

Legal Newsletter – „Financial and Capital Market Developments in Russia“

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1. Insurance and Pension Funds

Draft Law on Insurer’s Taxation The State Duma of the Russian Federation is considering a draft law which addresses the issue of the taxation of insurers in connection with implementation in the territory of the Russian Federation of the direct claims adjustments system under the Law “On Motor Third-Party Liability”. The alterations are to introduce (i) VAT exemptions with regard to an insurer that received money under an agreement on direct claims adjustments, (ii) possibility to include such money into costs for calculating income tax base and (iii) the possibility to include the costs of payments for the services of specialists supporting an activity within an agreement on direct claims adjustments into the costs for calculating the income tax base.

Draft Law on Bankruptcy Procedures in Financial Companies The State Duma of the Russian Federation intends to consider a draft law on amending the Federal Law “On Insolvency (Bankruptcy)” that has been proposed by the Ministry of Economic Development of the Russian Federation. The concept of the draft law concerns the specific activity of such financial organizations as insurance companies, management companies, non-state pension funds and special depositories in cases of insolvency procedures and to cover measures of preventing the bankruptcy of such financial organizations. The proposed draft law aims to shorten the insolvency procedure and to empower the controlling authority to introduce a temporary administration which either resumes the paying capacity of the company or decides on the expedience of the bankruptcy of the company. It should be noted that at present the introduction of a temporary administration is provided for credit organizations only. In particular, among other measures, the draft law intends to prevent bankruptcy by way of reducing the actual amount of assets and obligations of a given

company and to change the structure of the assets covering equity funds.

Approval of New Forms of Documents for Payment of Pension Accruals to Successors of the Deceased Insured Person The following new forms of documents for non-state pension funds were adopted by the Ministry of Health and Social Development of the Russian Federation¹:

- decision on the payment of pension accruals to the successors of deceased insured persons;
- decision on the additional payment of pension accruals to successors;
- decision on the refusal of payment of pension accruals to successors;
- decision on the determination of the successor’s share of pension accruals;
- decision on the transfer of pension accruals to the reserve of the Pension Fund of the Russian Federation on obligatory pension insurance.

Pension Reserves Structure According to the changes introduced by the Federal Financial Markets Service of the Russian Federation² (hereinafter – “FFMS”), the pension reserves of a non-state pension fund, along with shares of a foreign joint-stock company and bonds of foreign commercial organizations, may include shares (participatory interest, units) of foreign investment funds on the condition of having listed them with one of the stock-exchanges approved by the FFMS.

2. Capital Market and Securitization

Foreign Financial Instruments – Newly Adopted Legislation

New Regulation on Recognition of Foreign Financial Instruments as Securities³ (hereinafter

¹ Order of Ministry of Health and Social Development of the Russian Federation No.796 of December 24, 2007

² Order of Federal Financial Markets Service of the Russian Federation No. 07-110/пз-н of December 25, 2007

³ Approved by the Order of the FFMS of the Russian Federation of October 23, 2007 No. 07-105/пз-н.

–“**Regulation**”) came into force on February 1, 2008. The Regulation stipulates that a foreign financial instrument can be qualified as a security if: (a) it has both the ISIN and CFI identification codes or (b) it is qualified by the FFMS as a security on a case-by-case basis⁴. The mentioned ISIN and CFI codes are assigned by a member of the Association of National Numbering Agencies (ANNA) (in Russia it is presented by the National Depository Centre (NDC)).

As regards the qualification by the FFMS on a case-by-case basis, we note that it would only be possible to the extent that the features of the security or financial instruments resemble that of a "mass-issued security" (i.e., issued in a series or tranches and which provide the same equal volume of rights and equal periods for the exercising of such rights within a single issue, irrespective of the time of acquisition of such security).

The **Amendments to the above-mentioned Regulation**⁵ entered into force on March 12, 2008. The general rule is that professional participants are prohibited from engaging in professional activities and conducting operations with foreign financial instruments which are not recognized as securities in accordance with the Regulation⁶. However, in particular cases, the amendments allow brokers and securities managers to conduct operations with foreign financial instruments which are not qualified as securities in accordance with the Regulation. Such operations may be carried out only in respect of qualified investors. Further, the regulations for depository records of such “unrecognized” foreign financial instruments are introduced along with the stipulations of the confirmation of the foreign financial instruments’ recognition. Additionally, the amendments introduce a transition period of until 1 July 2008 during which professional participants of securities markets should bring their operations into compliance with the new regulations.

⁴ The Decree of the FFMS of the Russian Federation of December 24, 2003 N 03-48/nc “On the Order of Securities’ Qualification”

⁵ Approved by the Order of the FFMS of the Russian Federation of January 22, 2008 N 08-2/03-n

⁶ Section 3 of the Order of the FFMS of the Russian Federation of October 23, 2007 No. 07-105/ПЗ-Н.

New in the Regulation of Capital Adequacy Requirements

Increase of the Minimum Normative Amount of Capital Adequacy The Order of the FFMS⁷, effective as of January 1, 2008, provides for an increase in the requirements of capital adequacy for professional market participants, management companies for joint-stock investment funds, unit investment funds and non-state pension funds, which are to be fulfilled in order to reduce the risks of their professional activity.

