RUSSIA / EURASIA Executive Guide

WORLD TRADE Executive

Monthly Digest of Business, Law, Tax and Finance

February 2009
Volume 19, Number 2

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REEG answers questions frequently asked by directors of firms doing business in Russia concerning D&O insurance and indemnification agreements and related issues such tax liabilities, the issue of compensation issued to board members and personal tax implications.
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What is Ahead for Oil and Gas Licensing in Ukraine

Despite negative trends in 2008, the Ukraine government will have no choice but to improve the licensing regime in 2009 and to make the oil & gas sector much more attractive for investment.
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New Tax Code in Kazakhstan Establishes Clearer Set of Regulations for Corporate Income Tax

Kazakhstan's new Tax Code has abolished corporate income tax (CIT) advance payments for small and medium-sized enterprises and extended the term of tax loss carry-forwards up to 10 years instead of 3 years under the previous legislation.
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Review of Major Changes to Legislation Concerning Limited Liability Companies in Russia

The new Law will make it possible for shareholders (participants) of limited liability companies to conclude agreements under which they will be able to undertake to perform their rights as shareholders in a pre-agreed manner or to abstain from exercising such rights. The Law directly provides for the option of concluding shareholders agreements, and thus completely changes the existing practice in this sphere.
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Overview of the Ukrainian Insurance Industry

By Valeriy Semenets
(Frishberg & Partners)

Prior to the adoption of the Law of Ukraine No. 2745-III "On Introduction of Amendments to the Law of Ukraine 'On Insurance'" (the "Insurance Law"), dated October 4, 2001, by the Ukrainian Parliament, foreign insurance companies found that doing business in Ukraine independently was impossible due to the 49% limitation on foreign ownership of Ukrainian insurance companies. Finally, the above-mentioned amendments to the Insurance Law lifted this discriminatory limitation and allowed foreign insurance companies to freely carry out their intended activities in Ukraine. In effect, foreign insurers are able to form fully controlled companies or possess a controlling interest in joint insurance companies in Ukraine.

The insurance market in Ukraine started in 1991. The number of insurance companies operating in Ukraine has fallen since 1994, when there were more than 700. However, this reduction had a positive effect, as insolvent companies and pseudo-insurance firms have been removed from the insurance market. This process was in part the result of legislative regulation of the insurance business, strengthening of state control over the insurance market and tougher requirements for the size of insurance companies' authorized funds.

In Ukraine, unfortunately, confidence in the insurance sector was seriously undermined within 1991-1997, when many Ukrainian insurance companies went bankrupt. At the same time, the potential of Ukraine's insurance market is rather high. Today, a rather low percentage of risks are insured in Ukraine, while in most countries, 90-95 percent of risks are insured. Still, the percentage of insured risks in Ukraine is rising steadily, as the insurance industry remakes its social image and reinforces in the minds of the Ukrainian people the stability of the market (as opposed to the instability of the past).

The domestic insurance market is developing dynamically and is one of the few sectors of the Ukrainian economy that has been able to boast of a steady growth in turnover over the last couple of years. In fact, the insurance market continues to develop very fast with over 3% growth each year. Certain key domestic insurance incentives are rapidly appearing, such as mortgage insurance and mandatory motor liability, which boost the market with the inflow of premiums from rank and file people.

The market has shown trends of becoming even healthier, i.e., lesser companies and higher capitalization. Property insurance volume is growing constantly covering industrial, corporate and personal objects. Automobile insurance, even above and beyond mandatory motor insurance, is growing at a remarkable rate due to the increasing amount of car loans granted to citizens each year. Even life insurance, which was almost dead within the period of 1996 through 1999, has started to show progress with the introduction of changes in the personal income tax law and the Law "On Insurance".

Insurance companies, which accumulate huge financial resources, assist in developing various areas of business, in addition to ensuring stable production. Continuous changes in taxation legislation and insurance regulation, however, remain to be key problems for insurance managers, who are unable to make long-term plans.

At the end of 2002, the insurance regulatory and supervisory authority was handed over to the State Commission for Regulation of Financial Services Markets of Ukraine, which was established pursuant to the Law "On Financial Services and State Regulation of Financial Services Markets" by Presidential Decree of December 11, 2002, No. 1153/2002. The Regulation on the Commission was approved by Presidential Decree No. 292/2003, dated April 4, 2003.

