Banking Law in Russia.
Credit Relations with Foreign Banks

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Contents

Preface

When preparing this brochure we endeavoured to give our readers, in particular, representatives of lending institutions already active in Russia or willing to enter the Russian market, a brief overview of the Russian banking system and the legal framework for the lending and other banking activities of foreign organizations in Russia.

More specifically, we have focused on those aspects of Russian legislation that need to be taken into account when granting loans in Russia. We have studied different kinds of pledges as well as legal means of their realisation and recovery.

The authors of this brochure are Russian and German lawyers with many years of consulting experience in banking and credit financing law, who are members of the new Banking and Finance practice group of Beiten Burkhardt.

Earlier, Beiten Burkhardt has already published a series of the following analytical brochures:

- Investments in Russia;
- Investments in Real Estate in Russia;
- Labour Law in the Russian Federation.

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Moscow, 29 June, 2006

Dr. Christian von Wistinghausen

1. Banking

1.1 General Description of the Russian Banking Sector

The banking sector in Russia is made up of the Central Bank of the Russian Federation (hereinafter the "CBRF"), lending institutions, as well as branches and Representative Offices of foreign banks (i.e. institutions that, under the laws of corresponding foreign jurisdictions, are deemed to be banks). Lending institutions include banks and non-banking lending institutions. The main difference between the two is the number and type of banking transactions they are permitted to perform. Banks are authorized to carry out a broad range of transactions: they may utilise funds deposited by individuals and legal entities; invest such funds in their own name and for their own account and agree the terms and conditions of their investment as regards disbursement, profitability and maturity of payments; and they may open and maintain bank accounts for individuals and legal entities. Conversely, the scope of banking transactions that non-banking lending institutions are allowed to perform is limited.

The banking sector in the Russian Federation is regulated by a number of legislative acts, including:

- The Federal Law “On Banks and Banking” No. 395-1 of December 2, 1990 (as amended by the Federal Law No. 17-ФЗ of February 3, 1996 and others) (hereinafter the "Law on Banks");
- The Federal Law “On the Central Bank of the Russian Federation (Bank of Russia)” No. 86-ФЗ of July 10, 2002 (hereinafter the “CBRF Law”);
- The Federal Law “On Insolvency (Bankruptcy) of Lending Institutions” No. 40-ФЗ of February 25, 1999 (as amended).

The Russian banking sector has been rapidly developing since the break-up of the Soviet Union. Russian commercial banks enjoyed a period of remarkable growth between 1995 and 1998. However, the fateful decision of August 17, 1998, to restructure Russia’s foreign debt, as well as its debt on Russian treasury bills (“GKOs”), led to a near collapse of the national banking system. The financial consequences of August 17, 1998, known as the “Russian financial crisis,” have had a profound impact on the Russian banking industry and have left it in a much weakened state. Currently, the banking sector in Russia is steadily developing and moving towards a reduction in the quantity of banks through mergers, while the quality of banking services is improving and the amount of accumulated funds is growing. Furthermore, the standards established for Russian lending institutions by

the Central Bank of the Russian Federation have been brought into line with international banking standards.

Traditionally, the Russian state has always been deeply involved in the banking system. There are still several banks in which the Russian Federation hold major stakes. The largest state-owned bank in Russia is Sberbank, which has a large regional network of branch offices and dominates the retail banking market.

1.1.1 Central Bank of the Russian Federation

The CBRF is the primary regulatory authority for the Russian banking sector.

Article 75 of the Russian Constitution states that the CBRF's primary responsibility is to defend and guarantee the stability of the Russian ruble. Furthermore, CBRF regulates banking activities throughout the Russian Federation, while also issuing binding instructions to banks. As a part of its general supervisory role, the CBRF issues licenses to banks wishing to take-up operations, establishes the requirements as to minimum charter capital and net worth for lending institutions, and approves senior management appointments at all banks (including branches of foreign banks).

The CBRF is one of the few institutions under the control of the Russian legislative branch. The State Duma must approve not only the nomination of the Chairman of the CBRF, but also his resignation. The CBRF Law provides for the establishment of a special body within the structure of the CBRF, the National Banking Council (the "NBC"), which is comprised of representatives of various state authorities. This body is to exercise control over the CBRF's Board of Directors, while participating in establishing the basic principles of Russian banking and financial policy.

1.1.2 Licensing

Russian banks are authorised to carry out banking activities on the basis of the following licenses:

- The license to carry out banking activities with monetary funds in rubles (this license does not grant the right to invest the funds of individual persons);
- The license to carry out banking activities with monetary funds in rubles and foreign currency (this license does not grant the right to invest the funds of individual persons); and
- The license to store and trade precious metals.
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Any bank that has registered its operations for a minimum of two years can also obtain the following licenses:

- The license to accept and keep on account individuals' funds in rubles;

- The license to accept and keep on account individuals' funds in rubles and foreign currency; and
- In addition, a bank that has been granted all of the above-mentioned licenses (with the exception of a license to store and trade precious metals) and that is in compliance with the relevant CBRF regulatory asset requirements may apply for *a general license*, which covers all of the above-mentioned activities.

1.1.3 Transition to International Accounting Standards

The Russian Government announced its planned transition to International Accounting Standards in the document entitled "Strategy for the Development of the Banking Sector in the Russian Federation," which was ratified on December 30, 2001. The CBRF issued the Official Notice "On the Transition of the Russian Federation Banking Sector to International Accounting Standards" on June 2, 2003, setting out how it intends to implement the said Strategy and reach this objective.

Since January 1, 2004, all Russian lending institutions have been preparing and submitting their financial reports in compliance with International Accounting Standards (IAS).

1.1.4 Standards Applying to Russian Banks

The CBRF establishes standard requirements (including a minimum capital requirement) and reserve fund requirements for Russian banks. Special requirements were also established for nominees to managing positions of banks. Any bank's prospective chairman of the executive board and chief accounting officer must complete a questionnaire, indicating their levels of education and years of experience with a bank or any other lending institution. Candidates with a university degree in law or economics need to have only one year of management experience in the banking sector, whereas all other candidates are required to have two years of management experience. Furthermore, all candidates must submit proof that they have no criminal record.

In addition, the Federal Law "On Insurance of Individuals' Deposits in Banks of the Russian Federation", No. 177-ФЗ" of December 23, 2003 (hereinafter the "Deposit Insurance Law"), which entered into force on December 27, 2003, established special requirements that the banks authorised to receive deposits from individuals must satisfy.

This Deposit Insurance Law introduces the basic structure in legal, financial, and administrative terms for the system of mandatory insurance that covers individuals' deposits; regulates the establishment of the organisation authorised to provide mandatory insurance (called the Deposit Insurance Agency hereinafter), its responsibilities and scope of activities; and also defines the deposit reimbursement procedure.

Upon notification issued by the CBRF, the Deposit Insurance Agency registers a bank with the deposit insurance system by entering it in the register of banks. Banks that have already been entered in this register are obligated to comply with the requirements established for participants in the deposit insurance system. A bank that has been licensed by the CBRF prior to the effective date of the Deposit Insurance Law shall be deemed to be in compliance with the requirements for participating in the deposit insurance system, provided such bank meets the particular criteria stated in the Deposit Insurance Law. Under the Deposit Insurance Law, banks that do not participate in the deposit insurance system will be denied the right to accept deposits from individuals and to credit additional funds to accounts held by individuals under existing bank account or bank deposit agreements.

