

and referral sites to find the best deals online.

New distribution and logistics capacity
Distribution companies are experiencing an overwhelming demand for last-mile and contactless package delivery, which has enabled them to build up new capacity. Additionally, in December 2019 Ozon announced the launch of a "logistics marketplace" and a special programme to open Ozon-branded affiliate pickup points.

Elderly consumers are going online
With the elderly population in self-imposed quarantine (and for an extended period), their online shopping is expected to further increase as the existing behavioural trend accelerates. The 65+ population comprises roughly thirty-seven million people – more than 25% of the total population of Russia, and a sizable customer segment for companies to serve digitally in the future.

Distribution companies are experiencing an overwhelming demand for contactless package delivery, which has enabled them to build up new capacity.

The following is a selection of guidance that, according to Deloitte research, is critical for responding to the new e-commerce reality.

Search for a digital business model
Revisit the foundation of your business model to make sure it's still valid in the context of digital sales channels, profit models, and the services that you can provide for your customers. Now is the time to create that digital market place, introduce that subscription model, or launch that click-and-collect universe you've been considering.

Overinvest in digital marketing channels
Funnel your marketing spending towards digital channels and media versus out-of-home platforms. Revisit both your paid and organic marketing (SEO) maturity. If you do not have the scale to invest competitively, find a suitable digital marketplace. Above all else, get your marketing messages right during and after the pandemic.

Enhance the customer experience
Understand the path to purchase of your new online customers and provide them with simple, human-centric UX design to create a pleasant shopping experience across devices that utilises the latest technological innovations. If you have physical stores, ensure that they are capable and digitally connected to your e-commerce channel.

Upgrade your supply chain and fulfillment
For many businesses, making the supply chain more customer-centric means catering for a stronger product availability, fast last-mile delivery and easy returns, examining flexible warehousing (perhaps utilising physical stores), logistics partnerships, and auto-replenishment models to manage profitability.

Strengthen your technological platforms
Pressure test your e-commerce platform, expand the necessary capacity limits to prepare for increased consumer flow, and take the opportunity to invest in advanced analytics to facilitate personal, timely and automated customer interactions and recommendations across devices.

Reinvigorate your organization
New digital talent (UX, visual design, scrum, etc.) will be needed and many of your existing employees won't be able to adapt. Seize the opportunity to replenish your talent base by investing ambitiously in your culture and digital ways of working using the latest corporate team and interaction platforms.

For company management
Elevate e-commerce to your business's executive agenda to ensure it gets the adequate attention and priority. CEOs and managing directors should seize the opportunity to communicate clearly and firmly on the gravity of change needed for the company to emerge strongly in the post-pandemic world. COVID-19 will permanently reshape e-commerce as we know it, separating the winners from the rest.

Now is the time to act. Bold and ambitious companies that embrace the new reality and take timely action can capture market shares and emerge as market leaders after the crisis. Action requires the courage to reinvent your business model and invest during times of high uncertainty.

Part IV.
Surveys and research findings

Strategies and prospects for European companies in Russia

ALEXEY DOROFEEV

Managing Director (CEO), GfK Rus

Alexey Dorofeev has extensive experience in corporate governance and business development for businesses operating in the market sectors that GfK currently specializes in Russia: FMCG, durables, retail and services.

Prior to joining GfK, Alexey headed the business in Russia and the CIS countries of the Safilo Group.

He used to be Vice President of Mobile & Note PC at Samsung Electronics.

Previously, he held various management positions in the business units of such major companies as Wimm-Bill-Dann, Kraft Foods, Procter & Gamble.

GfK was one of the first employers of Alexey at the very start of his career in the 1990s.

The survey "Strategies and prospects for European companies in Russia" was conducted by the AEB for the thirteenth time, and in conjunction with the global leading market intelligence company GfK since 2011. This survey is a highly valuable source of first-hand information that gives an overview of the attractiveness of the Russian investment climate and highlights the key challenges and strategies of European companies doing business in Russia. In addition, the wave-like nature of the survey makes it possible to analyze and compare year-on-year data.

The current survey was conducted in July–August 2020. The survey involved 90 AEB member companies.

Company profiles

The survey involved companies from different countries: Russia (24%), Germany (18%), the Netherlands (8%), Sweden (6%), Italy (4%), Finland (4%), United States (3%), United Kingdom (2%) and others. It is worth noting that many Russian member companies of the AEB have a share of European capital and/or were established by citizens of European countries.

16% of member companies stated that their main operations are in professional services, the same amount in chemicals & pharmaceuticals, 12% in automotive and 9% in FMCG & retail.

52% of companies indicated that there are 100 or fewer employees in their company in Russia. The survey involved companies employing more than 5,000 people, and they made up 4% of all participants in the survey.

Most companies (61%) noted that their turnover in 2019 increased from last year. At the same time, 18% of companies saw a decrease in turnover from last year.

