

### 3.24 RUSSIA

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#### I. FRAMEWORK

In Russia, the legal basis for covered bonds is the Law on Mortgage Securities.<sup>2</sup> This law is supported by rules in the Mortgage law, the Bankruptcy law, the Credit organisations bankruptcy law and Securities market law.

In addition the Central Bank of the Russian Federation (CBRF) issued the Mortgage cover mandatory requirements instruction<sup>3</sup>. The Federal Financial Markets Service (FSFR) released

- > the Mortgage cover determination order,<sup>4</sup>
- > a joint order containing (i) the Special depositor decree and (ii) the Register maintenance rules<sup>5</sup> and
- > the Mortgage administrator/cover special depositor data reporting decree<sup>6</sup>.

Further rules are in general regulations of the CBRF and the FSFR.

#### II. STRUCTURE OF THE ISSUER

The Russian Law on Mortgage Securities foresees three types of securities:

- > Two types of "mortgage obligations"<sup>7</sup> (art. 7 sec 1<sup>8</sup>): Obligations<sup>9</sup> issued
  - (i) by a credit organisation (covered bonds) or
  - (ii) by a SPV ("mortgage agent") (MBS).
- > Mortgage participation certificates (art 17 – 31). These certificates are similar to investment fund certificates, giving a direct share in the mortgage secured loans. Due to their different structure in this article we will not look after them.<sup>10</sup>

Obviously the mortgage obligations issued by credit organisations, are oriented on the European covered bond model, those mortgage obligations issued by SPVs on the MBS model. As many rules in the law apply similarly for both types of securities, for a better understanding they will be presented here together.<sup>11</sup>

1 Special thanks goes to colleagues from Bank VTB Capital and DeltaCredit for proofreading and commenting on this article.

2 In this Fact Book edition the correct translation for the title of the law is used (in Russian: Federal'nyy zakon "Ob ipotechnykh tsennykh bumagakh"). Instead of "Covered bond law", as in the former editions. A list of the legal framework is attached to the country report in ECBC Fact Book 2010, p 274 – 276.

3 Instruction of the CBRF dated 31 March 2004 No 112-I "On mandatory requirements for credit organisations, issuing securities with mortgage cover". Last amendment: Direction dated 21 January 2011 No 2569-U, published Herald (Vestnik) of the CBRF No 12 (1255) dated 22 February 2011).

4 Order dated 1 November 2005 No 05-59/pz-n "On confirmation of the Decree on the method of determination of the mortgage cover". Last amendment by Order dated 21 January 2011 No 11-1/pz-n (pt 4) published Bulletin (Byulleten') of Normativ Acts of Federal Executive Authorities 2011, No 17, registration no (Ministry of Justice) 20290.

5 Order dated 1 November 2005 No 05-60/pz-n "On confirmation of the Decree on the activity of the special depositor for the mortgage cover and the Rules of the maintenance of the register of the mortgage cover".

6 Order dated 15 December 2009 No 09-57/pz-n "On confirmation of the Decree on data reporting of the administrator of the mortgage cover and the Decree on data reporting of the specialised depositor of the mortgage cover"

7 Language of the law: "Obligations with mortgage cover".

8 Law citations without link are citations of the Law on Mortgage Securities.

9 A special type of mortgage obligations are "Housing mortgage obligations" (in Russian "zhilishchnaya obligatsiya s ipotechnym pokrytiem"): Their cover pool consists only of claims, secured by mortgages over housing premises (art 3 pt 5).

10 For details see: Gabov, Andrey V.: Tsennye bumagi (Securities), Moscow 2011, p 518 – 525.

11 Knowing, that in fact MBS are no covered bonds!

As a general rule mortgage obligations are secured by basically static cover pools (other as dynamic cover pools in most other European countries<sup>12</sup>). Even if the Russian Law on Mortgage Securities allows several issues from one cover pool, the cover for every issue is static and can be modified only in some cases, stipulated by the law. Nevertheless, different from classic MSB structures, a dynamic element is implemented: For already issued covered bonds, permanently new mortgage secured claims have to be added, to secure the volume of the cover pool (art 13 sec 1 para 2).

### **1. Credit institution (art 7 sec 2)**

A credit organisation has to comply with the Banking law and the rules, set up by the Central Bank for covered bond issuing credit organisations. If the credit organisation does not fulfil the statutory requirements, the licence can be revoked (art 20 sent 1 no 10 Banking law).

By pt 2 and 3 Mortgage cover mandatory requirements instruction<sup>13</sup> the CBRF has set up special regulations for:

- > Minimal ratio between the cover pool and the equity of the credit organisation: 10% (pt 2.3 Mortgage cover mandatory requirements instruction),
- > Minimal ratio between the volume of the cover pool and the volume of the issued covered bonds: 100 % (pt 2.4 Mortgage cover mandatory requirements instruction),
- > Maximum ratio of all claims against the credit organisation, privileged before the covered bond holders<sup>14</sup> and the equity: 50% (pt 2.5 Mortgage cover mandatory requirements instruction).

The Central Bank has not used its right to set a limit special limit for covered bond issuers of the interest rate and foreign exchange risk.<sup>15</sup>

### **2. SPVs (mortgage agents, art 8)**

The mortgage agent has to be a joint stock company, its only task is the purchase of mortgage secured credits (loans) and issuance of covered bonds (art 8 sec 1 para 1). This has to be foreseen in its charter, these parts of the charter can not be changed or amended later (art 8 sec 1 para 4).

In the founding documents of the mortgage agent has to be stipulated the number of covered bond issues, this agent is founded for. After this issuance(es) the mortgage agent has to be liquidated (art 8 sec 1 para 6).

A mortgage agent is not allowed to have employees. As executive organ a commercial organisation has to act, the bookkeeping has to be done by a specialized organisation (different from the executive

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12 European Central Bank: Covered Bonds in the EU Financial System, December 2008, p. 7.