The Commission is comprised of five departments headed by Directors, who are members of the Commission. These departments include:

1. Department for State Regulation and Development of Financial Services Markets;

2 Insurance Supervision Department;

3. Credit Union Supervision Department;

4. Financial Institution Supervision Department;

5. Non-State Pension Fund Supervision Department.

The Commission has issued Instructions approving each department's Regulations and defining their tasks, terms of reference and powers. The main tasks of the Commission as a whole and its departments within the terms of reference provided by law include:

1. To implement unified and effective state policy regarding the provision of financial services;

2. To elaborate and implement market development strategies for financial services;

3. To exercise state regulation and supervision over the provision of financial services and compliance with the law in the industry;

4. To ensure consumer protection in the industry by enforcing law in order to prevent or stop violations on financial services markets;

5. To generalize application practices of financial services legislation in Ukraine, and to develop and propose improvements in the legislation;

6. To introduce internationally-accepted market development rules for financial services;

7. To perform state financial monitoring of financial services markets in order to ensure implementation of the Law of Ukraine "On Prevention of Money Laundering;"

8. To facilitate integration into European and world financial services markets.

Local insurance companies today have two tasks before them: to eliminate the negative attitude that most people have towards insurance and to disseminate more information about their services. Below we provide you with the legislative analysis of this emerging sector of the Ukrainian economy.

Discussion

Overview

The creation and operation of insurance companies, including companies with foreign ownership, are regulated by the Laws “On Insurance,” “On Economic Associations,” “On the Foreign Investment Regime,” “On Profit Taxation of Enterprises” and other legislative acts. In combination, these laws set up a system whereby any person may insure any proprietary interest permissible under Ukrainian legislation.

Specifically, Article 1 of the Insurance Law governs the legal protection of individuals and legal entities in case of insured accidents. Depending on the type of insured object, insurance may be divided into one of the following categories: (i) *personal* (insurance of proprietary interests associated with life, health or labor capabilities); (ii) *proprietary* (insurance of proprietary interests connected with the possession, use and disposal of property); and (iii) *liability* (insurance shielding an individual or company against liability for certain acts resulting in damage to any third party or its property).

Furthermore, insurance may be either voluntary or obligatory. Voluntary insurance is documented by an agreement between the insurer (i.e., insurance company) and the insured. The general principles and terms and conditions of voluntary insurance are described in the insurance rules, which are established independently by each insurance company. Specific terms and conditions of voluntary insurance should be defined in the insured individual’s personally tailored agreement.

The terms and conditions of mandatory insurance are set forth by the relevant legislative acts. Mandatory insurance is usually required for companies or individuals who perform acts which are potentially dangerous either to themselves or to those for whom they perform services (e.g. doctors, sportsmen, firemen, soldiers and officers and construction workers). In most cases, an individual is free to choose the insurance company, unless otherwise provided by applicable laws.

Legal Forms of Insurance Companies

Regarding the creation of new insurance companies, the founders must keep in mind that Ukrainian law mandates specific legal forms for insurance companies. Insurance companies must have at least three participants and can structure themselves only as:

1) a joint stock company;
2) a general partnership;
3) a limited partnership; or
4) a company with additional liability.

Importantly, the amended Insurance Law prohibits the creation of insurers by way of re-profiling existing enterprises, even if such re-profiled enterprises will meet all requirements of Ukrainian law.

As briefly mentioned above, currently, foreign investors may have a majority ownership in Ukrainian resident insurance companies. This is significant because a minority 49% ownership stake by a foreign investor only gives such an investor the right to receive dividends and exercise control over limited strategic issues, as the resolution of most issues requires more than 51% of votes of the participants. In other words, thanks to the amendments to the Insurance Law, foreign participants are able to freely adopt so-called “fundamental” decisions, which include the all-encompassing right to amend the charter of the company and to terminate the activity of the company, among others.

Insurance Intermediaries

Some foreign insurance companies, however, prefer to reinsure risks already insured in Ukraine rather than directly providing insurance services in Ukraine. Such foreign insurers typically carry out reinsurance activities through reliable Ukrainian insurance companies and, in most cases, are satisfied with the level of their Ukrainian activities.

Reinsurance activities may also be carried out with the assistance of reinsurance brokers. Ukrainian law expressly allows foreign reinsurance brokers to provide intermediary services associated with the reinsurance of risks insured in Ukraine by foreign re-insurers. However, foreign reinsurance brokers may only render intermediary services in Ukraine through permanent representative offices, which must be registered in accordance with Ukrainian legislation. Note that the right to render reinsurance brokerage services is granted only to those brokers, who are duly certified and are entered into the State Register of Reinsurance Brokers.

On May 28, 2004, Regulation No. 736 on the Registration of Insurance and Re-Insurance Brokers and the State Register of Insurance and Re-insurance Brokers was passed by the State Commission for the Regulation of Financial Services Markets of Ukraine. The Regulation provides for mandatory registration of insurance and re-insurance brokers in the State Register of Insurance and Re-insurance Brokers. In addition, insurance and re-insurance brokers are subject to mandatory certification of their qualifications.