Market entry

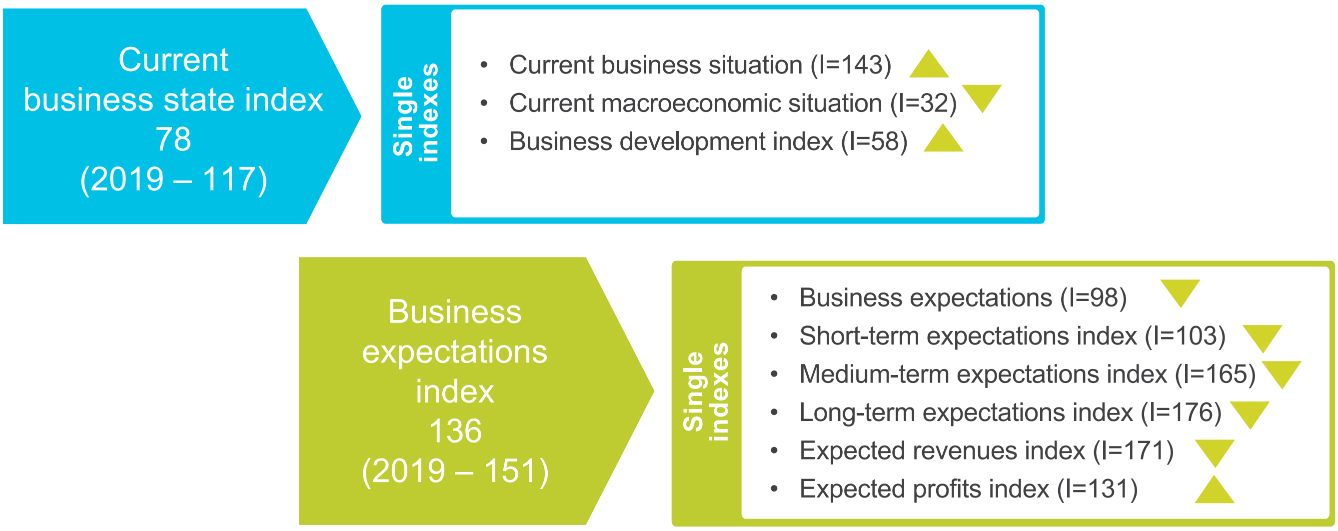
The main reasons for entering the Russian market continue to be the large size of the market, the large market potential, and the positive market dynamics (95%, 92% and 90%, respectively, of the companies noted these reasons as the most important). These factors keep their relevance as reasons for presence on the Russian market today.

Prospects for companies and the business environment

Most of the macroeconomic indicators show a negative dynamic. The majority of companies (72%) noted that the overall state of the economy in the first half of 2020 is developing worse than their expectations. 56% noted that their company in 2020 is developing worse than they expected.

Only 27% of the member companies expect the Russian economy to grow in the short term. In the medium and long term, the forecasts are more positive: 66% of companies expect the Russian economy to grow in the

AEB-GfK barometer: business expectations in Russia



next 3-5 years and 79% in the next 6-10 years.

28% of companies expect an increase in investment in their industry in the next 2-3 years.

24% expect an increase in investment in Russia as a whole in the same period.

The economic climate in Russia remains challenging, and company operations are affected by a variety of factors:

- 77% of companies said that volatility of the rouble had a negative impact on their performance in Russia;
- 73% pointed to the negative impact of sanctions against Russia;
- 64% noted their business decreased due to the coronavirus pandemic;
- 56% indicated that US policy towards Russia negatively affects the activities of their company, but, compared to previous years, it has less influence (75% in 2019);
- compared to 2019, the negative impact of oil prices on business has significantly increased (in 2020 this factor is noted by 51% of companies vs. 26% in 2019).

The above factors, in the opinion of the members, have the most negative impact not only on their company, but also on the economy of the Russian Federation as a whole.

64% of respondents noted that their business had decreased due to the COVID-19 pandemic, and only 10% could gain an advantage.

Financing

Slightly less than half of companies (45%) have gone to court to recover debt, and the majority of the cases were successful. 33% of companies have never had bad debts.

The main problems related to financing remain the lack of cash flow/available financing (26%), high interest rates (20%), and a new factor for 2020 – restrictions caused by the coronavirus pandemic (42%).

Perception of the business environment

The business culture and business environment of the country have a modest rating. Work with legislative, customs, tax and other authorities is rated rather negatively.

Regulatory restrictions are a major barrier to business (68% of companies mentioned regulatory restrictions as the main barrier to business). Another important problem is the lack of qualified personnel (22% of companies noted the lack of qualified personnel as a major barrier). 21% of companies named the insufficient reliability of the supply chain as a main barrier to business. A new factor arose in 2020 – restrictions caused by the coronavirus pandemic (57% of companies named it as the most significant barrier to business in Russia).

Most members of the AEB do not expect an improvement in the situation with regard to bureaucracy and corruption (56% and 57% of companies, respectively, do not expect an improvement in the next two years).

Coronavirus pandemic's effects on business in Russia

64% of surveyed participants noted that their business had decreased due to the coronavirus pandemic, and only 10% could gain an advantage and their businesses have grown.