Further, the FFMS Order of 25 December 2007 N 07-112/ ПЗ-Н has supplemented the above-mentioned capital adequacy requirements and allows the reducing of their normative standards up to 20%. According to this Order, professional participants may reduce their capital adequacy normative by (i) effecting the insurance of the professional liability (ii) obtaining an application for a Self-Regulatory Organisation. Capital reduction may not exceed 20% and may not be above 25% of the insurance sum. Therewith, the Order specifies the conditions to be fulfilled: (i) the particular term of the insurance agreement’s validity, (ii) the insurer’s obligations to provide reimbursement at the onset of a particular insured event and (iii) an insurance company is to have existed for at least three years. In addition, the Order establishes stipulations about the application of a Self-Regulatory Organisation (of which professional participant are members) and terms of the filing of such application.

Changes in the Regulations on Securities Market

Additional Requirements for Issuers Carrying out Self-sustained Securities Registry’s Maintenance In its Order of December, 27 2007, the FFMS⁸ provided that issuers which maintain securities registers of securities owners by themselves should fulfil additional requirements. In particular, such issuer should provide at least one employee, having a qualificati-

⁷ The Order of the FFMS of the Russian Federation of April 24, 2007 No.07-50/ ПЗ-Н

⁸ The Order of the FFMS of the Russian Federation of December 27, 2007 No. 07-113/ ПЗ-Н “On Demands to the Order of Maintenance of the Securities Registry by Securities Issuers”

on certificate of a registry maintenance specialist. The respective issuers are to bring their activity into compliance with the mentioned requirements within 6 months from the date of the entering into force of this FFMS Order (February, 24 2008).

New Procedures for FFMS Examinations

Examinations of organisations subject to FFMS control will be carried out in accordance with the new regulations. Firstly, the Statute „On Conducting of Examinations of Organisations Liable to FFMS Control”⁹ has entered into force on March 1, 2008. This Decree regulates the procedures for the conducting of the FFMS examination of professional market participants and their Self-Regulatory Organisations, issuers, management companies for joint-stock investment funds, unit investment funds, non-state pension funds and their Self-Regulatory Organisations; special depositaries for joint-stock investment funds, unit investment funds and non-state pension funds; managers of mortgage coverage; special depositaries for mortgage covers and other financial markets participants. In particular, the Statute provides that in specific cases the examination of appeals and applications of persons and legal entities concerning probable breaches of legislation may be carried out without appointments of a desk audit, only by way of a request of the necessary information and documents.

Following this regulation, the particular procedures for the carrying out of the examinations are settled by the new FFMS Administrative regulation¹⁰.

New Regulation on the Organisation of Securities Market Trading

Organisors of trading activities (including stock exchanges) and professional market participants are to bring their activity into compliance with the requirements of the new Statute „On Activity of Organisation of Securities Market Trading”¹¹ by 1 March 2008. The Statute came into force on

January 1, 2008. In particular, the Statute includes additional stipulations on the termination and stoppage of bidding by the organisor. It is provided that such requirements are to be applied to both the principal and supplementary trading sections. It should be noted that the State Duma of the Russian Federation is considering a draft law concerning exchanges and organised trading. This draft law, if adopted, would be followed by the altering of relevant specific regulations.

Draft Law on the Changes to the Securities Market Law

The State Duma of the Russian Federation is considering Draft Laws relative to the introduction of amendments into the Securities Market Law and separate respective legal acts. The forthcoming amendments concern (i) the simplification of securities issuing, (ii) regulation of Russian Depository Receipts, (iii) acquisition regulations and (iv) securities management regulations.

Changes in the Law on Investment Funds

The amendments to the Federal Law “On Investment Funds”¹² introduce significant changes made to the regulation of the activity of investment funds (hereinafter- “**IF**”). The new legislative provisions, *inter alia*, concern the following:

- shares/units of IF can be purchased only by qualified investors. This means that the shares/units are limited in circulation and operations therewith may be carried out only by qualified investors;
- the name of a unit of investment fund shall contain an indication of the contents and the structure of its assets;
- the possibility to change one particular type of a unit of investment fund to another a strictly defined type of investment fund unit;
- in the case of the bankruptcy of the managing company (hereinafter – “**MC**”), cash assets credited to the transit account of the MC for the payment for the investment unit, are not included in the bankruptcy estate;

⁹ Approved by the Order of the FFMS of the Russian Federation of November 13, 2007 N 07-108/ПЗ-Н

¹⁰ Approved by the Order of the FFMS of the Russian Federation of November 13, 2007 N 07-107/ПЗ-Н

¹¹ Approved by the Order of the FFMS of the Russian Federation of October 09, 2007 N 07-102/ПЗ-Н

¹² Federal Law of December 6, 2007 No.334-FZ “On Amending the Federal Law on Investment Funds and Other Legislation Acts of the Russian Federation”

- the procedure of the establishment of the IF is clarified;
- the introduction of the requirement on the registration of the rules of maintenance of the register of the investment units holders with the FFMS;
- the introduction of new requirements and procedures for the obtaining of licenses as well as the grounds and procedure for the cancellation of licenses;
- authorization of the FFMS to prohibit share and unit investment funds from conducting certain operations.