13 Instruction of the CBRF dated 31 March 2004 No 112-I "On mandatory requirements for credit organisations, issuing securities with mortgage cover", based on art 7 sec 2 para 1 and 2 Law on Mortgage Securities.

14 Due to art 50.36 sec 3 and 4 Credit organizations bankruptcy law physical persons as holders of deposits have to be served before creditors secured by a pledge. Despite the regulations, that the cover pool is separated from the bankruptcy estate, the ranking between physical deposit holders and mortgage securities' holders is not clear.

15 But issuing credit organisations have to describe the f/x and the interest rate risk in the prospectus (annex 5 pt 3.5.3.2 and 3.5.3.3 Instruction 128-I/2006). For f/x risk see: Efimova, L. G.: Bankovskoe pravo (Banking law) – Tom (volume) 1, Moscow 2010, p 88 et seq.

19 The former rule of a general liquidity of 20% for mortgage securities' issuers (former pt. 2.2 Mortgage cover mandatory requirements instruction) was abolished by CBRF-Direction dated 18 February 2005 No 1550-u.

20 Even not by general rules, although it is foreseen in art 62 Central bank law. But issuing credit organisations have to describe the f/x and the interest rate risk in the prospectus (annex 5 pt 3.5.3.2 and 3.5.3.3 Instruction 128-I/2006). For f/x risk see: Efimova, L. G.: Bankovskoe pravo (Banking law) – Tom (volume) 1, Moscow 2010, p 88 et seq.

organ organisation). If the commercial organisation, acting as executive organ, exercises transactions in contrary to the list of allowed transactions, these transactions will be on account of the commercial organisation, not of the mortgage agent (art 8 sec 2).

The mortgage agent is not allowed to sign contracts against payment with physical persons or to perform commercial activities other than stipulated in the Law on Mortgage Securities. In case of breach of this rule, the FSFR may apply for liquidation of the mortgage agent (art 8 sec 3).

The FSFR has the right to set up rules on capital requirements, field of activities, bookkeeping and accounting of mortgage agents (art 43 sec 1).

### **Protection of terms:**

Due to art 6 the words "obligation with mortgage cover" (in Russian "obligatsiya s ipotechnym pokrytiem"), mortgage participation certificate ("ipotechnyj sertifikat uchastiya"), mortgage cover ("ipotechnye pokrytie"), mortgage agent ("ipotechnyj agent") and "mortgage specialized organisation" ("ipotechnaya specializirovannaya organisatsiya")<sup>16</sup> may be used only for the purposes of the Law on Mortgage Securities.<sup>17</sup>

### **III. COVER ASSETS**

Eligible assets under the Russian Law on Mortgage Securities are mortgage secured claims under a loan or credit agreement, including interest (art 3 sec 1). These secured claims may be certified by mortgage certificates ("zakladnaya", art 13 – 18 Mortgage law)<sup>18</sup> or mortgage participation certificates under the Law on Mortgage Securities.

Eligible are also money in Russian and foreign currency, state bonds and real estate (art 3 sec 1). Real estate can only be used as cover, if it is purchased in foreclosure of a cover mortgage (art 3 sec 1; 13 sec 1 para 3).

Requirements for eligible mortgage secured claims are:

- > The mortgage shall content a prohibition on sale of the mortgaged property by the mortgagor without consent of the mortgagee (art 3 sec 2 pt 2).
- > The property has to be insured to the benefit of the mortgagee for the whole term of the loan to an amount not less than the mortgage secured claim (art 3 sec 2 pt 3).
- > The share of mortgage secured construction claims is limited to 10% of the cover pool (art 3 sec 3 para 3). For Housing mortgage obligations mortgage secured construction claims are not eligible (art 3 sec 3 para 1 sent 2).
- > Claims, secured by a second ranking mortgage are eligible, as far as they do not exceed the LTV limit of 70% (art 3 sec 3 para 2).

One asset may only be used for one cover pool. A mortgage participation certificate can not be part of the cover pool, where it represents a share in the mortgage secured claims. (Art 3 sec 5).

<sup>16</sup> "Mortgage specialized organization" is another allowed name for "mortgage agent" (art 8 sec 1 para 5).

<sup>17</sup> The word "Obligation with mortgage cover" have to be shown on the title page of a prospectus, the words "Housing obligations with mortgage cover" can be shown (pt 3.14 sec 1 and 2 Order FSFR No 06-117/pz-n/2006; annex 5 Instruction CBRF 128-I/2006).

<sup>18</sup> A mortgage certificate is only eligible, if it is not pledged of another purpose (art 3 sec 3 para 1).

## **Publishing of information**

The Law on Mortgage Securities stipulates a wide range of publishing information on the covered bonds by the issuer (art 37 – 41). In addition to the main rules according to the Securities market law (art 37 para 1; 40 sec 1) an important information is an account report on performance of the cover assets (art 40 para 4 sec 2). Credit organisations issuing covered bonds have special reporting duties to the Central bank (art 7 sec 1 para 3; pt 3.1 – 3.5 Mortgage cover mandatory requirements instruction ).<sup>19</sup>

Main points for publishing information are:

If the covered bonds are rated by a rating agency, this rating has to be published (art 37 para 2).

Interested persons have the right to get knowledge of the cover register (art 39 para 1). The issuer is obliged to allow all interested persons to get knowledge of the information, contained in the cover register.<sup>20</sup> After obtaining the state registration of the issue, the issuer is obliged to publish the cover register as of the registration for a term of three months on his internet site (pt 10.3.4 sec 1 and 2 Order FSFR No 06-117/pz-n/2006).

The regulators set up further special rules for covered bond issuers in the general acts on disclosure of information.<sup>21</sup> Issuers of mortgage securities have – in addition to the general requirements – to disclose (i) information, that might have significant influence on the value of the mortgage securities and (ii) information contained in the cover register and the note on the volume of the securities' cover pool (pt 10.1.1 Order FSFR No 06-117/pz-n/2006).