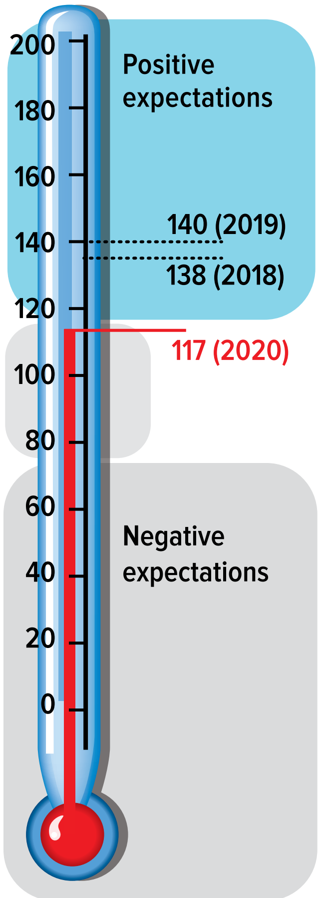
The leading negative impacts on business:

- 56% of the companies stated a drop in sales;
- 33% had to cut advertising bud-gets;
- 21% had to cut market research budgets;
- 20% postponed the launch of new products;
- 14% were forced to cut employee salaries.

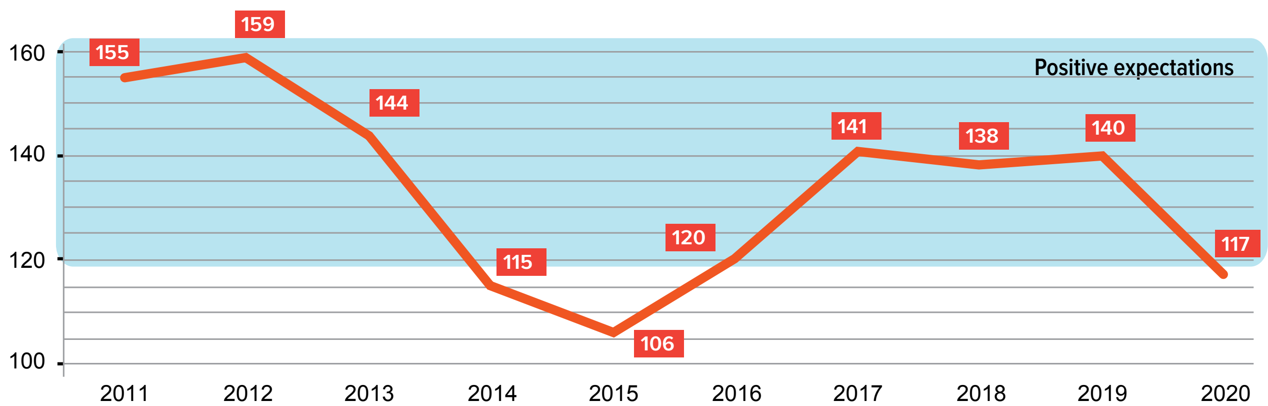
Only a quarter of the companies who suffered due to the coronavirus crisis expect to recover by the end of 2020. Most companies believe that recovery will take more time (during 2021).

The comprehensive AEB-GfK index decreased by 23 points from last year to 117 points out of a possible 200. The main contributor to the decrease was the assessment of the macroeconomic situation, business development, and short-term expectations regarding the Russian economy. The index shows lower-than-positive expectations and is on level with 2014 and 2016.

AEB-GfK index, 2020



AEB-GfK index dynamics



Russian government support for industrial investment projects and the real effects on the investor's financial model

NEJAT OZCIMEN
Managing Partner & Founder, MonDef

Nejat Ozcimen has more than 20 years of experience in managing projects in major construction companies with over 10 years focusing on financial & banking services by conducting project financing deals at European banks in Russia.
He investigates, analyzes and provides advice on Russian government support programmes, Special Economic Zones and Industrial Parks in Russia (for investors who plan to invest in Russia).

Today in Russia, there are a large number of state measures and instruments aimed at increasing the investment attractiveness and development of the country's economy. This topic is obviously quite extensive, and it is impossible for one article to cover the full range of support measures available in Russia, which also vary by industry. Therefore, this article will focus on industrial investment projects and provide an overview of the most popular state stimulus measures and their crucial impact on the financial model of investment projects.

The main issues of concern to investors at the initial stage are: the selection of a production site; support from the state in the form of tax benefits, etc.; the search for optimal funding.

In order to answer these questions, we tried to structure and simplify the information as much as possible, presenting it in the form of "Four Squares©".

What are the most popular sites for hosting industrial projects in Russia?