Securitization of Mortgage Loans

The State Duma of the Russian Federation is considering a draft law on amending the Mortgage Law and the Mortgage Securities Law¹³. The draft law is mainly aimed at improving safety and reducing the time required for one of the stages of the securitization of mortgage loans – the transfer of large pulls of mortgage papers (*zakladnaya*). The draft law addresses the relationship with regard to the transfer of mortgage papers for the recording of the rights thereon by the depositary (immobilization). There are two immobilization procedures:

- when filling-in the mortgage paper, the pledgor specifies that the rights thereon are subject to permanent recording in the depositary;
- in cases in which the mortgage paper has already been issued, its holder has the right to endorse it; according to such endorsement the mortgage paper for the purpose of recording the rights thereon is transferred to the depositary.

Upon the transfer of the mortgage paper to the depositary (its immobilization), all operations therewith are carried out in the form of records in the security account with the depositary. During the entire period of the immobilization of the mortgage paper, the rights on it are transferred as of the moment of its entry into a record on the security account; the right of pledge on the mortgage paper originates as of the moment of the recording of this fact by the depositary. Within the mentioned period of time, no remarks or notes are to be made on the mortgage paper with regard to its new owner or origin of pledge.

¹³ www.akdi.ru

The introduction of the new law will favor the conditions for the effective creation and transfer of mortgage collateral, which serves as a security for the fulfillment of the obligations towards the owner of the mortgage securities. Mortgage securities risks and expenses decrease will enhance the reliability of mortgage securities. On the whole, the adoption of the draft law will contribute to the securitization of mortgage loans.

3. Banking Law

New in the Regulation of Bank Activity

Definition of Internal Structural Subdivision of Credit Organizations Pursuant to the amendments to the Federal Law “On Banks and Banking Activity”¹⁴, an internal structural subdivision of a credit organization (its branch) is its subdivision located in a place other than the domicile of the credit organization (its branch) which performs banking operations on behalf of the credit organization, the list of which is set forth by the legal acts of the Central Bank of the Russian Federation (hereinafter – “**CB RF**”), within the scope of the license of the CB RF granted to the credit organization (branch regulations). The forms and procedure for the establishment of internal structural subdivisions of credit organization (its branch) are specified in the legal acts of the CB RF.

Short Names of Credit Organizations In accordance with the Federal Law “On Banks and Banking Activity”, the official name of a credit organization must contain a reference to the type of its activity by using the words “bank” or “non-banking credit organization”. However, the Law does not specify whether the above-mentioned words should be used in the full or short name of the credit organization. In this respect the CB RF in its letter¹⁵ clarifies that in cases when the full name of the credit organization contains the words “bank” or “non-banking credit organization”, the short name of the credit organization may contain such abbrevia-

¹⁴ Federal Law of March 3, 2008 No.20-FZ “On Amending Article 22 of the Federal Law “On Banks and Banking Activity” – will enter into force within 10 days as of the date of its official publication.

¹⁵ The Letter of the CB RF No. 11-T of January 31, 2008

tions commonly used in business practice as, for example, АКБ, КБ, НКО, etc.

Cross-sectional Study of Prepayment of Mortgage Home Loans The CB RF approved the form of cross-sectional study of prepayment of mortgage home loans and specified the procedure for the submission thereof by credit organizations to the relevant offices of the CB RF¹⁶.

4. Anti-money Laundering Legislation

Moratorium on Applying Sanctions for Non-compliance with the New Requirements of the Anti-money Laundering Law In its Letter of January 14, 2008 No.5-T, the CB RF recommends to applying only preventive measures to credit organizations for the non-fulfillment of the new requirements up to May 15, 2008 (effective as of January 15, 2008) of the Anti-money Laundering Law¹⁷.

Identification of Foreign Public Officials In its Letter of January 18, 2008 No.8-T, the CB RF clarifies the issues in relation to the fulfillment of the Anti-money Laundering Law provisions concerning the obligation of organizations performing operations with monetary funds or other property to identify foreign public officials.

Changes in the Forms of Settlement Documents In compliance with the new requirements of the Anti-money Laundering Law, the CB RF introduced the relevant changes in the forms of the settlement documents and the procedure for the completion thereof¹⁸.

¹⁶ Directive of the CB RF of January 21, 2008 No. 1963-Y “On Cross-sectional Study of Prepayment of Mortgage Home Loans”

¹⁷ Federal Law of November 28, 2007 No.275-FZ “On Amending Articles 5 and 7 of the Federal Law “On Countering Legalization of Income (Money Laundering) Derived from Criminal Activity and Financing of Terrorism”. Please see also our previous Bulletin (January 2008) in this respect.

¹⁸ Directives of the CB RF of January 22, 2008 No.1964-Y and No.1965-Y

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