If the issuer is a credit organisation, it has to give in the prospectus information on fulfilment of the special ratios for mortgage securities' issuers, set up by the Central Bank.<sup>22</sup>

Mortgage securities qualify as secured bonds.<sup>23</sup> The pledge over the cover pool has to be named as security for the bonds.<sup>24</sup>

The prospectus has as well to show information on the specialized depositar, on the planned issues and fulfilment of the cover mortgage assets, on insurance of the issue and a servicing agent (both if applicable) and composition, structure and volume of the cover pool<sup>25</sup>, also information on the structure of the mortgage secured claims<sup>26</sup>. Similar information have to be shown in the quarterly data report.<sup>27</sup>

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19 Instruction of the CBRF dated 31 March 2004 No 112-I "On mandatory requirements for credit organisations, issuing securities with mortgage cover".

20 For credit organisations as issuers explicitly stipulated in pt 14.5 Instruction CBRF 128-I/2006.

21 FSFR: Order No 06-117/pz-n/2006 and Order No 07-4/pz-n/2007.  
Central Bank: Instruction No 128-I/2006.

22 Annex 5 pt 5.2 sec 4 Instruction CBRF 128-I/2006.

23 In Russian: "Obligaciya s obespecheniem". Pt 6.4 Instruction 128-I/2006.

24 Annex 8 pt 10.3.2 sec 2 subsec 14; annex 8 pt 10.5 Order FSFR No 06-117/pz-n/2006; pt 6.4.2 Instruction CBRF 128-I/2006. As well in the prospectus: Annex 5 pt 10.3.2 sec 13 FSFR Instruction 128-I/2006.

25 Annex 8 pt 9.1.5.1 – 9.1.5.5; annex 8 pt 10.5.1 Order FSFR No 06-117/pz-n/2006; annex 5 9.1.5.1 – 9.1.5.5 (publishing information on the issued securities) and – regarding depositar, insurance, service agents and cover pool - pt 10.5.1 lit a – g (publishing information on the issuing credit organisation) Instruction CBRF 128-I/2006.

26 Annex 8 pt 10.5.1 sec 2 no 2.2; pt 3 -5 Order FSFR No 06-117/pz-n/2006; annex 5 pt 9.1.5.5 lit g – zh (publishing information on the issued securities) and pt 10.5.1 lit g no no 2.2 – 5 (publishing information on the issuing credit organisation) Instruction CBRF 128-I/2006.

27 Annex 10 pt 8.5; 8.5.1 Order FSFR No 06-117/pz-n/2006.

#### **IV. VALUATION AND LTV CRITERIA**

Due to art 3 sec 2 para 2 the LTV limit is 80% of the market value of the property. If a second ranking mortgage is used for cover, the LTV limit is 70% of the market value (art 3 sec 3 para 2). In both cases, the valuation has to be made by an independent valuer.<sup>28</sup>

The law does not contain special regulations on the valuation.

#### **V. ASSET-LIABILITY MANAGEMENT**

Art 3 sec 4 stipulates, that the amount of the cover is defined by summing up the mortgage secured claims, amount of money in the cover and value of other assets.

Details are set up by the FSFR in the Mortgage cover determination order. The mortgage secured claims are defined as the outstanding capital and/or interest<sup>29</sup>, as defined in the credit or loan agreement (pt 2.1 Mortgage cover determination order). The volume of the cover has to be accounted in RUB, as far as the mortgage securities are not nominated in foreign currency. If this is the case, the cover has to be accounted in the foreign currency. In both cases, for including cover assets, nominated in another currency than the accounting currency, in the calculation, the exchange rate of the CBRF of the calculation date has to be used. (Pt 2.5 Mortgage cover determination order)

The following claims shall not be encountered by summing up the mortgage cover:

- > No payment made on the claim for more than six month,
- > Loss of the mortgage object, including if the mortgage was declared void by a court,
- > Secured obligation declared void by a court,
- > Bankruptcy of the debtor,
- > No insurance of the mortgage object for more than 6 month.

Only in these cases and in case, that the cover asset does not fit to the general rules for eligible claims, cover assets can be replaced by other assets (art 14 para 1; art 3 sec 4). Cover assets may be deleted from the cover pool in case of their exchange or sale or if the secured obligation is terminated (art 4 sec 1).

At the moment of state registration of the issue, the volume of the cover pool has to be not less than the nominal value of the covered bonds (art 13 para 3 sec 1). For proper performance of the obligations under the covered bonds the amount of the cover pool for the whole maturity of the bonds shall not be lower than the aggregate outstanding nominal value of the bonds (art 13 sec 2 para 2 sent 1).

The decision of the terms of issue of the covered bonds may stipulate an excess cover. In this case the excess cover has to be kept during the whole maturity of the mortgage obligations. (Art 13 sec 2 para 2 sent 2 and 3) For credit organisation the excess amount of the cover pool shall not be more than 20% (art 13 para 3 sec 2).

The Instruction 128-I/2006 of the CBRF foresees that the cover pool has to secure completeness ("полнота") of payment and timely payment (pt 6.4.2 sent 8 Instruction 128-I/2006):

<sup>28</sup> Information according to pt 10.1.1 lit a, b and zh has also to be published in print media.

<sup>29</sup> The form of publishing this information is fixed in annex 10 Order No 06-117/pz-n/2006 (pt 10.2.2).

*Completeness of payment* is secured, when the amount of the cover pool on every day until repayment covers the amount (sum) of unfulfilled obligations under the mortgage securities (pt 6.4.2 sent 9).