The priority is undoubtedly land plots, which investors will be able to acquire more quickly and affordably. At the same time, the degree of development of engineering and transport infrastructure and the full provision of required resources for the planned production complex during commissioning are of particular importance. Well-known sites such as Special Economic Zones, Industrial Parks, Territories of Advanced Socio-Economic Development (TASED/ТОСЭР) and other land designated for industrial use are relevant here. The first three types of sites are aimed at increasing investment attractiveness and the development of industry in Rus-

Government support – in general

	Special Economic Zone	Industrial Park	TASED	Neutre Land Plot
Tax benefits	✓ (provided)	✓ (on condition)	✓ (provided)	✓ (on condition)
Benefits for insurance premiums			✓ (provided)	
Customs preferences	✓ (provided)	✓ (on condition)	✓ (on condition)	✓ (on condition)
Other state support programs	✓ (on condition)	✓ (on condition)	✓ (on condition)	✓ (on condition)
Infrastructure and Capacity	✓ (provided)	✓ (provided)	✓ (on condition)	✓ (on condition)

✓ - provided ✓ - on condition

Government support – taxes

Special Economic Zone

Profit tax	fed	2%
Profit tax	reg	0…13,5%
Property tax	fed	0% (~ for 10-12 years)
Land tax	fed	0% (~ 5-10 years)
Transport tax	reg	0% (~ 5-10 years)
VAT (import)	fed	0%

Industrial Park

Profit tax	fed	3% (2017-2024)
Profit tax	reg	0…17%
Property tax	reg	0%…2,2% (~ for 4 years)
Land tax	reg	0%…1,5% (~for 4 years)
Transport tax	reg	2…500 rub/hp
VAT (import)	fed	0…20%

TASED

Profit tax	fed	0% (5 years)
Profit tax	reg	0..5..10..17% (5 + 5 + more than 10 years)
Property tax	reg	0% (~ for _ years)
Land tax	reg	0% (~ for _ years)
Transport tax	reg	2…500 rub/лс
VAT (import)	fed	0…20%

Neutre Land Plot

Profit tax	fed	3% (2017-2024)
Profit tax	reg	0…17%
Property tax	reg	0%…2,2% (~ for _ years)
Land tax	reg	0%…1,5% (~for _ years)
Transport tax	reg	2…500 rub/лс
VAT(import)	fed	0…20%

● - provided ● - on condition

sia. For this reason, each of them has not only a high degree of development and readiness in transport and engineering infrastructure, as well as favourable technical interconnection conditions, but also a certain set of preferential conditions. Let's consider the main ones.

As shown in the diagram, all sites offer investors roughly the same set of preferential placement conditions. However, it is worth noting that in the SEZ and TASED/ТОСЭР, these measures are provided and guaranteed mainly at the federal level, whereas in industrial parks and other land plots they are provided at the regional or municipal levels and depend on the specific region and applicable local regulatory legal acts. In our diagram, red signifies collateral at the federal level, while grey represents the regional level (both may be present or absent in various regions).

As such, it is impossible to immediately conclude which of these sites is more attractive and suitable for an individual project. Evaluation and selection must account for the presence and proximity of the raw material base for the producer, or the proximity of the manufactured products to the main buyers.

Going deeper into the study and the comparison of tax benefits and customs preferences, it is likely that there are misconceptions that the platform with the largest set of benefits and the lowest rates is the most attractive. This may remain only a psychological factor that influences the decision-making process while having absolutely no effect on the main indicators of the project's financial model, such as NPV (Net Present Value), IRR (Internal Rate of Return) and PBP (Payback period). We will now provide a detailed example and a conclusion about it.

What additional tools does Russia offer to stimulate the investment activities of industrial projects?

There are a large number of state programmes, funds, and development institutions willing to provide additional support measures aimed at providing a comfortable environment for implementing investment projects, creating new industrial enterprises, localizing production, creating new jobs, supporting exports, etc.

Investors can choose the most suitable programme for the project depending on the specific industry. For an investor who attaches particular importance to the stability of the legal regime for carrying out activities, it may be appealing to conclude an Agreement on the Protection and Promotion of Investments (СЗПК), which contains guarantees for a stabilization clause and also includes compensation for the costs of creating (reconstructing) any necessary support or infrastructure for the project. This agreement may also include other support measures, but federal law does not provide for any tax benefits compared to the owners of SPIC 2.0.

When considering the possibility of concluding a special investment contract (SPIC 2.0), it should be highlighted that from now on, it is aimed at implementing investment projects for the introduction of modern technologies included in the list for the de-

Financial model – main project assumptions

Technical Information

	Unit	Amount
Area Information		
Land plot	Ha	2,0
Building Area	m2	10 000
Infrastructure		
Electricity	MW	1,5
Gas	m3/h	400
Water supply	m3/d	5
Duration	months	15
Labor	per	15
Shift	unit	1
Average salary	Rub/m	40 000

Investment Costs

Scenario I

Item	Rub (mil)	
Land Plot	40	5%
Construction	250	33%
Equipment	400	53%
Infrastructure	60	8%
Total	750	100%

Scenario II (TOSER and SEZ)

Item	Rub (mil)	
Land Plot	-	0%
Construction	250	38%
Equipment (all imported)	400	62%
Infrastructure	-	0%
Total	650	100%

Taxes and Profit Margins

VAT	20,0%
Profit Tax	20,0%
Property Tax	2,2%
Personal Tax	13,0%
Social Funds	30,0%
	Cost/Income 87%
Margins	
Operational Expenses	65,0%
Administrative Expenses	22,0%
EBITDA/Income	13,0%
Net profit/Income	5,0%
Interest Rate	10%

Investor's Questions

- When will the project pay back ? (PB)
- How much interest does an investment bring me? (IRR)
- What if, I use loan instead of equity?
- What is the interest rate and what for?
- How much tax preferences effect the Fin. Model?
- How the Infrastructure and Land cost effect results?

velopment of the serial production of industrial products. In turn, the state provides a set of incentive measures in the form of tax benefits, the possibility to apply accelerated depreciation, an accelerated and simplified procedure for obtaining "Made in Russia" status, the ability to obtain the status of sole supplier for government orders, and more. The state also ensures the stability of business conditions.