The lending activity of banks must furthermore comply with the requirements of the Federal Law "On Credit Histories," No. 218-ФЗ December 30, 2004 (hereinafter the "Law on Histories"). This law was promulgated to facilitate the further development of the market, mainly in the fields of consumer and mortgage lending, both of which are gradually growing.

Following the introduction of the Law on Histories on June 1, 2005, credit history bureaus have commenced operations. They collect information, compile databases, and provide information on loans issued to individuals and legal entities, subject to the prior written consent of these parties. The information provided by these bureaus in the latter context include, *inter alia*, the loan amounts, the repayment status or, respectively, the status of any default. It is expected that this will result in a drop in the number of bad loans, and in an increase in the number of loans issued, thus contributing to the further development of the lending sector.

The sources supplying the data on which these credit histories will be based are the lending institutions themselves. Since September 1, 2005, they are under an obligation to provide information on loans with respect to all borrowers who have consented to this, such information to be provided to at least one credit history bureau listed in the state register of credit history bureaus (Article 5 of Section 3 of the Law). For this purpose, an agreement on the provision of informational services must be concluded by the lending institution and the bureau.

According to the law information stored at the credit history bureaus may be provided to the following parties:

- the borrower;
- a bank upon prior consent from the borrower;
- the court and investigation authorities.

The Law does not restrict the number of credit history bureaus that may be instituted, as is the practice in Germany also. Primarily, this is to prevent a

monopoly from developing. However, the “Central Catalogue of Credit Histories” will be established and maintained at the CBRF.

1.1.5 Banking Transactions and Other Banking Services

Pursuant to Article 5 of the Russian Law on Banks, banking transactions include:

1) Keeping of funds on account that have been deposited by individuals and legal entities (call deposits and fixed-term deposits);
2) Investing of funds deposited, doing so in the bank's own name and on its own account;
3) Opening and maintaining bank accounts for individuals and legal entities;
4) Settling invoices from the accounts held by individuals and legal entities, including correspondent banks, on their behalf;
5) Collecting funds, promissory notes, payment and settlement documents and providing retail banking services to individuals and legal entities;
6) Selling and buying cash and non-cash foreign currency;
7) Storing and trading precious metals;
8) Issuing bank guarantees;
9) Transferring funds for individuals who do not maintain an account with the bank (excluding postal money orders).

In addition to the above-mentioned banking transactions, banks are entitled to:

1) Issue guarantees for monetary obligations on behalf of third parties;
2) Acquire monetary claims of third parties,;
3) Manage funds and other property in trust, subject to the respective agreement concluded with individuals and legal entities;
4) Implement transactions with precious metals and precious stones in accordance with the laws of the Russian Federation;
5) Lease out dedicated space, or a safe deposit box within such space to individuals and legal entities for storage of documents and other valuables;
6) Enter into leasing agreements;
7) Provide consultancy services and offer information.

Banks are also entitled to carry out other transactions in accordance with the laws of the Russian Federation.

It bears noting that current legislation prohibits banks from pursuing any activities as manufacturer, trader or in the insurance sector.

1.2 Banks held by Foreign Shareholders

1.2.1 Legislative Regulation of the Activity pursued by Banks held by Foreign Shareholders in the Russian Federation

The establishment of banks in the Russian Federation held by foreign shareholders is regulated by the following fundamental legislative acts:

- The Federal Law “On Banks and Banking” No. 395-1 of December 2, 1990;
- The CBRF Instruction "On the Decision-Making Procedure of the CBRF concerning the State Registration of Lending Institutions and Issuance of Licenses for Banking Transactions" No. 109- *И* of January 14, 2004;
- Regulation on the details of registering lending institutions held by foreign shareholders and on the procedure of obtaining preliminary permission from the CBRF for increasing the charter capital of a registered lending institution using funds paid in by non-residents No. 437 of April 23, 1997;
- The CBRF instruction "On the Minimum Charter Capital of newly Established Lending Institutions, on the Net Worth (Equity Capital) of the Operating Lending Institutions as a Condition for Establishing their Subsidiaries and/or Opening their Branches in the Territory of a Foreign State, on the Net Worth (Equity Capital) of Non-Banking Lending Institutions Applying for Status as a Bank" No. 1346-*У* of December 12, 2003.

1.2.2 Procedure for Establishing a Bank held by Foreign Shareholders

The following table summarizes the procedure that must be observed in establishing a bank in the Russian Federation in which foreign shareholders hold a stake:

№	Stage	Executive Body	Comments
1	Confirmation of the bank's ability to use the prospective company name	Central Bank of the Russian Federation	Implementing the decision to establish the bank and preparing its foundation documents are possible only after the positive ruling by the CBRF regarding the prospective bank name has been issued to the applicant.
2	General assembly of the bank's founders	Founders of the bank	At the general assembly, the bank's founders resolve on the candidates for the position of the bank's director, its chief accountant and its deputy chief accountant. These candidates must meet certain requirements in terms of their education, professional experience and other legal requirements. The bank's founders – in this case, foreign legal entities – must submit proof of written approval by the relevant controlling body of the country in which they are incorporated (Central Bank, Ministry of Finance or other authority) for their participation in the charter capital of a lending institution in the Russian Federation, or they must submit confirmation from said controlling body that such approval is not required.
3	Election of the chairman of the bank's board of directors (supervisory board)	Members of the bank's board of directors	The election of the chairman of the board of directors (supervisory board) is to be recorded in the minutes of the relevant session of the bank's board of directors (supervisory board). Submitting these minutes is mandatory in order for the bank to be registered.
4	Preliminary permission of the CBRF for establishing the bank held by foreign shareholders	Central Bank of the Russian Federation	The preliminary permission by the CBRF consists of its approval in principle of the involvement of foreign founders in establishing the bank in question. Such preliminary permission for establishing the bank held by foreign shareholders is valid for a period of 1 year following its date of issue and is a mandatory requirement for official registration of the bank.

№	Stage	Executive Body	Comments
5	Approval from the cartel office of the Russian Federation	Russian Federal Cartel Office	Obtaining the approval from the cartel office of the Russian Federation for establishing the bank is a mandatory requirement for official registration of the bank.
6	State registration of the bank	Central Bank of the Russian Federation	It takes 6 months for the CBRF to decide on the state registration of the bank. The Federal Tax Service registers the bank with the state, subject to approval having been granted by the CBRF, by feeding the information on such bank into the Unified State Register of Legal Entities.
7	Payment of the charter capital of the bank	Founders of the bank	The minimum established for the charter capital of a newly established bank is 5.000.000 Euro. The bank's founders shall pay 100% of the charter capital within 1 month following receipt of the notification that the bank has been registered; and they are to provide the local branch of the CBRF with documents confirming such due payment of the charter capital of the bank.
8	License to operate a bank	Central Bank of the Russian Federation	The license issued to the bank sets out a list of transactions that the bank is authorised to carry out. The license for banking transactions is issued for an indefinite period of time. The issuance of the license for carrying out banking transactions is subject to a fee of 0.1 % of the charter capital of the bank as set out in its charter deed. The license fee is paid by the founders of the bank prior to submitting the documents with which state registration of the bank is applied for.