*Timely payment* is secured, when

at the starting date of the next period (coupon period), at the end of which the investors have to be paid the respective return (interest (coupon) return) the

- > amount of mortgage secured claims which have to be performed until this payment date,
- > together with the cash money and the value of the state securities in the cover pool,

cover the amount (sum) of the return to be paid to the investors at the end of the next period (coupon period) (pt 6.4.2 sent 10).

One cover pool can secure two or more issues of covered bonds (art 11 sec 2 para 1; 12 sec 2). In this case the rules on calculation of the necessary cover for one issue apply similarly (art 11 sec 2 para 1). Among the two or more issues the issuer may define an order of priorities: The performance of claims of one issue is only allowed after proper performance of the claims of the higher ranking issue(s) (art 11 sec 2 para 2 and 3). If mortgage securities are issued in several issues on the bases of one cover pool, the volume of the cover pool has to be not less than the nominal value of last priority rank and the foregoing ranks (art 13 sec 2 para 3).

The decision on the issue shall define the maturity and denomination on the day of maturity (art 13 sec 3).

At least 80% of the cover pool have to be mortgage secured claims. If this ratio is lower than 80% within three months the issuer has to increase the share of mortgage secured claims. This can be done by obtaining new mortgage secured claims and/or by prepayment of outstanding covered bonds (art 13 sec 1 para 2).

Money received from the repayment of the mortgage secured claims has to be included into the cover pool as far as this is necessary to fulfil the legal stipulations on the volume of the cover pool (art 13 sec 4).

The mortgage securities' holders have the right to claim for prepayment of the covered bonds in the following cases (art 16): Breach of the rules regarding

- > volume of the cover pool,
- > replacement of cover assets,
- > proper fulfilment of obligations under the covered bonds,
- > the issuer is active in fields not allowed for it,
- > other reasons stipulated by the decision on issuing covered bonds.

## **VI. COVER POOL MONITOR, COVER REGISTER AND BANKING SUPERVISION**

### **Cover Pool Monitor**

The cover pool is controlled by a cover monitor (the “specialized depositor of the mortgage cover”<sup>30</sup>), art 33 sec 1. The cover monitor has to be a commercial organisation<sup>31</sup>, licenced for depositary activities for investment funds, non-state pension funds and on the securities market (art 32 para 2). The FSFR has published the Special depositor decree.

The specialized depositor is acting on the bases of a contract with the issuer (pt 1.2 Special depositor decree). The monitor is acting solely in the interests of the holders of mortgage securities (art 35 para 1). He is controlled by the FSFR (art 43 sec 1 pt 7, sec 2 para 1) and is obliged to inform the FSFR on breaches of the Law on Mortgage Securities (art 35 para 3; pt 4.14 Special depositor decree) and on the elimination of breaches (pt 4.15; 4.16 Special depositor decree).

Task of the cover monitor is to control the fulfilment of the Law on Mortgage Securities and other corresponding legal acts (art 34 sec 1 para 1). He has to determine the volume of the cover pool (4.5 sec 1 Special depositor decree) and – when the issuer is a credit organisation – sign the prospectus (pt 12.4 sec 6 Instruction CBRF 128-I/2006). One cover pool may be only administrated by one monitor (art 33 sec 3 para 1).

Every cover monitor has to implement a reglament<sup>32</sup>, to be registered by the FSFR, describing the procedure of control, of schedule and time frames for registration in the cover register, disposal of cover assets and the overall course of working (pt 2 Order FSFR No 05-60pz-n/2005). The reglament also stipulates the rules for the exchange of documents between the issuer, the specialized depositor and mortgage securities’ holders (pt 1.4 Register maintenance rules).

For the cover monitor it is forbidden to give his consent to disposal of cover assets, if this disposal is in contradiction to the Law on Mortgage Securities or other legal acts (art 34 sec 1 para 3).<sup>33</sup>

The cover monitor is obliged to (art 35 sec 2):

- > Safekeeping of the documents confirming the mortgage secured claim (pt 2.1 – 2.3; 3.1 – 3.5 Special depositor decree),
- > deciding on consents for the disposal of cover assets (pt 2.4 Special depositor decree),<sup>34</sup>
- > submission of data information to the FSFR,<sup>35</sup>
- > information of the covered bond holders of their right to claim for prepayment of the covered bonds according to art 16 (pt 4.7 Special depositor decree).

30 In Russian “spetsializirovannyj depozitarij ipotechnogo pokrytiya”.

31 Not affiliated with the issuer (art 33 sec 3 para 2).

32 In Russian “reglament spetsializirovannogo depozitarya”.

33 In case of non-fulfillment of these tasks the cover monitor has a shared responsibility with the issuer in front of the covered bond holders (art 34 sec 2).

34 Consents to disposals have to be registered in the recording journal for disposal consents (in Russian “uchëtnyy zhurnal o vydache soglasiya na sovershenie sdelki”), pt 2.4 Special depositor decree.

35 The FSFR adopted for this purpose the Mortgage cover special depositor data reporting decree. The data has to be provided to the FSFR quarterly (pt 3 Mortgage cover special depositor data reporting decree).

For safekeeping e. g. mortgage certificates, evidencing a mortgage secured claim, have to be kept by the depositor (art 16 sec 2 subsec 6 Law on Mortgage Securities; pt 3.4 sec 2 Special depositor decree).

For including assets in the cover the cover pool monitor has to control, e. g. if the assets are eligible under the Law on Mortgage Securities, if the issuer is the holder of the claim and if the mortgage is registered (pt 4.2 Special depositor decree). The accordance of the cover pool structure with the Law on Mortgage Securities has to be verified by the monitor daily (pt 4.3; 4.4 Special depositor decree).

The payment of the monitor can be done on the account of the cover pool. Nevertheless the rules on necessary volume of the cover pool have to be observed. (art 13 sec 5)

The monitor has also to control the payment of other costs, which have to be borne by the cover pool (e. g. for the specialized depositor, for the registrar of bearers securities etc.). This includes also controlling the amount of the costs. (Pt 4.11; 4.12 Special depositor decree)

The monitor may insure his responsibility in front of the covered bond holder on his own account (art 36).