Both certification and registration of insurance brokers is performed by the State Commission for the Regulation of Financial Services Markets of Ukraine. Non-resident insurance brokers are permitted to provide their services only through their permanent establishments in Ukraine, being registered as a taxpayer in accordance with Ukrainian legislation.

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Certification of Insurance Brokers

Certification is arranged through attending an appropriate academic course or the passing of a relevant test by insurance brokers' managers, which must be confirmed by the respective Certificate of Improved Insurance Education. Training and testing is performed by appropriate educational establishments having the respective license of the Ukrainian Ministry of Education, while certification documents are issued by the State Commission for Regulation of the Financial Services Markets.

Registration of Insurance Brokers

According to the Regulation, all insurance brokers registered as subjects of business activity along with non-resident brokers performing their activity on the territory of Ukraine are subject to registration in the State Register of Insurance Brokers. The State Register of Insurance Brokers contains the following characteristics of insurance brokers: identification, classification, informative data, registration data and economic data.

In order to be registered in the State Register of Insurance Brokers, insurance brokers must submit to the State Commission for Regulation of Financial Services Markets of Ukraine the following documents:

1. an application for registration in the State Register of Insurance Brokers;
2. a certified copy of the relevant state registration certificate with the local state authorities;
3. a certified copy of the document evidencing the proper qualification issued by the State Commission for Regulation of the Financial Services Market to the director of the legal entity-applicant or to an entrepreneur;
4. an economic substantiation of the intended intermediary activity of the insurance broker;
5. A copy of the Resolution of a non-resident to create a permanent representation (branch) in Ukraine (if applicable).

Structure of the Authorized Capital of Insurance Companies

As previously mentioned, the Law "On Insurance" was amended and signed by the President on October 4, 2001. These latest amendments provide new requirements for the authorized funds of insurance companies and abolish the ban of 49% ownership of the authorized capital by a foreign investor. From now on, foreign investors may control 100% of the authorized funds of insurance companies.

To minimize the chances of an insurance company's failure to pay its clients due to the lack of available funds, Ukrainian legislation provides rather strict capitalization requirements for insurance companies. Specifically, the total amount of the authorized capital may only be paid in cash. Certain exemptions exist, however. For instance, cash contributions to the authorized capital may be effectuated by contributing state securities at par value, provided that such contribution does not exceed 25% of the total amount of the authorized capital.

Other assets, including any intangible assets, credits and secured loans, may not be contributed to the authorized capital of an insurance company. Furthermore, cash from the insurance reserve fund may not be used for forming the authorized capital. An insurance reserve fund is created in each company for the purpose of assuring future payments of insured sums, depending on the insurance and reinsurance types.

Limitations also are placed on an insurance company's investment activities. For example, the total amount of an insurance company's contribution to the authorized capital of other Ukrainian insurance companies cannot exceed 30% of its own authorized capital. Further, the amount of investment contributions by an insurance company to each individual insurance company cannot be more than 10%. These limitations, however, are not applied to those non-life insurance companies that make investment contributions to the authorized funds of life insurance companies.

The amended Insurance Law also establishes minimum capitalization requirements for insurance companies, which are harsher than the previously existing minimum capitalization requirements. Currently, the minimum authorized capital of an insurance company is EUR 1,000,000; while insurance companies which are involved in providing life insurance services must have a minimum authorized capital of up to EUR 1,500,000.

Types of Insurance-Related Activities

Ukrainian law provides for an exclusive list of activities, which an insurance company may carry out. Such activities include:

a) insurance;

b) reinsurance; and

c) financial activities in connection with the formation, allocation and management of insurance reserves.

An insurance company may also carry out the above activities by providing its services to other insurance companies via joint activity agreements. In addition, an insurance company may also carry out transactions required for the ensuring of its own economic needs.

Licenses

In order for an insurance company to begin its insurance activities, it will need to obtain a license from the State Commission for Regulation of Financial Services Markets of Ukraine (the "Commission") for each type of intended insurance activity. To do so, an insurance company must first file an application with the Commission, along with the following documents:

- copies of the company's founding documents and a copy of its certificate of state registration;

- a bank certificate or audit statement, which confirms that the company's authorized capital has been paid in full;
- a certificate, confirmed by a licensed auditing firm, evidencing the financial status of the insurance company's founders (if the insurance company is established in the form of a general partnership, limited partnership, joint stock company or a company with additional liability);
- the insurance conditions and rules (i.e., policies);
- the economic grounds for planning insurance (reinsurance) activities; and
- information about the founders of the insurance company and the chairman and deputies of the management board; a copy of the diploma of the chief executive or his first deputy, evidencing his or her higher economics or legal education; a copy of the diploma of the chief accountant evidencing his or her higher economics education; and information on the availability of the above certificates if the Commission so requires;
- the approved procedure for conducting internal financial monitoring;
- a certified copy of the document evidencing the appointment of the person responsible for conducting financial monitoring with information regarding the officers or specialists also responsible for carrying out financial monitoring.