1.2.3 Representative Offices of Foreign Banks in Russia

1.2.3.1 Legal Status of a Representative Office of a Foreign Bank

The legal issues of accreditation and the activities of Representative Offices of foreign banks in the Russian Federation are governed by the provisions of the Federal Law “On Banks and Banking” No. 395-1 of December 2, 1990 and by the CBRF Directive "On the Procedure for Instituting Representative Offices of Foreign Lending Institutions and their Activities in the Russian Federation" No. 02-437 of October 7, 1997.

A Representative Office of a foreign lending institution (hereinafter "Representative Office") is an independent division of a foreign lending institution that has been instituted in the Russian Federation and has obtained permission from the CBRF to open a Representative Office in accordance with Russian law.

A foreign lending institution may decide to open a Representative Office in order to monitor the Russian economy and the banking sector of Russia, to offer consultancy services to its clients, to support and foster contacts with Russian lending institutions and, last but not least, to promote international cooperation.

A Representative Office is not a legal entity, has no right to carry out commercial activities, and acts in the name and on behalf of the lending institution that it represents and that is named in the permit granted for opening a Representative Office.

Thus, foreign banks are not allowed to perform the full range of their banking activities via the Representative Offices they may have established in the Russian Federation.

1.2.3.2 Accreditation Procedure for the Representative Office of a Foreign Bank

The following table summarises the accreditation procedure that must be observed in establishing a Representative Office of a foreign bank in the Russian Federation:

№	Stage	Executive Body	Comments
1	Decision to open a Representative Office in Russia and preparation of internal documents setting out the prospective	Foreign bank	

№	Stage	Executive Body	Comments
	activities of the Representative Office.		
2	Submission of the application to the CBRF for a permit to institute a Representative Office in Russia.	Foreign bank	Requirements to be met by a foreign bank: - Must have been active in its country of origin for at least 5 years; - Must be a bank of good standing in its country of origin, also among other banks; - Must have a solid financial standing. The application must specify the objectives that are being pursued in opening a Representative Office. The application must be accompanied by all of the documents required by the CBRF.
3	Personal accreditation of the foreign employees of a Representative Office	Central Bank of the Russian Federation	Candidates for the position of the director and deputy director of a Representative Office must either hold a university degree in law or economics, or must have at least 2 years of professional experience working in the banking sector. The director of the Representative Office and his/her deputy may not simultaneously be employed by a Russian bank in which the foreign lending institution now opening a Representative Office holds shares.
4	Permit to open a Representative Office in the	Central Bank of the Russian Federation	It takes at least 30 days for the decision on granting of the permit to be taken. The permit is granted for a period of

№	Stage	Executive Body	Comments
	Russian Federation (accreditation)		3 years. The permit will no longer be valid if a Representative Office has not started actual work within 6 months after the date of its issuance.
5	Entering of Data regarding the Representative Office into the Unified State Register of representative offices of foreign companies accredited in the Russian Federation	State Registration Chamber at the Ministry of Justice of the Russian Federation	Time required – from 7 to 21 days.
6	Registration of a Representative Office with the tax authority and state non-budgetary funds	Federal Tax Service Social Insurance Fund Pension Fund Mandatory Medical Insurance Fund Federal Bureau of Statistics	

1.2.4. Acquisition of a Russian Banking Business

Primarily, successful Russian banks attract investment because they have interesting client databases and an existing, well-developed network of branch offices throughout Russia.

Practical experience has shown that the easiest way for an investor to enter the Russian banking market is to acquire a bank that is already operating. To cite but one example, GE Capital International Financing Corporation (a subsidiary of General Electric) closed a deal in late 2005 by which it will acquire 100% of the shares in the Russian ZAO "Deltabank", while in 2006 Raiffeisen International (Austria) plans to complete its acquisition of the controlling stake in the Russian OAO "IMPEXBANK".

Traditionally, a Russian bank is bought by a foreign bank acquiring stock (shares in the share capital).

Russian law stipulates that the local branches of the CBRF and the Federal Antimonopoly Service (FAS) must consent to such acquisition of stock (shares in the share capital) in Russian banks.

The criteria by which deals are defined that require the prior written approval of the CBRF and FAS, and also the procedural rules for obtaining such approval, have been set out in the Federal Law "On Banks and Banking" No. 395-1 of December 2, 1990, in the Federal Law "On Anti-Competition in the Financial Services Market" No 117- ФЗ, of June 23, 1999 and other rules and regulations issued by the CBRF and FAS.

1.3. Money Laundering Legislation

Based on the recommendations on money laundering made by the Financial Action Task Force on Money Laundering (FATF), which is an inter-governmental body with the goal of developing and promoting policies for national legal systems to combat money laundering, the State Duma adopted the Federal Law No. 115-ФЗ “On Combating Legalisation (Laundering) of Criminal Profit and Financing of Terrorism” of August 7, 2001 (hereinafter the "Money Laundering Law"), which came into force on February 1, 2002.

The Money Laundering Law requires banks to report to the Federal Service for Financial Monitoring (*Rosfinmonitoring*) on all transactions covered by the criteria stipulated in Article 6 of the Money Laundering Law. One such mandatory criterion is the value of the banking transaction; it may not be equal to or exceed 600.000 rubles (or the equivalent amount in foreign currency).

It is worth noting that banks cannot be held liable should they fail to report to Rosinfomonitoring any transactions of their clients that, under the stipulations of the Money Laundering Law, would represent a breach of this law.

Russian banks that fail to comply with the requirements of the Money Laundering Law more than once within a one-year period will have their licenses revoked.

2. Credit Relations with Foreign Banks

2.1 Applicable Law

In practice, loan agreements concluded between foreign banks and Russian borrowers are generally governed by the law of the state in which the foreign bank is incorporated. But often it is only possible to enforce a borrower's obligation under a loan agreement against property located in Russia (owned by a borrower, a pledgor, a surety).

In such a case, it is mandatory to employ the legal remedies under Russian law serving to enforce a borrower's obligation and to initiate proceedings for immediate execution *in rem* (the property).

In addition, loan agreements concluded between a foreign bank and a Russian borrower are to comply with the mandatory provisions of Russian law, for example, the stipulations of the laws on currency control and currency regulation, on banks and banking activities, and on the budget.

2.2 Currency Control

Russian currency regulation legislation is now in the process of liberalisation. As of 01.07.2006 one of the provisions of the Federal Law No. 173-ФЗ "On Currency Regulation and Currency Control" of December 10, 2003 (hereinafter referred to as "the "Law on Currency Regulation") is no longer in force. The provision stipulated that in the course of ongoing currency transactions between a resident (a Russian company) and a non-resident (a foreign bank), such transactions being subject to a loan agreement in which foreign currency was used and which was concluded for a period shorter than 3 years, a resident was to use a special bank account and to deposit a certain amount of reserved funds on it.

In any case, prior to such transaction (involving a foreign currency loan) being concluded between a foreign bank and a Russian company, the Russian partner must prepare what is called a transaction passport.

A transaction passport is a currency control document issued by the Russian bank with which the Russian company's accounts are kept, such passport serving the payments in foreign currency between Russian and foreign companies.

The CBRF Instruction No. 117-И "On the Procedure to Present Documents and Information on Currency Transactions by Residents and Non-residents to Authorised Banks, on the Procedure to Account for Currency Transactions and to Prepare Transaction Passports by Authorised Banks" establishes the procedure involved in preparing a transaction passport and lists the documents required for this purpose.