### **Cover register**

Cover assets have to be registered in a "register of mortgage cover"<sup>36</sup> (art 5). The FSFR has adopted Register maintenance rules.

The register of mortgage cover is maintained by the cover monitor (art 33 sec 1). Maintenance means, among others, bringing in entries in the register, granting of information from the register and safekeeping of documents (pt 1.2 Register maintenance rules).

Cover assets are enclosed in the cover pool by bringing in a respective entry<sup>37</sup> in the cover register (pt 4.1 Register maintenance rules). Basis for the entry is a disposition<sup>38</sup> of the issuer (pt 4.2 Register maintenance rules). Simultaneously with a new entry, the cover pool monitor has to register the value of the mortgage cover<sup>39</sup> (pt 3.8 Register maintenance rules).<sup>40</sup>

Within three working days the entry in the cover register has to be done or the issuer has to be informed about a refusal of entry by the monitor (pt 4.20 – 4.22 Register maintenance rules).

The cover register itself has to contain information on the issuer (pt 3.1 Register maintenance rules) and on the different types of cover assets (pt 3.2 Register maintenance rules).

A copy of the register has to be given to the issuer montly (pt 7.2), to state authorities on request (pt 7.3).

Register maintenance ends – based on an dispositon of the issuer – in cases, when the issue will not take place or when all mortgage securities have been repaid (pt 1.9 Register maintenance rules).

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36 In Russian "reestr ipotechnogo pokrytiya".

37 In Russian "zapis".

38 In Russian "rasporyazhenie". Documents to be added to the disposition are named in pt 4.9 Register maintenance rules.

39 This has to be done also when changes to the cover assets are entered into the cover register. For these entries regarding the mortgage cover value a disposition of the issuer is not necessary (pt 6.3 Register maintenance rules). Details are foreseen in the Mortgage cover determination order.

40 Similar rules are existing for deletion (pt 5.1 – 5-11 Register maintenance rules) and replacement (pt 6.1 – 6.9) of cover assets.

## **Supervision**

State regulation of issuing covered bonds is done by the FSFR in co-ordination with the Central Bank of the Russian Federation (art 42).

Banks, issuing covered bonds, are supervised by the Central Bank (art 7 sec 2), mortgage agents are by the FSFR (art 43 sec 2).

## **Issuing of covered bonds**

Normally the volume of possible issues of securities is limited to the amount of the charter capital and/or the amount of security provided by third parties. Obligations (bonds) with mortgage cover are exempt from this rule.<sup>41</sup>

For issuing securities, Russian law foresees a four step process:<sup>42</sup> (i) Decision on issue<sup>43</sup>, (ii) state registration of issue, (iii) distribution of securities and (iv) state registration of the report on results of the issue.<sup>44</sup> For these general steps the FSFR and the CBRF set up special requirements for the issue of mortgage securities.

The decision on the issue<sup>45</sup>, taken by the issuer, has to show, that the issuer is a credit organisation,<sup>46</sup> contain information of the security for the bonds,<sup>47</sup> of composition, structure and volume of the cover pool<sup>48</sup>, procedure for exclusion and replacement of cover assets<sup>49</sup>, on the special depositar<sup>50</sup>, on the bonds<sup>51</sup>, insurance of the issue and service agents (if applicable)<sup>52</sup> and procedure of prepayment<sup>53</sup>. The decision has to foresee interest payments to the investors, not less than once a year<sup>54</sup> and can foresee costs to be paid from the cover pool<sup>55</sup>. On the first page of the decision has to be written "Obligations with mortgage cover", it has to be signed by the special depositar.<sup>56</sup> The prospectus has to be signed as well by the auditors and – if stipulated by the FSFR – the independent valuer, to prove true the authenticity in the respective parts of the prospectus (pt 12.4 para 2 Instruction CBRF 128-I/2006).

41 Restrictions by art 102 sec 2 subsec 2 sent 3 Civil code; art 27.5-4 sec 3 subsec 1 Securities market law; art 33 sec 3 sent 3 JSC law and art 31 sec 2 sent 3 LLC law do not apply for the issuance of covered bonds.

42 Pt 2.1.1 Order FSFR No 07-4/pz-n/2007.

43 The decision sustains of two parts: Taking the decision and approval of the decision.

44 In Russian: (i) "Reshenie o vypuske" (sustaining of: "prinyatie resheniya" and "utverzhenie resheniya", (ii) "gosudarstvennaya registraciya vypuska", (iii) "razmeshchenie obligacij", (iv) "gosudarstvennaya registraciya otcheta ob itogakh vypuska".

45 The form of the decision is stipulated in annex 4 (7) Order FSFR No 07-4/pz-n/2007; for credit institutions: Annex 4, esp. pt 10.6.2.3 Instruction CBRF 128-I/2006.

46 Pt annex 4 Pt 10.6.1 sec 5 Instruction CBRF 128-I/2006.

47 The pledge over the cover pool (pt 6.7.2.2 lit a – n Order FSFR No 07-4/pz-n/2007; annex 4 pt 10.6.2.3 no 1 Instruction CBRF 128-I/2006), including description of the procedure, how investors can foreclose into the cover pool (pt 6.7.2.2 lit m Order FSFR No 07-4/pz-n/2007; annex 4 pt 10.6.2.3 no 8 Instruction CBRF 128-I/2006 ).

48 The cover register as of the date of the decision's confirmation has to be added (pt 6.7.2.3 lit a Order FSFR No 07-4/pz-n/2007; annex 4 pt 10.6.4.2 Instruction CBRF 128-I/2006).