At the same time, investors have access to various subsidiary programmes such as the Corporate Programme for Increasing Competitiveness, which provides support for export-oriented production in Russia and/or abroad in the form of interest rate credit subsidies.

Of course, we must not forget the importance of the question that the investor has before the implementation of the investment project, by choosing the optimal way of financing.

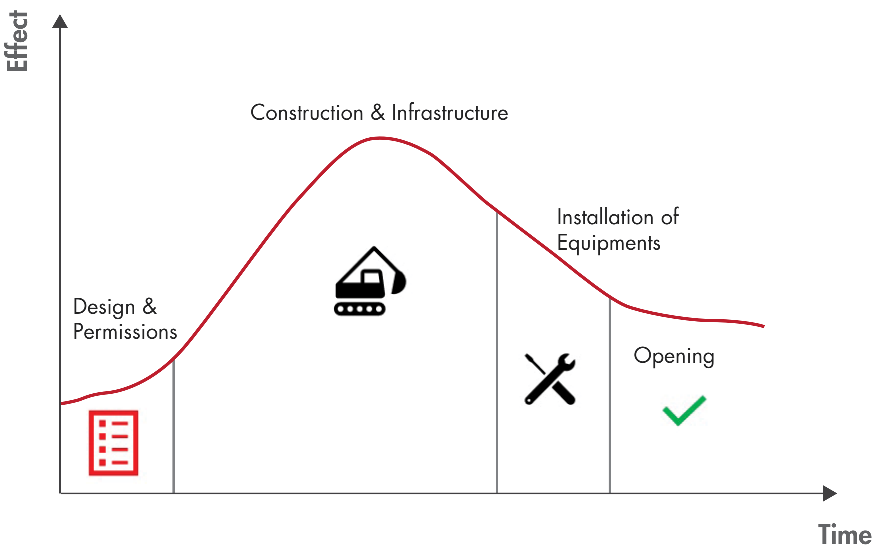
What options does Russia offer to support financing for industrial projects?

As mentioned above, there are various subsidy programmes available for different industries. In addition, there are funds and development institutions such as the Industrial Development Fund (IDF/ФРП), which offers preferential conditions for financing projects. The MSP Corporation and regional guarantee organizations offer guarantee support, while MSP Bank is responsible for offering financing at reduced interest rates.

Numerous support mechanisms are available, including preferential conditions for the purchase of land, tax and customs benefits, subsidies and preferential loans. That said, it is the figures on how a measure really affects key financial indicators that ultimately show the attractiveness of a project to investors.

To do this, we propose analyzing an example of an average medium-sized project located on 2 Ha land plot that requires a 10,000 m2 closed area, consumes gas and water for production, and is supplied 1.5 MWt of power.

We know that any kind of industrial investment has 4 main stages: the 1st stage is permission and design; the 2nd is construction and infrastructure connection to the building, and the 3rd is the installation of equipment already ordered during the construction



period and the beginning of production. Let's say that the total time span of our project will be 15 months.

As shown in the table on the previous page, we can estimate that the total cost of the investment will be roughly RUB 750 million. Of this, RUB 250 million will be construction costs, more than half will be allocated to imported equipment, and the rest will be for the land plot and infrastructure costs.

The next step: how to finance the project

Let's assume that 25% will come from investor equity and the remaining 75% will come from a bank loan. The principal amount and interest payments will be repaid through the sale of the finished product after opening with a 13% EBITDA margin.

Once we have estimated the total budget and its breakdown, time schedule, loan/equity ratio, operational and administrative expenses, taxes, salaries, etc., we can comfortably say that we have enough input data to create a financial model to see traditional parameters of financial models such as the NPV, IRR and PBP for the project.

But there's another important variable: the total cost of construction can change in some cases. For example, in state Special Economic Zones, the government offers land plots and infrastructure almost free of charge. That means that the total cost of the

▶ Financial model – scenario I: If we assume that the total cost is RUB 750 mln for all

Profit Tax

Location	%	NPV	IRR	PBP
TOSER	0%	333 151	28,6%	4,5
SEZ	2%	323 652	27,9%	4,6
IP	20%	231 717	21,7%	4,9
	20%	101 434	6,9%	0,4

Total cost: RUB 750 mln
Profit tax changes from 0% to 20%,
while other rates stay maximum