2.3 Some Mechanisms for Enforcing a Borrower's Obligations

As a rule, if a foreign bank grants a loan to a Russian legal entity, property of the borrower/third parties located on the territory of the Russian Federation will serve as security for this loan. In this respect, this section contains basic provisions of Russian law and the current judicial practice related to methods of enforcing a borrower's obligation.

It should be additionally noted that application of the laws governing the financial markets prompted the necessity to update Russian laws on the enforcement of claims and obligations. To this end, the Government of the Russian Federation instructed the federal executive bodies (the Ministry of Finance of the Russian Federation, the Ministry of the Economic Development of the Russian Federation) to co-operate with the CBRF in drafting laws from 2006 until 2008 that are to provide for the following innovations[1]:

1) Introduction of escrow accounts;
2) Addition of new types of collateral, for example, the funds deposited in an account may be pledged;
3) Abolition of the procedure of selling pledged items at public auction; introduction of a simplified procedure for transferring full title to pledge collateral from a pledgor to a pledgee;
4) Separation of the pledged object from the other assets upon insolvency of a debtor;
5) Promotion of extra-judicial enforcement procedures against immovables pledge collateral by granting the right to pledgees to conclude notarised agreements

1 The Russian Federation Banking Sector Development Strategy until 2008 / Statement of the Government of the Russian Federation and the CBRF No. 983п-П13, No. 01-01/1617 of April 05, 2005.

with those pledgors who are legal entities, and to do so at any time during the period for which the object has been pledged, and not only after occurrence of an enforcement event;

6) Specification of certain general pledge-related provisions, including those referring to pledges over inventory, taking into account the special characteristics of this type of pledge;
7) More rights granted to creditors to monitor the sale of pledged property;
8) Legal confirmation of a simplified assignment of claims under loan agreements.

2.3.1 Property Pledge: General Provisions

The Russian Civil Code, the Russian Federation Law "On Pledging" No. 2872-1 (as amended) of May 29, 1992, the Federal Law "On Mortgage (Real Estate Pledge)" No. 102-ФЗ of July 16, 1998 are the basic current regulatory legal acts.

Pledge – a method to ensure that a borrower fulfils its obligations under the loan agreement, by granting the, creditor (hereinafter referred to as the "**Bank**") the pre-emptive right to satisfy its claims against the pledged property upon default of the borrower under his obligations.

The parties to a pledge are:

Pledgor – the person or legal entity pledging the property;
Pledgee – the person accepting the property as pledge.

Important: Under a loan commitment, both a borrower and a third party may act as a pledgor (par. 1 Article 335 of the Russian Civil Code).

The pledged asset may be any property, including tangibles and intangibles (claims), with the exception of any assets withdrawn from the market or from circulation, and non-assignable claims directly associated with the creditor, these being in particular alimony claims, claims for compensation of damages to life or limb, and any other rights, the assignment of which to another person is prohibited by law.

Important: future tangibles and intangibles which the pledgor may also be the subject of a pledge.

The *pledge agreement* must set out the asset pledged, its value, nature, extent and the period within which the secured obligation is to be discharged. It shall also state the party currently in possession of the pledged property.

The pledgor may only allow a third party the use of the pledged asset by way of lease or transfer to a third party, or disposal of it in any other way, if the pledgee has granted its prior consent, unless otherwise agreed.

It should be noted that Russian legislation permits the same property to be pledged to several pledgees (successive pledges) (Article 342 of the Russian Civil Code). In practice, this means that if a Bank accepts collateral that has already been pledged to another creditor, it will be able to enforce its security interest only after the claims of the preceding pledgee have been satisfied. Naturally, this risk compromises the pledgee's interests.

In order to protect the Bank's interests and to exclude the risk of having accepted a successive pledge, the pledge history of the object pledged is to be comprehensively reviewed, and the pledge agreement is to include special terms and conditions in this regard.

If a pledge is accessory to an obligation securing the principal obligation, it shall be cancelled as soon as the principal obligation has been met.

2.3.1.1 Mortgage

Mortgages are another form of non-possessory pledge as described above under 2.3.1.

Mortgage agreements are governed by mandatory Russian law (Article 1213 of the Russian Civil Code).

The Russian Civil Code, the Russian Federation Law "On Mortgages" No. 102-ФЗ of July 16, 1998, the Federal Law "On State Registration of Rights to Immovable Property and Transactions" No. 122-ФЗ of July 21, 1997 represent the basic legislative acts regulating mortgages.

The following immovable property may be mortgaged (Article 5 of the Federal Law "On Mortgages"):

1) Privately owned plots of land, provided these are not owned by the state or the municipality;
2) Enterprises as well as buildings, structures, and other immovable property used in entrepreneurial activities;
3) Residential buildings, apartments and parts of residential buildings and apartments consisting of one or several separate rooms;
4) Datchas, summer houses, garages, and other constructions for consumer use;
5) Airplanes and seagoing vessels, inland waterways vessels and objects in space,
6) Immovable property under construction (in practice, this type of pledge entails a number of complications in terms of value appraisal, registration of rights, and sale).

The rules governing the pledge of immovable property also apply if a lessee's rights under a lease agreement in respect of such property (leasehold) are pledged.

Any mortgage agreement must be concluded in writing and registered with the Federal Registration Service. Failure to comply with this provision will result in the agreement becoming void.

The mortgages are officially registered at the location of the charged property by entering them in the Uniform State Register of Rights to Immovable Property and Transactions.

From the date of registration of the mortgage agreement until it is terminated, the pledgor/mortgagor shall not be entitled to divest itself of the immovable property (by means of sale, exchange, contributing it as non-cash contribution to a company, or by any other means) without having obtained the prior written consent of the pledgee/mortgagee. Transactions by which the pledgor/mortgagor divests itself of an object pledged that are concluded in violation of this provision are deemed to be null and void.

By contrast the subsequent mortgage of a mortgaged asset by demise is permitted for a certain period of time without the consent of the pledgee/mortgagee, unless otherwise provided for by the agreement (Article 40 of the Federal Act "On Mortgages"). For this reason it is prudent to provide in the mortgage agreement how the mortgagor shall use the mortgaged property.

Mortgaging a building structure is only permitted if the plot of land on which the building or structure is erected, or that part of the land that provides all the required utilities and other facilities for the mortgaged building (structure), or the leasehold of the mortgagor regarding this real estate is likewise charged.

2.3.1.2 Share Pledge over the Share Capital of a Limited Liability Company

The procedure by which a stake held in the share capital of a limited liability company is pledged is governed by the Russian Civil Code and the Russian Federation Law "On Limited Liability Companies" No. 14-ФЗ of February 08, 1998 (hereinafter referred to as the "**Law on Limited Liability Companies**").

Any company's shareholder is entitled to pledge to a third party, either wholly or in part, the shares it holds in the company's share capital unless prohibited by the charter provided such prohibition has been consented to by the shareholders' meeting. The shareholders' meeting shall pass the decision by a simple majority unless the company's charter requires a greater majority. The vote of the shareholder intending to pledge its share either wholly or in part shall not be counted (Article 22 of the Law "On Limited liability Companies").