The Commission has thirty (30) calendar days to review the above documents and decide whether to grant or deny a license to the insurance company. In case of refusal, the Commission must state in writing the reasons for such refusal. Significantly, an insurance company, which receives a license to sell life insurance, does not have the right to carry out any other forms of insurance activities. From October of 2003, all new licenses issued are for an indefinite period. All licenses issued before October 2003 will be valid until their original date of expiration. Thereafter, an application may be filed for a license with an indefinite term.

On September 7, 2006, the Commission approved separate licensing conditions for the branches of non-resident insurers (Order No. 6201). These new licensing conditions are a direct result of Ukraine's desire to join the World Trade Organization, as evidenced by the fact that they will come into legal force only 5 years after Ukraine is accepted into the WTO. While the licensing conditions and procedure are similar to those for resident insurers, they will allow non-resident insurers to act in Ukraine via branches without the creation of a legal entity.

Taxation

Taxation of Resident Insurers

The Ukrainian taxation system is notorious for its instability and constant changes. Each year, several amendments are made to the Law "On Profit Taxation of Enterprises" (the "Profit Tax Law").

The Profit Tax Law categorizes insurance-related activities as a special type of transaction, subject to a specific tax rate. According to the Profit Tax Law, gross income obtained by Ukrainian resident insurers from insurance activities (except for long-term life and private pension insurance) are taxed at a rate of 3%. For taxation purposes, gross income means the amount of insurance contributions and payments or premiums earned by insurers during the reporting period under agreements for insuring and reinsuring risks on the territory of Ukraine or abroad decreased by the amount of insurance payments (insurance contributions, insurance premiums) paid by the insurer under re-insurance agreements with a resident.

Please note again that transactions associated with life insurance are treated (and registered) separately. Income

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earned by insurance residents from long-term life and private pension insurance is generally not taxed.

Taxation of Non-Resident Insurers

Ukrainian law is highly sensitive about enforcing the taxation of foreign insurance companies earning income from Ukrainian sources. Specifically, current legislation provides that any income obtained by Ukrainian non-residents from Ukrainian sources as a result of carrying out business activities will be taxed in accordance with the procedure and rates provided by the Profit Tax Law. Income earned by Ukrainian non-residents from Ukrainian sources includes contributions and premiums for insurance or reinsurance against risks in Ukraine (including life insurance) or insurance of Ukrainian residents against risks outside the territory of Ukraine.

Income earned by Ukrainian non-residents in the form of insurance contributions, insurance payments or insurance premiums for risk *reinsurance*, including life insurance on the territory of Ukraine and insurance against risks of Ukrainian residents outside of Ukraine, is taxed at a rate of 12%. It is collected at the source of payment of, and from, such income.

In addition, any income obtained by Ukrainian non-residents in the form of insurance contributions, insurance payments or insurance premiums for risk *insurance* and life insurance on the territory of Ukraine is taxed at a rate of 0% or 12%, at the source of payment of, and from, such income. Income obtained by non-residents for the payment of advertisement services in Ukraine is taxed at a rate of 20%.

Accounting Books and Reports

Ukrainian resident insurers must file, on a quarterly basis, their balance statements, profit and loss reports and other information, as approved by the owners of such insurance companies, with the Ministry of Finance. The above reports must be prepared in the manner established by the said Ministry. The Ministry may also require that insurers provide the relevant explanations regarding the above reports. Further, insurance companies must publish their annual balance statements according to the procedure established by the Ministry of Finance. Finally, a licensed auditing firm must confirm the authenticity and completeness of such balance statements.

Conclusion

The Ukrainian insurance market is clearly a fast growing child, and requires significant improvements. In more diplomatic terms, the Ukrainian insurance industry has great potential, which remains largely untapped by Western insurance companies. With nearly 48 million interested customers, eagerly awaiting the giant foreign insurers and their multi-millions in foreign currency reserves, the potential Ukrainian market is worthy of consideration.

Reluctant as they may have been in the past, foreign investors now have a greater opportunity to explore Ukraine's "great potential." Undoubtedly, Ukraine has recently witnessed an influx of foreign insurers into the Ukrainian market which continues to restructure the insurance sector. As the concept of insurance is becoming more and more familiar in a positive way to Ukrainian society, Ukrainians are beginning to realize the advantages of insurance and, unfortunately, the potential schemes that come along with a developed insurance market. The result is that the insurance market continues to grow and not just for mandatory types of insurance, but for "taboo" insurance plans such as life and health insurance. And, Ukrainians are becoming more demanding from their employers with respect to additional insurance plans and more demanding from consumers with respect to insurance of automobiles, apartments, etc.

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