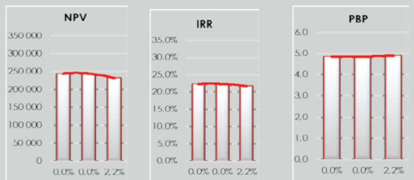
Social Tax

Location	%	NPV	IRR	PBP
TOSER	7,6%	235 323	21,9%	4,9
SEZ	30,0%	231 717	21,7%	4,9
IP	30,0%	231 717	21,7%	4,9
	22%	3 606	0,2%	0,0

Total cost: RUB 750 mln
Social fund changes from 7,6% to 30%,
while other rates stay maximum

Property Tax

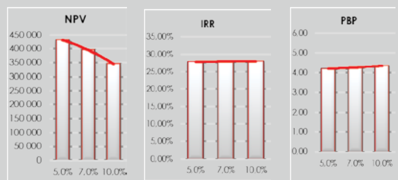
Location	%	NPV	IRR	PBP
TOSER	0,0%	244 492	22,3%	4,8
SEZ	0,0%	244 492	22,3%	4,8
IP	2,2%	231 717	21,7%	4,9
	2,2%	12 775	0,6%	0,1



Total cost: RUB 750 mln
Property tax changes from 0% to 2,2%,
while other rates stay maximum

Interest Rate

Location	%	NPV	IRR	PBP
TOSER	5,0%	432 343	27,85%	4,21
SEZ	7,0%	395 821	27,91%	4,27
IP	10,0%	345 163	28,00%	4,36
	7%	87 180	0,1%	0,2



Total cost: RUB 750 mln
Interest rate changes from 0% to 12%,
while other rates stay maximum

* All in mln RUB, PB in years

2 Ha land plot will be around RUB 100 million less than the RUB 750 million total. This leaves us with a RUB 750-million scenario and a RUB 650-million one.

If we want to establish a correlation between these parameters, then one of them should be variable and the others should remain constant under the same conditions.

Let's start with profit tax as though we have received tax incentives under a contract with the government, such as 0% in TASED/ТОСЭР, SEZ and Industrial Parks instead of the standard 20% rate. When we compare the effect of these rates, the maximum government support demonstrates the highest NPV – around RUB 333 million and a 6.9% IRR surplus, where the payback period is 0.4 years less.

Unfortunately, the next diagram does not show the same behaviour for

The total cost of construction can change. For example, in state Special Economic Zones, the government offers land plots and infrastructure almost free of charge.

property taxes and social fund payments, as their effects on the financial model are very minor.

Given that we know that some investors may be confused about when to use their own funds instead of a loan, the effect of interest rates on the financial model also become significant parameters. Additionally, some state funds now offer investors up to half interest compared to the average rates in the market for project finance deals.

If we analyze this difference in the table on the previous page, we see (as in the profit tax case) that the NPV will be much higher than the standard interest rate's effect, while IRR and the related repayment period will not significantly change.

Furthermore, in the second RUB 650-million scenario, the effects on financial parameters are the same.

Given that financial models account for not only the investment period but also the post-operational period, productivity becomes increasingly important in investors' race against time.

How should we approach all these parameters?

Know that the most important thing an investor considers is the expectation of a quick and easy return on their investment – but it also has to be as safe as possible.

You may notice something else hidden among these three principles: "the cost of time". If we have a graph of cost and time on the X and Y axes, we can use maths to find the accuracy. In other words, this is an area where financial models are a crucial decision-making tool for investors.

Given that financial models account for not only the investment period but also the post-operational period, productivity becomes increasingly important in investors' race against time. Time goes faster than we think, and ends up being more expensive than we expect.

In conclusion, the cards in an investor's hand are raw materials, suppliers, qualified workers, location, tax incentives, subsidies, equity and loan conditions, equipment productivity, efficiency and other such parameters. Only a tailor-made and considered financial model can reveal the real rules of the game.

Investing in Russia's future

KIRA GOLUBEVA
Commercial Director for Russia and CIS, TMF Group

Kira Golubeva is Commercial Director for Russia and CIS at TMF Group, an international provider of financial and administrative services.
Kira holds a Master's degree in Corporate Management and an MBA from the Russian Presidential Academy of National Economy and Public Administration, and a diploma in HR Management from the Russian State University for the Humanities.
Kira has a decade's experience in business processes outsourcing companies. Among Kira's clients are large and renowned companies from pharmaceuticals, retail, manufacturing, online services and software development industries.

Russia has emerged as a favourable jurisdiction for doing business, attracting ambitious companies from around the world through a range of carefully-considered incentives. The government has also been proactive in rolling out a raft of measures to help businesses combat the disruption caused by COVID-19.

Despite the recent dramatic changes in its economic and political situation, Russia ranks ninth among the top 20 global investment destinations according to EY and remains a priority market in Central and Eastern Europe.

With a consumer base of over 140 million people and the eleventh-largest nominal GDP in the world, Russia offers numerous and diverse investment opportunities for foreign companies.

While there are certainly challenges – TMF Group's Global Business Complexity Index 2020 highlighted that Russia is the 22nd most complex jurisdiction in which to do business – they are outweighed by the opportunities available.