In practice, this method of securing a claim s rarely used, and if at all, then in addition to other methods. This is the result of the fact that in Russia there is no legally established procedure on how to pledge shares in companies. In addition, the pledge of a share in the share capital of a limited liability company does not

prevent the pledgor from exercising its rights under the Law "On Limited Liability Companies" as a shareholder of the company (in particular, to vote at the shareholders' meeting on issues such as profit distribution or the conclusion of major transactions). This may adversely affect the value of the share pledged.

2.3.1.3 Securities Pledge

Russian law distinguishes between non-certificated and certificated securities.

Among non-certificated securities, **stocks** and among certificated securities, **promissory notes** are widely pledged in banking practice.

The following laws and regulations govern the pledge of **stocks**: the Russian Civil Code, the Federal Law "On Joint Stock Companies" No. 208-ФЗ of December 26, 1995, the Federal Law "On the Securities Market" No. 39-ФЗ of April 22, 1996, the Federal Law "On Protection of Rights and Legitimate Interests of Investors in the Securities Market" No. 46-ФЗ of March 05, 1999, and a number of resolutions of the Federal Commission for the Securities Market (with effect from April 09, 2004, the Federal Commission for the Securities Market was abolished, and the Federal Service for Financial Markets established as successor).

In contrast to the general rule contained in Article 341 of the Russian Civil Code, the pledge of non-certificated securities becomes effective from the date of registration under the established procedure, i.e. from the date of entry of a relevant record into the Register of Securities Held (Information Letter of the Supreme Arbitration Court of the Russian Federation No. 67 of January 21, 2002).

From the date on of entry in the Register of Securities Held of the fact that stock has been pledged , the shareholder shall not be entitled to divest itself of such pledged stock until the pledge has been redeemed.

The pledgee accepting the pledged shares should be aware that this share pledge does not prevent the shareholder from exercising its rights – to participate in annual general meetings of the stock corporation, to vote in them, to receive dividends, and, in case of the stock corporation's liquidation, to receive a part of its assets. This interpretation of the law is supported by current judicial practice (please refer to resolution of the East Siberian Federal Arbitration Court of April 08, 2004 in case No. A74-2127/03-К1-Ф02-762/04-С2).

In practice, when a pledgor exercises his rights of a shareholder (in particular by voting at annual general meetings of the stock corporation and receiving dividends), it lead to the assets of a stock corporation losing value, and as a result, to the value of the stock pledged declining as well.

Thus, it is a question, whether it is possible to pledge to the bank also the shareholder's rights, secured by the pledged stock, in particular, the right to receive dividends and to participate at the annual general meetings of the stock corporation?

The share pledge agreement may provide for the pledgor to transfer to the bank his rights to receive dividends on the pledged stock. To do so, it is necessary to introduce the relevant provision into the pledge instruction that requires the signature of both the pledgor and the bank. Such pledge instruction is forwarded to the person in charge of the share register of the stock corporation whose stock is being pledged (resolution of the Federal Commission for the Securities Market of April 22, 2002, No. 13 ПС).

The situation is different in respect of transfers to the bank of participation rights at annual general meetings of stock corporations under the share pledge agreement. Current provisions for annual general meetings of stock corporations do not allow for the bank to participate at such meetings in its own name under the share pledge agreement.

A bank representative may only attend the annual general meeting of the stock corporation whose stock has been pledged by the pledgor if a respective power of attorney has been issued by the pledgor.

It should be noted that pursuant to Article 188 of the Russian Civil Code, an entity that issues a power of attorney is entitled to revoke it at any time. This may allow the Bank to demand early repayment of the loan.

The pledge procedure for promissory notes is governed by the Provision on Promissory Notes and Bills of Exchange approved by Resolution of the Central Executive Committee and the Soviet of the People's Commissaries of the USSR of August 07, 1937 (hereinafter referred to as the "**Provision on Promissory Notes**").

A promissory note is marked as pledged by imprinting a note on it which must use terms such as "value in security", "value in pledge" or any other clause that designates a pledge. The pledged promissory note shall be placed with the pledgee during the period for which the pledge has been agreed.

2.3.1.4 Attachment of a Bank Account

One of the enforcement measures used worldwide is attachment of a borrower's bank accounts. The efficiency of this method depends on the applicable law.

Under Russian law, it is extremely difficult to create this type of collateral since the laws governing both the attachment of bank accounts and the legality of limiting a borrower's rights to maintain an account are ambiguous. Furthermore, Russian laws on pledging and banking activities, are contradictory on enforcement proceedings.

As for the attachment of non-cash accounts as well as pledges of rights under an account agreement, the Russian Federation Supreme Arbitration Court has repeatedly ruled that such types of pledge are invalid (Resolution of the Russian Federation Supreme Arbitration Court No. 7965/95 of July 02, 1996, Information Letter of the Presidium of the Russian Federation Supreme Arbitration Court No. 26 of January 15, 1998).

2.3.1.5 Intangibles Pledge

The current civil legislation of the Russian Federation allows a claim to serve as a pledge. Paragraph 1 Article 336 of the Russian Civil Code states that any property, including intangibles (claims) may be the subject of a pledge. The Russian Federation Law "On Pledges" (par. 2 Article 4) sets out the provisions governing the pledging of intangibles.

The provisions of current Russian legislation, though allowing for claims to be pledged, do not set out any clear rules regarding the legal regime to which such pledge is subject.

In banking practice, it is not usual to pledge claims since the rules regarding enforcement are unclear.

2.3.1.5 Enforcement of a Pledge

Should a pledge not be redeemed, a pledgee's claims is usually satisfied from the proceeds of a sale of the pledged property *at public auction*.

The initial sale price of the pledged property at the beginning of the auction is in the case of judicial execution determined by a court ruling, and in all other cases by way of mutual agreement between pledgee and pledgor.

The pledged property is sold to the highest bidder at the auction.

If enforcement is into **immovable property**, a special procedure is to be initiated according to which a pledgee's claims (equivalent to a creditor's claims) are satisfied from the proceeds of an execution sale of the mortgaged property in accordance with a court ruling (Article 349 of the Russian Civil Code).

It is permissible to satisfy a pledgee's claim from the proceeds of an execution sale of the mortgaged property without appealing to a court in one case only – if a notarised agreement to such effect has been concluded between pledgee and a pledgor after the grounds for enforcement of the pledge have arisen.

A different procedure is applied where enforcement into **movable** tangible property is concerned. Here, the relevant provision is discretionary and stipulates that a pledgee's claims are satisfied from the proceeds of a judicial execution sale of the object pledged, unless otherwise provided for by an agreement concluded between pledgor and pledgee. If this is the intended procedure, it is sufficient to include such clause in the pledge agreement providing for out-of-court enforcement of the pledge.

Irrespective of whether the pledged property was enforced judicially or in an out-of-court procedure, the object pledged is always to be sold at auction.

Similarly, a share pledge may be enforced out-of-court by having the shares sold at public auction. In this case the buyer of the shares (be this the entire share or only

a part of same) shall become a shareholder in the company, without the need for any consent of the company or its other shareholders hereto.

Such changes in the company's shareholder structure must be recorded in the company's documentation by way of official registration under the Federal Law "On State Registration of Legal Entities and Individual Entrepreneurs" No. 129-ФЗ of August 08, 2001.

Only after declaration that repeated auctions have remained unsuccessful is the pledgee entitled to appropriate the object pledged, valued at a price that is no more than 10% below the initial selling price determined for the repeated auction. If a pledgee fails to exercise this right within one month after the second auction was declared invalid, the pledge agreement becomes invalid.