49 Pt 6.7.2.4 Order FSFR No 07-4/pz-n/2007. The replacment procedure shall contain a regulation, that purchase of a mortgage security by an investor means also giving the consent to this procedure (pt 6.7.2.4 sec 7). Similar regulations in annex 4 pt 10.6.2.3.2 Instruction CBRF 128-I/2006.

50 Pt 6.7.2.5 Order FSFR No 07-4/pz-n/2007; annex 4 pt 10.6.2.3.3 Instruction CBRF 128-I/2006.

51 E. g. number of issues, number of bonds, volume of interest and maturity, pt 6.7.2.6 Order FSFR No 07-4/pz-n/2007; annex 4 pt 10.6.2.3.4 Instruction CBRF 128-I/2006.

52 Pt 6.7.2.7; 6.7.2.11 Order FSFR No 07-4/pz-n/2007; annex 4 pt 10.6.2.3.5 and 10.6.2.3.6 Instruction CBRF 128-I/2006.

53 6.7.2.8 Order FSFR No 07-4/pz-n/2007.

54 6.7.2.9 Order FSFR No 07-4/pz-n/2007; annex 4 pt 13.2.5 Instruction CBRF 128-I/2006.

55 E. g. for the special depositar, administration costs for the cover pool. The costs have to be set in a fix number or in a procedure, how to assess it later. Pt 6.7.2.12 Order FSFR No 07-4/pz-n/2007.

56 Pt 6.7.2.12; 6.7.2.14 Order FSFR No 07-4/pz-n/2007; pt 12.4 para 6, annex 4 part A Instruction CBRF 128-I/2006.

For state registration of the issue the contract with the special depositar and the notes of the special depositar on overall volume (sum) of mortgage secured loans and on the volume of the mortgage cover<sup>57</sup> (on the date of presentation) have to be presented.<sup>58</sup> Credit organisations also have to present the fulfilment of the mandatory requirements of the CBRF and the coverage regulation according to art 13 Law on Mortgage Securities.<sup>59</sup>

The state registration has to be refused, when the cover pool is not in line with the Law on Mortgage Securities, especially not able to secure the fulfilment of the claims of the bond holders and when no right to interest payments at least once a year is foreseen.<sup>60</sup> For credit organisations additional reasons to refuse the registration are the non fulfilment of the CBRF mandatory requirements for credit organisations, issuing mortgage securities and the coverage rules according to art 13 Law on Mortgage Securities an the day of approval of the issue.<sup>61</sup>

The mortgage securities can only be distributed, after the issuer made the access to the information in the cover register possible, in line with the Law on Mortgage Securities.<sup>62</sup>

For state registration of the results of the issue a copy of the cover register and a note of the specialized depositar on the volume of the cover pool, a note from the issuer on obeying the rules to secure the due performance of the obligations under the mortgage securities<sup>63</sup>, all as of seven days before applying, but later than the factual end of the distribution, and evidence on publication of information have to be presented.<sup>64</sup> Credit organisation have to show as well fulfilment of the CBRF mandatory rules for credit organisations, issuing mortgage securities and the coverage regulations according to art 13 Law on Mortgage Securities.<sup>65</sup>

The state registration has to be refused, if based on changes in the cover register the cover assets are not securing the due performance of the mortgage securities.<sup>66</sup> For credit organisations the state registration has to be refused as well in case of non fulfilment of the mandatory requirements of the CBRF for credit organisation, issuing mortgage securities and the coverage regulations according to art 13 Law on Mortgage Securities.<sup>67</sup>

## **VII. HOW ARE SEGREGATION OF COVER ASSETS AND BANKRUPTCY REMOTENESS OF COVERED BONDS REGULATED?**

The claims of the mortgage securities' holders are secured by a pledge over the cover pool (art 11 sec 1).

### **Asset segregation**

In case of bankruptcy the cover pool is excluded from the bankruptcy estate of the issuer (art 16.1 para 1 Law on Mortgage Securities; 131 sec 2 Bankruptcy law; art 50.35 sec 2 and 4 Credit organizations bankruptcy law).

57 In Russian: "Spravka o sovokupnom razmere (summe) obespechenykh ipotekoy trebovaniy" and "spravka o razmere ipotechnogo pokrytiya".

58 Pt 6.7.3.1 Order FSFR No 07-4/pz-n/2007; pt 13.3 sent 2 sec 1 and 2 Instruction CBRF 128-I/2006.

59 Pt 13.3 sent 2 sec 3 and 4 Instruction 128-I/2006.

60 Pt 6.7.3.3 Order FSFR No 07-4/pz-n/2007; pt 13.10 sent 2 sec 3 and 4 Instruction CBRF 128-I/2006.

61 Pt 13.10 sent 2 sec 1 and 2 Instruction CBRF 128-I/2006.

62 Pt 6.7.4.1 Order FSFR No 07-4/pz-n/2007.

63 This note has to contain information on the volume of non performed obligations under the mortgage securities and the respective amount of cover, pt 6.7.5.1 sec 4 Order FSFR No 07-4/pz-n/2007.

64 Pt 6.7.5.1 Order FSFR No 07-4/pz-n/2007.

65 This has to include notes on completeness of payments and timely payment, annex 8 I B pt 8 sec 2 Instruction CBRF 128-I/2006.

66 Pt 6.7.5.2 Order FSFR No 07-4/pz-n/2007.

67 Pt 16.18 sent 2 sec 11 Instruction CBRF 128-I/2006.

The insolvency administrator is obliged to open special bank accounts for the cover pool to collect the money paid on the mortgage secured claims or from realization of this claims and to make payments to the covered bond holders (art 133 sec 4 Bankruptcy law). A special administrator of the cover pool, different from the insolvency administrator of the general bankruptcy estate is not foreseen.