Building upon stable foundations

There's no doubt that the Russian government is committed to enhancing the nation's business environment. To illustrate, Russia ranked 31st in the World Bank's Doing Business 2019 report, climbing 89 positions in just seven years. This is the best 2012–2019 performance among all the countries surveyed. There's work still to do, but Russia is on the right path.

A broad framework of more than 900 support measures has been set up in Russia in response to the needs of investors. Support is provided by the government and development institutions at both the national level and local levels for all types of industries and projects, from manufacturing to R&D and innovation.

Russia has stable legislation aimed at protecting ownership and capital, investors, and their investments. Recent legislative and regulatory efforts have focused on improving stability and predictability, as well as making the investment climate milder and much easier to enter.

The Russian tax system is becoming increasingly consistent with international best practice, while favourable tax regimes have been implemented in Special Economic Zones (SEZs) to entice companies. Russia's SEZs have been designed to further diversify economic activity and drive innovation where it's most needed. These include industrial zones, port zones, tourism zones that tap into the country's stunning natural attractions, and technical research zones for scientific projects – the Interfax news agency recently reported that Russia has produced the first batch of a new vaccine for COVID-19.

There are also a number of notable non-tax incentives associated with SEZs, including the allocation of budget subsidies, partial compensation of capital expenditures, the provision of guarantees to banks, simplified access to infrastructure facilities, lower rental charges, and administrative and legal support. Reduced social contribution rates are available for residents of the industrial zones if they are directly engaged in R&D activities.

The addition of Advanced Development Zones (ADZs), which aim to develop the Russian Far East, is another initiative that companies operating in Russia should be aware of and look into. The ADZs in the Smolensk region and the Komi Republic, for example, offer special terms for companies operating in various industries, such as pharmaceuticals, telecommunications, and science and technology. These include free customs zones, project financing, simplified rules for hiring foreign employees and reduced Corporate Income Tax (CIT).

Amendments to SPICs

Companies operating in Russia can enter into two types of contract with the Russian Federation: a special investment contract (SPIC) and a regional investment project. These open up a range of additional incentives for investors.

In August 2019, Putin signed three federal laws introducing new rules on SPICs, recognizing their importance as a support mechanism for much-needed localized investments. These have become even more important in light of COVID-19 and the search for stability.

For example, the legislation was supplemented with a provision regarding the idea of long-term subsidies for projects implemented through SPICs – a departure from one-year subsidies. This should encourage a longer-term focus. The requirement regarding the minimum investment amount has been abolished and, importantly, investors will now be protected against future legal changes that restrict or prevent their rights under the SPIC. Additionally, tax legislation has been adjusted to provide clearer rules on the application of profit tax advantages by investors.

A rapid response to COVID-19

According to Russian Federal State Statistics Service data, after growing by 1.6% in the first quarter of 2020, Russia's GDP fell by 8.5% in the second quarter as a result of COVID-19 and the associated lockdown measures imposed across the country.

However, it's important to note that the damage to the national economy turned out to be less significant than initially expected. The Ministry of Economic Development had estimated the likely drop in GDP for the second quarter at 9.6%, while the Central Bank expected a decline of 9–10%.

Russia's GDP fell by 8.5% in the second quarter as a result of COVID-19 and the associated lockdown measures imposed across the country.

The government worked quickly to implement a number of economic measures that have helped to mitigate the pandemic's impact. A financial reserve of up to RUB 300 billion has been established to support the economy and compensate quarantined citizens for lost income.

In April, the Bank of Russia cut the key rate to 5.50% per annum, then again down to 4.25% in July. It has also eased certain banking regulations, such as loan risk weightings, to ensure that banks continue lending to producers of essential pharmaceuticals and medical equipment.