The procedure by which a pledge of a promissory note with a pledging endorsement is enforced differs from the general rule of enforcement of pledged property (cf. 2.3.1.6). By virtue of Article 19 of the Provision on Promissory Notes, a pledgee shall be entitled to exercise its rights by directly enforcing the promissory note, without having to sell this pledged property at auction. This procedure was established by the joint resolution of the Plenums of the Russian Federation Supreme Court and the Russian Federation Supreme Arbitration Court "On Some Issues of Considering Disputes Related to Promissory Notes' Forfeiture" No. 33/14 of December 04, 2000.

2.3.2 Surety

Under a contract of suretyship, a surety assumes liability towards the creditor of another party for that party fulfilling its obligations, such liability to extend to the entire obligation or to a part thereof. A surety may be obligated for future obligations as well (Article 361 of the Russian Civil Code).

A contract of suretyship must be concluded in writing in order to be effective. A contract of suretyship may be concluded in order to secure contractual penalties.

Surety and debtor whose performance is guaranteed are jointly and severally liable vis-à-vis the creditor, unless the law or contract of suretyship provide for a surety's secondary liability. Entities that grant a surety shall be liable to a creditor jointly and severally.

A surety shall be liable to a creditor for the same amount as the debtor whose performance it guarantees.

The Russian Civil Code sets out the following grounds for terminating the surety:

1) Redemption or cancellation of the principal obligation secured by a surety;

2) A modification of the principal obligation that entails the increase in liability or any other adverse consequences for a surety, without the surety having consented to such modification;
3) Assignment to another entity of a debt related to the principal obligation secured by it, if a surety has not consented vis-à-vis the creditor that it accepts liability also towards the new debtor;
4) A creditor's refusal to accept the redemption as offered by a debtor or a surety;
5) Expiration of the term for which a surety was granted (or established by law), unless a creditor has filed a claim against a surety during this period.

2.3.3 State and Municipal Guarantees

State guarantees represent a written obligation of a guarantor (the Russian Federation itself or a subject of the Russian Federation) that they accept liability for the full or partial fulfilment by a borrower of its obligation vis-à-vis a creditor, such guarantee to be covered by the funds of the federal budget or the budget of a subject of the Russian Federation.

Municipal guarantees are defined as the obligation of a guarantor (a municipality) in writing to the effect that it accepts liability for the full or partial fulfilment by a borrower of its obligation vis-à-vis a creditor, such guarantee to be covered by the funds of the municipal budget.
The procedure and the terms and conditions of issuing state and municipal guarantees are set forth in the Russian Federation Budget Code (hereinafter referred to as the "**RF BC**") as well as the regulatory legal acts of subjects of the Russian Federation and municipal formations.

A guarantee must provide information on the guarantor, including its name (the Russian Federation, a subject of the Russian Federation, a municipal body and the name of the responsible authority issuing this guarantee on behalf of the named guarantor, while also specifying the commitment under the guarantee.

The guarantee's term depends on the expiration date of the obligations for which a guarantee is being issued; however, it shall not exceed 30 years for state guarantees and 10 years for municipal guarantees.

If a state guarantee is issued, the guarantor's obligations may be listed in foreign currency amounts; some restrictions apply to municipal guarantees.

A guarantor issuing a state or municipal guarantee takes on *secondary* liability in addition to the debtor's obligations it guarantees.

This means that prior to submitting its claim to a guarantor, a creditor must enforce its claim vis-à-vis the debtor. Should the debtor fail to satisfy the creditor's claim, or should it satisfy the claim only in part, the unsatisfied portion of this claim may be submitted to the guarantor (Article 399 of the Russian Civil Code).

Judgements delivered by Russian courts regarding this secondary liability show that the debtor's failure to satisfy the creditor's claim must be supported by a valid court ruling as to the debt being enforced. A creditor must prove that it was impossible to enforce a court ruling vis-à-vis the debtor by presenting documents on the closing of the enforcement proceedings pursuant to the Federal Law "On Enforcement Proceedings" No. 119-ФЗ of July 21, 1997.

The maximum liability that state and municipal guarantees may agree to is established by legislative acts establishing the budgets of the relevant governmental levels as adopted annually by them. In practice, this means that it may become impossible to enforce a guarantor's obligation as there are no mechanisms under Russian civil law for the formulation of state/municipal budgets so that a binding maximum annual cost for provision of guarantees could be established.

A state/municipal guarantee is issued as a guarantee contract. This must be concluded in writing in order to be effective.

It should be noted that the Russian Federation is not liable for any debts incurred by states of the Russian Federation that it has not guaranteed.

Subjects of the Russian Federation and municipal formations are not liable for each other's liabilities, unless these liabilities were guaranteed by them, as well as for liabilities of the Russian Federation.

2.3.4 Guarantees Issued by Export Credit Agencies (ECA)

Many countries have special organisations that assist domestic producers in selling their goods (as a rule it is equipment) abroad. They are called export credit agencies.

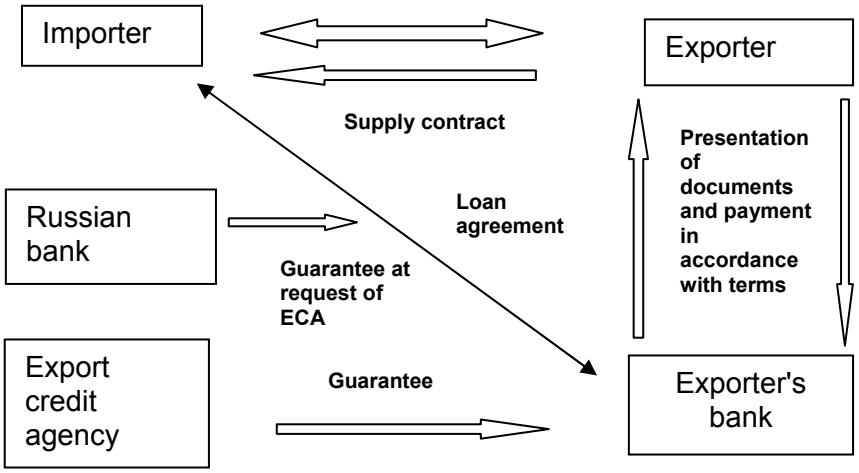
The following are the best-known export credit agencies:

- **Austria:**
  Österreichische Kontrollbank AG (OeKB) - www.oekb.co.at
- **Belgium:**
  Ducroire / Delcredere (ONDD) - www.ducroire.be
- **Canada:**
  Export Development Canada (EDC) - www.edc.ca
- **Denmark:** Eksport Kredit Fonden (EKF) - www.ekf.dk
- **Finland:**
  Finnvera (Export Credit Agency) - www.finnvera.fi
  FIDE (Interest Support Institution) - www.fide.fi