### **Impact of insolvency proceedings on Covered Bonds**

The Law on Mortgage Securities stipulates two possibilities of realization of the cover pool in case of bankruptcy of the issuer (art 16.1 para 2):

- > Change of the issuer ("zamena émitenta obligaciy s ipotechnym pokrytiem"): The cover pool will be sold with the obligation for the buyer to fulfill all conditions of the decision on issuing the covered bonds. Details have to be stipulated by a federal law. This federal law has not been enacted yet.
- > Selling of the cover pool ("prodazha ipotechnogo pokrytiya"): The cover pool assets will be sold and the money received will be distributed among the covered bond holders.

The decision which type of realization will be used is made by the bankruptcy administrator (art 16.1 para 3). After adjudication in bankruptcy the exchange of cover assets in the cover pool is forbidden (art 16.1 sec 4).

Costs in connection with the realization, including payment of the bankruptcy administrator, will be covered out of the cover pool in accordance with the Bankruptcy law (art 16.1 para 8).

### **Preferential treatment of Covered Bond holders**

Covered bond holders enjoy preferential treatment as the Russian law stipulates the separation of the cover pool from the general insolvency estate of the issuer (art 16.1 para 1 Law on Mortgage Securities; 131 sec 2 Bankruptcy law; art 50.35 sec 2 and 4 Credit organizations bankruptcy law).

In case they are not satisfied in the realization of the cover pool, the covered bond holders may ask for satisfaction from the general bankruptcy estate of the issuer (art 16.1 sec 1 para 3).

### **Access to liquidity in case of insolvency**

#### Change of issuer

Details have to be stipulated in a federal law (art 16.1 sec 2 para 2).

#### Selling the cover pool

In this case further liquidity is not needed, as the claims of the covered bond holders are becoming due, the cover assets are sold and the return is used to satisfy the bond holders' claims.

### **Sale and transfer of mortgage assets to other issuers**

#### Change of issuer

Details have to be stipulated in a federal law (art 16.1 sec 2 para 2).

#### Selling the cover pool

The process of "selling the cover pool" is described in detail in art 16.2.

The bankruptcy administrator has to sell the cover assets not later than nine month after the adjudication in bankruptcy (art 16.2 sec 1). The assets have to be sold under the rules of the Law on Bankruptcy

law (art 16.2 sec 2). If the covered bonds have been issued with different priorities, the claims will be satisfied in these priorities (art 16.2 sec 3 para 2).

Cover assets or proceeds from their sale, remaining after the satisfaction of the claims of all covered bond holders and of the costs of realization will be included in the general bankruptcy estate of the issuer (art 16.2 sec 4).

### **Enforcement into the cover pool**

The Russian Law on Mortgage Securities gives to the covered bond holders the right to foreclose into the cover pool, based on the pledge over the cover pool assets. This is stipulated by law (art 15) and further described in the bylaws, set up by the CBRF<sup>68</sup> and the FSFR<sup>69</sup>.

If the issuer does not or not properly fulfil his obligations in front of the holders of the covered bonds, the holders have the right for enforcement into the cover pool based on a court decision.<sup>70</sup> As the cover pool is pledged to the covered bond holders, the rules on the Mortgage law apply to this foreclosure and realisation, as far as special regulations in the Law on Mortgage Securities do not exist.<sup>71</sup>

Realisation of the mortgage cover in a public auction can not take place earlier than two month after the date, on which the liability under the mortgage securities has become due.<sup>72</sup> The covered bond holders can apply to the issuer to receipt the proceeds from the realisation of the cover.<sup>73</sup> The proceeds from realisation of the cover are paid to covered bond holders, who have applied before the public auction for the cover takes place.<sup>74</sup> Applications can be made after this moment, but not later as stipulated in the decision on the issue of the bonds.<sup>75</sup>

If the proceeds from the realisation – after deduction of costs related to foreclosure and realisation – exceed the amount of the covered bond claims, the difference has to be paid back to the issuer.<sup>76</sup> The amount of proceeds, not exceeding the amount of covered bond claims and remaining after satisfaction of covered bond holders, having applied, has to be paid in a notariel deposit. Covered bond holders, which have not applied in written form earlier, can get satisfaction from this deposit.<sup>77</sup> If the amount of

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68 Pt 6.4.3; annex 4 B pt 10.6.2.3 no 8 and 9 Instruction CBRF 128-I/2006.

69 Pt 6.7.2.1 lit m and n; annex 4 (7) B pt 12.2.1 lit k and l Order FSFR No 07-4/pz-n/2007.

70 Art 15 sec 1 para 1 Law on Mortgage Securities. Due to pt 6.7.2.1 lit m para 1 and annex 4 (7) B pt 12.2.1 lit k para 1 Order FSFR No 07-04/pz-n/2007 this has to be shown in the decision on the issue. Pt 6.4.3 para 1 Instruction CBRF 128-I/2006 stipulates differing, that the cover is subject to realisation, when a bondholder claims for this in written form, sent to the issuer and the person, named in the decision on the issue as person, being in charge for realisation. Annex 4 B pt 10.6.2.3 no 8 para 1 Instruction CBRF 128-I/2006 stipulates, that the decision on the issue has to show, that the enforcement has to be based on a court decision.

71 Art 15 sec 1 para 2 Law on Mortgage Securities.

72 Art 15 sec 2 para 1 Law on Mortgage Securities. This has to be shown in the decision on the issue: Pt 6.4.3 para 2 and 3, annex 4 B pt 10.6.2.3. no 8 para 2 Instruction CBRF 128-I/2006, pt 6.7.2.1 lit m para 2 and annex 4 (7) B pt 12.2.1 lit k para 2 Order FSFR No 07-04/pz-n/2007.

73 Art 15 sec 2 para 2 Law on Mortgage Securities. This has to be shown in the decision on the issue: Annex 4 B pt 10.6.2.3. no 8 para 3 Instruction CBRF 128-I/2006, pt 6.7.2.1 lit m para 3 1st half and annex 4 (7) B pt 12.2.1 lit k para 3 Order FSFR No 07-04/pz-n/2007.