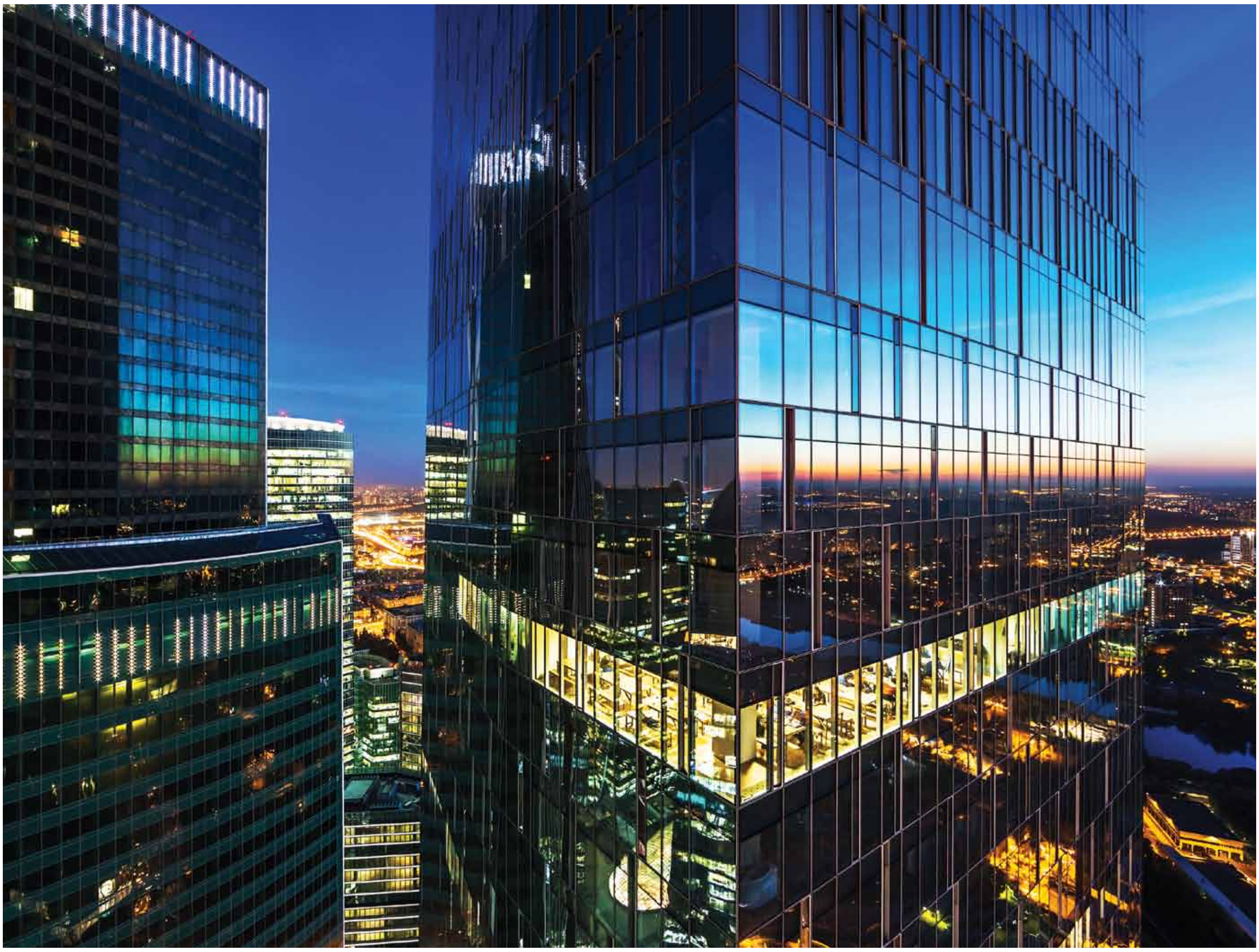
SMEs in hard-hit industries such as leisure and travel have been handed a lifeline through the deferral of existing loan payments and the introduction of new six-month 0% interest loans that can be used to pay employee salaries. A wider raft of new labour policies have also been introduced to help minimize the disruption of COVID-19, including remote working and a shorter work week.

Accelerating towards a greener, digital future

Indeed, working from home is set to become the norm, which means that there's a new emphasis on digitalization. The COVID-19 pandemic has highlighted the crucial role played by digital technologies in ensuring an agile economic response to unfolding crises. As such, some commentators see the current crisis as an opportunity to bridge the digital divide between different regions by increasing broadband access and creating new incentives to adopt digital technologies across all key government, industry, and service sectors.

The government is keen to promote a much stronger digital culture throughout the population. Russia-based IT companies engaged in software development and sales are now eligible for reduced insurance contribution rates through to 2023 (14% as opposed to the standard 30%). In addition, expenses for certain types of R&D activities can be deducted at 150% in the period incurred, regardless of the result of those activities.

Much of the development in the high-tech space will depend on the Russian venture capital (VC) market, a relatively new development formed over the last 10 years or so. According to Reuters, 2019 was a record year for the Russian VC market in terms of both



the amount invested (USD 869 million) and the value of exits (USD 5.55 billion). The number of deals fell from 310 in 2018 to 230 in 2019, but this drop is largely due to the state-owned Internet Initiatives Development Fund (the most active Russian early-stage investor) scaling down on new investments and focusing on portfolio companies. The Russian IT sector looks to be the most active sector, comprising about 90% of the total market in terms of both the amount invested and the number of transactions.

The combined effect of climate change and COVID-19 has also made people realize just how fragile the environment is at present. The green agenda is increasing in urgency. In April, Russia's Ministry for Economic Development published a new draft strategy for low-carbon development through to 2050.

It is hoped that nuclear output will grow from 203 TWh in 2017 to 225 TWh in 2030, then to 260 TWh in 2050. The Ministry has said that the strategy is aimed at ensuring that the country can effectively transition to a trajectory of diversified economic development characterized by low levels of greenhouse gas emissions. Speaking to Reuters, Deputy Minister of Economic Development Mikhail Rasstrigin said that the document is the government's first comprehensive attempt to do this, and that it sets specific goals for key areas where the "bulk of energy efficiency effects can be reaped". These areas include industry, infrastructure, energy generation, and transport.

COVID-19 has changed the world and fundamentally altered how we live and work. It has also been an unlikely catalyst in hastening the move towards a greener, more digitally-focused future that combines existing government measures and incentives to attract a new wave of investors. Russia is an appealing jurisdiction for foreign companies to set up operations in, and these investors will help the country to navigate these difficult times.

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