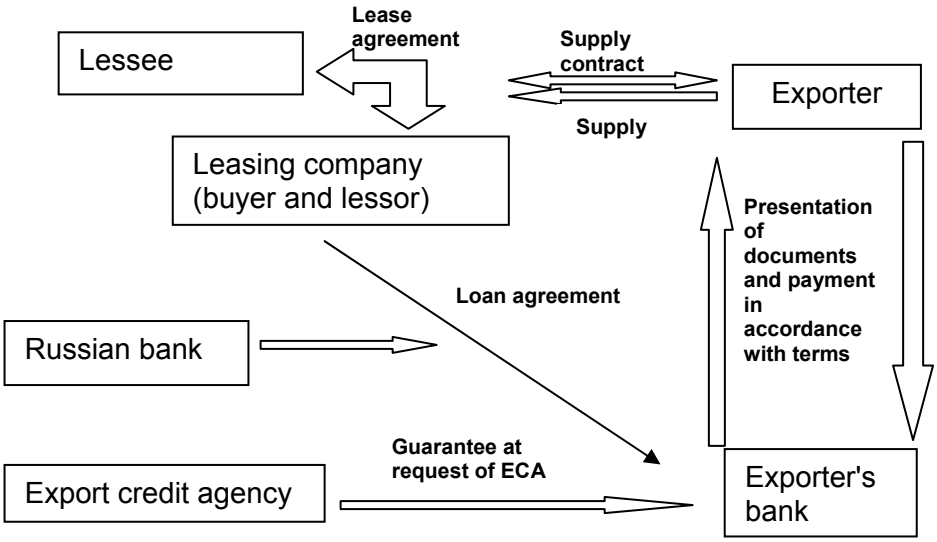
- **France:**
  Coface (Export Credit Agency) - www.coface.fr
- **Germany:**
  Hermes (Export Credit Agency) - www.eulerhermes.com; www.agaportal.de
  KfW (Interest Support Institution) - www.kfw.com
- **Italy:**
  SACE (Export Credit Agency) - www.isace.it
  SIMEST (Interest Support Institution) - www.simest.it
- **Japan:**
  Japan Bank for International Co-operation (JBIC) - www.jbic.go.jp/english/index.php
- **Sweden:**
  Swedish Export Credits Guarantee Board, Export Kredit Namnden (EKN) - www.ekn.se
  Swedish Export Credit Corporation (SEK) - www.sek.se
- **United States:**
  Export-Import Bank of the United States, (US EX-IM) - www.exim.gov
- **United Kingdom:**
  Export Credits Guarantee Department (ECGD) – www.ecgd.gov.uk/index.htm

To demonstrate how this type of security operates, a few examples are set out below of the financing models used by various banks with the participation of Euler Hermes (Germany) export credit agency.

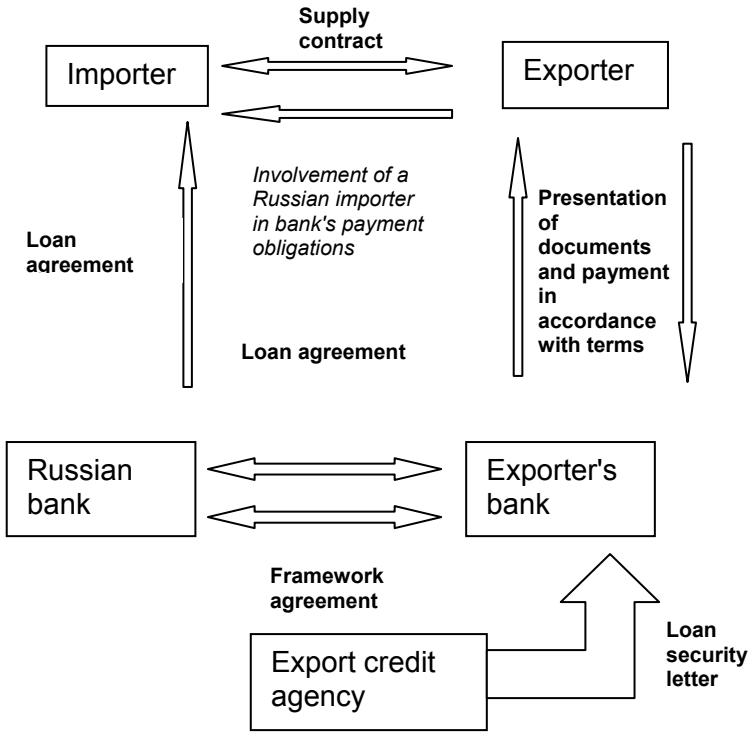
The most widespread form of securing such loans is to take out insurance for the importer's obligation. This means that the exporter's bank will grant a loan to the importer for a part of the order amount. The importer then pays the amount owed to the exporter as a pre-payment. In many instances, economic and political risks are insured against by federal financial credit coverage taken out with Euler Hermes. As a rule, this export financing provided by Euler Hermes is to be redeemed within an approximately five year period, depending on the loan amount. Additionally, should the expert credit agency so require, the loan agreement concluded by the Russian importer and an exporter's bank may be covered by a guarantee of a Russian bank.



In other cases, a loan is granted to the buyer on leasing terms. Here the buyer (importer) acts as a lessor, under a lease agreement with the lessee. The exporter's bank advances a loan secured by an export credit agency, which in turn, may request additional coverage in form of a Russian bank issued guarantee covering the obligations under the loan agreement.



When it becomes apparent after evaluation of an importer's financial standing, that the importer's bank should be involved as the borrower of a loan, inter-bank loans with integrated coverage from an export credit agency are a sensible solution. A loan agreement is then concluded with a bank at the location of the importer, and this bank will represent the importer's interests. Both banks conclude a framework agreement containing all terms and conditions (bank's commission for granting a loan, margin, etc.). Once a supply contract is then entered into, only an individual loan agreement with the importer will be made. It is recommended to use inter-bank loans when several supply contracts involving lesser volumes are concluded, since in these cases, a separate loan agreement for each individual contract would not be sensible in economic terms.



2.3.5 Assignment of Claims under a Loan Agreement

The banks payment claim against the borrower based on a loan agreement, may be assigned to another entity under an assignment agreement.

Russian statutory law and the jurisdiction of the Russian courts require that the assigned claims need to:

- be clearly specified at the date of assignment;
- be valid at the date of concluding the assignment agreement;
- not have been caused by set-off on the part of an assignor (a creditor).

It is not necessary for the borrower to have consented to the bank assigning its rights under a loan agreement to a third party, unless otherwise provided for by the loan agreement.

The bank assigning its claims to a third party must hand over the documents supporting its claims to the assignee and provide the information relevant to their enforcement.

Unless otherwise provided for in the loan agreement, the bank's rights are then assigned to the new creditor to the extent and under the same terms and conditions that existed at the date of assignment. In particular, all rights securing the claim as well as all other claim-related rights, including the right to outstanding interest, transfer to the new creditor.

Russian law and the jurisdiction of the Russian courts allow banks to assign claims under loan agreements to other entities that do not have a license for banking services.

2.3.6 Cross-Stream and Up-Stream Collateral under a Loan Agreement in the Russian Law

Cross-stream and up-stream collateral are used in international banking practice as forms of guarantee.

Cross-stream collateral is used when a bank grants loans to several affiliated companies. Loan agreements of such companies may be secured by assets of any of the companies. For example, a bank may grant loans to the affiliated companies A, B and C under separate loan agreements. Company A grants a mortgage in favour of the bank and such mortgage secures all three loan agreements.

Upstream collateral is such a form of guarantee when liabilities of the "mother company" under the loan agreement are secured by assets of a "daughter" company (pledge/surety).

Russian legislation allows for such guarantee forms and does not contain any specific restrictions for the companies to use cross-stream and up-stream collateral under the loan agreements (e.g. thin cap rules in the German law on limited liabilities companies).

The law only establishes general requirements for the alienation of assets by a company (including by way of pledge, surety, or loan), the value of which is in excess of 25 per cent of the book value of the company's assets.

Otherwise, those legislative provisions apply, which specifically deal with the type of guarantee in question (e.g. pledge or surety, as described in the previous paragraphs).

2.4 Enforcement of a Bank's Rights in Disputes

2.4.1 Jurisdiction

Parties to an international agreement under civil law may choose the law applicable to their agreement as well as the location at which disputes arising from their contract are to be settled. .

In dealing with the question of jurisdiction, foreign banks should bear in mind that rulings issued by foreign courts will be recognised and can be enforced within the territory of the Russian Federation only if Russia and the respective other state are party to an international treaty on mutual legal assistance. No such treaty is in place between Russia and Germany. Therefore, it is not possible to enforce a ruling of a German court on the territory of the Russian Federation.

Like most nations in which foreign banks carry out their activities, Russia is also a party to the UN Convention "On the Recognition and Enforcement of Foreign Arbitral Awards" (concluded in New York in 1958). For this reason, loan agreements concluded between foreign banks and Russian borrowers regularly contain an arbitration clause, according to which disputes are to be settled in international commercial arbitration tribunals.

In practice, disputes between Russian and foreign parties are usually resolved by the Arbitration Institute of the Stockholm Chamber of Commerce (the SCC Institute) (Sweden), the ICC International Court of Arbitration at the International Chamber of Commerce in Paris (ICC), the International Arbitral Centre of the Austrian Federal Economic Chamber in Vienna (Austria), and at the similar arbitration tribunal in Germany (Deutsche Institution für Schiedsgerichtsbarkeit) (DIS).

Among the permanently operating arbitration tribunals within the Russian Federation, the following courts deserve noting due to their prominence and the number of cases reviewed:

- the International Commercial Arbitration Court at the Chamber of Commerce and Industry of the Russian Federation (Moscow);
- Arbitration courts at the Chambers of Commerce and Industry of Moscow, St. Petersburg, Nizhny Novgorod, Novosibirsk, Yekaterinburg, as well as other large economic centres of the Russian Federation.

2.4.2 Enforcement of Arbitral Awards

2.4.2.1 Recognition and Enforcement of a Foreign Arbitral Award within the Territory of the Russian Federation

Foreign arbitral awards are implemented in the Russian Federation in two stages.

The first stage entails recognition by the arbitration courts within the territory of the Russian Federation of the awards issued by the foreign commercial arbitration courts. A foreign applicant must therefore file a petition with the competent arbitration court for recognition of the foreign arbitral award. After reviewing this petition, the arbitration court rules on the recognition and enforcement of a foreign arbitral award (Article 31 of the Arbitration Procedure Code of the Russian Federation (hereinafter referred to as the "**APC RF**").

On a second stage, a writ of execution is issued to the claimant and enforcement proceedings are initiated.

The foreign arbitral award is enforced on the basis of a writ of execution issued by the arbitration court ruling on the recognition and enforcement of the foreign arbitral award in accordance with the APC RF procedure and the Federal Law "On Enforcement Proceedings" No. 119-ФЗ of July 21, 1997 (hereinafter referred to as the "**Law on Enforcement Proceedings**").

The foreign arbitral award must be enforced within three years after entering into force. After such time, the arbitration court may grant reinstatement upon a petition of the claimant in accordance with the procedure set out in the APC RF.

It should be noted that generally, enforcement of arbitral awards issued in the territory of the Russian Federation is optional. However, if a debtor refuses to submit to the arbitral award voluntarily, the award shall be enforced in the course of special proceedings requiring the issue of a writ of execution. The arbitral awards issued in the territory of the Russian Federation are not subject to recognition procedures.

2.4.2.2 Compulsory Execution

In the Russian Federation, claims are generally enforced against the debtor's liquid assets held in bank accounts or cash.

Other assets of the debtor are used in enforcement of the claim only if such liquid assets are not available (or insufficient).

The claim is enforced against the debtor's assets by:

- Arrest (attachment) of the debtor's property. This process includes an inventory of the debtor's assets, prohibition of their alienation, and, if required, restricting usufructs in respect of the assets;
- Confiscation of the debtor's assets;
- Compulsory sale of the assets by a specialised institution. Such sale is to be carried out within 2 months following the date on which the property was attached.

2.4.2.3 Special Aspects of Performance of Obligations in the Event of the Debtor's (Borrower's, Pledgor's, Surety's) Insolvency

Pursuant to the Federal Law "On Insolvency (Bankruptcy)" No. 127-ФЗ of October 26, 2002, the following order is to be observed in satisfying creditors' claims:

- The first rank is occupied by claims for personal injury to life or limb, whereupon future payments are capitalised;
- The second rank of claims to be settled are those of employees for severance pay, claims to salaries under employments agreements both of current and former employees, and claims for remuneration under copyright agreements;
- The claims of other creditors are to be settled last and take third rank.

Claims that are secured by a pledge over the debtor's property are to be satisfied using the object pledged, such settlement taking priority over claims of any other creditor. However, claims of creditors of the first or second rank created prior to the conclusion of the pledge agreement shall not be superseded.

This means that if a bank has a claim against its borrower, a surety or a pledgor and if that borrower, surety or pledgor is insolvent, the bank's claims will rank third in the order of settlement.

It should be noted that settlements with creditors who are also pledgees take priority over the settlement of claims held by other third-ranking creditors.

2.5 Special Aspects of Syndicated Lending

In practice, syndicated lending provides banks with the opportunity of accumulating funds for large-scale financing of borrowers by spreading the risk between the participants. For the banking system as a whole, syndicated lending is a factor contributing to its stability.

The notion of a syndicated loan and the various forms it may take have been set out in Instruction of the CBRF No. 110-*И* of January 15, 2004 "On Obligatory Banking Standards".

A syndicated loan is a loan that two or more banks issue together by entering into an agreement with one another and accepting to bear a share of the risk.

The following parties can be the participants of a syndicated loan:

- A borrower;
- The lead manager coordinating the activities prior to the loan agreement being concluded (as a rule, lead banks are large foreign banks who have been part of several successful syndicates);
- The co-manager responsible for clearing, preparing and coordinating the documentation.

The CBRF has introduced the following classification of syndicated loans:

- **A jointly initiated syndicated loan** is the aggregation of single loans (hereinafter referred to as loans) granted by creditors (participants of a syndicated loan or a syndicate) to a borrower.
- **An individually initiated syndicated loan** is a loan initially granted by a bank (initial creditor) in its own name and at its expense to a borrower, the claims of which are subsequently assigned by this initial creditor to third parties (banks participating in a syndicate).
- **A syndicated loan granted without syndication conditions having been specified** is a loan granted by the bank arranging syndicated lending (referred to as a syndicate arranger) to a borrower in its own name, subject to the terms of a loan agreement concluded with a borrower, which is subject to the requirement that the syndicate arranger in turn take out a loan agreement with a third party (third parties).

In Russia, banks currently mostly grant syndicated loans in which no syndication conditions have been specified.

In spite of the fact that the Russian syndicated loan market is developing dynamically, some factors are restraining it.

The key problem for the field of syndicated loans in Russia is the fact that no clear legal standards governing syndicated loans exist, nor are there any uniform standards for the documentation that needs to be submitted.

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