74 Art 15 sec 2 para 3 Law on Mortgage Securities. This has to be shown in the decision on the issue: Annex 4 B pt 10.6.2.3. no 8 para 4 Instruction CBRF 128-I/2006, pt 6.7.2.1 lit m para 4 and annex 4 (7) B pt 12.2.1 lit k para 4 Order FSFR No 07-04/pz-n/2007. The procedure of transfer the proceeds to the bond holders has to be shown in the decision on the issue. This has to be shown in the decision on the issue: Annex 4 B pt 10.6.2.3. no 8 para 5 Instruction CBRF 128-I/2006, pt 6.7.2.1 lit m para 5 and annex 4 (7) B pt 12.2.1 lit k para 5 Order FSFR No 07-04/pz-n/2007.

75 Pt 6.4.3 para 4 sent 1 Instruction CBRF 128-I/2006.

76 Art 15 sec 2 para 4 sent 1 Law on Mortgage Securities, pt 6.4.3 para 4 sent 2 Instruction CBRF 128-I/2006

77 Art. 15 sec 2 para 4 sent 2 and 3 Law on Mortgage Securities, pt 6.4.3 para 4 sent 4 and 5 Instruction CBRF 128-I/2006. This has to be shown in the decision on the issue: Annex 4 B pt 10.6.2.3. no 8 para 6 Instruction CBRF 128-I/2006, pt 6.7.2.1 lit m para 6 sent 1 and annex 4 (7) B pt 12.2.1 lit k para 6 sent 1 Order FSFR No 07-04/pz-n/2007. The FSFR also stipulated, that this has to contain details on the notarius: Pt 6.7.2.1 lit m para 7 and annex 4 (7) B pt 12.2.1 lit k para 7 Order FSFR No 07-04/pz-n/2007.

the proceeds is not sufficient, it will be divided proportionally among the bond holders, having applied for satisfaction.<sup>78</sup> As this is not a bankruptcy situation, it should be possible to demand unsatisfied claims under the covered bonds from the issuing credit organisation.

When, in cases foreseen in the law, claims and other assets belonging to the cover pool, have to be transferred into ownership of the covered bond holders<sup>79</sup>, the claims and assets are transferred into joint shared ownership<sup>80</sup> of the holders.<sup>81</sup>

In case that one cover pool secures more than one bond issue and among the issues an order of priorities is defined, than the claims of the higher ranking bonds have to be satisfied first.<sup>82</sup>

If the pledge over the cover pool assets contains other conditions, this has to be shown in the decision on the issue.<sup>83</sup>

## **VIII. RISK-WEIGHTING & COMPLIANCE WITH EUROPEAN LEGISLATION**

No special treatment for covered bonds is foreseen.

Russian covered bonds, issued by credit organisations, comply with the requirements of art 52 sec 4 UCITS as well as those of the Directive of the business of credit institutions<sup>84</sup>, Annex VI, Part 1, Paragraph 68 a) to f).

## **IX. INVESTMENT REGULATIONS**

The EU investment regulations for covered bonds are not transferred into Russian law. Nevertheless different investment rules and privileges for mortgage securities are existing. In any case the investment rules are always include further requirements for mortgage securities to be eligible for investment.<sup>85</sup>

Mortgage obligations are included into the CBRF's Lombard list.<sup>86</sup> For lombard eligibility mortgage obligations have to fulfil one of the following criterias<sup>87</sup>:

- > Minimum rating on the international scale by at least one agency of long term creditworthiness of the issuer in foreign currency of BB (Standard & Poor's, Fitch Ratings) or Ba2 (Moody's Investors Service).

<sup>78</sup> Pt 6.4.3 para 4 sent 3 Instruction CBRF 128-I/2006.

<sup>79</sup> Russian law knows the *lex commissoria* as one kind of realisation of pledged assets.

<sup>80</sup> In Russian: *Obshchaya dolevaya sobstvennost'*.

<sup>81</sup> Art. 15 sec 2 para 5 Law on Mortgage Securities, pt 6.4.3 para 5 Instruction CBRF 128-I/2006. the order of the transfer has to be shown in the decision of the issue: Annex 4 B pt 10.6.2.3. no 8 para 7 Instruction CBRF 128-I/2006, pt 6.7.2.1 lit m para 7 and annex 4 (7) B pt 12.2.1 lit k para 7 Order FSFR No 07-04/pz-n/2007.

<sup>82</sup> Art. 15 sec 3 Law on Mortgage Securities. This has to be shown in the decision on the issue: pt 6.7.2.1 lit m para 3 2nd half Order FSFR No 07-04/pz-n/2007.

<sup>83</sup> Annex 4 B pt 10.6.2.3. no 9 Instruction CBRF 128-I/2006, pt 6.7.2.1 lit n and annex 4 (7) B pt 12.2.1 lit l 1st sent Order FSFR No 07-04/pz-n/2007. This can be e. g. inclusion of money, received from repayment of the cover mortgages, annex 4 (7) B pt 12.2.1 lit l 2nd sent Order FSFR No 07-04/pz-n/2007.

<sup>84</sup> Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions, Official Journal L 177 as of 30 June 2006.

<sup>85</sup> For details, see ECBC Fact Book 2010, p 269 – 271.

<sup>86</sup> Instruction of the CBRF "On the schedule of securities, to be included in the Lombard list of the Bank of Russia" dated 27 November 2008 No 2134-U (published Herald (Vestnik) of the CBRF No 74 (1090) dated 24.12.2008), as amended by Instruction dated 13 January 2009 No 2168-U (Herald No 5 (1096) dated 28 January 2009) and Instruction dated 01.07.2010 No 2455-U (Herald No 34 (1203) dated 23.07.2010). Following: Instruction CBRF No 2134-U/2008.

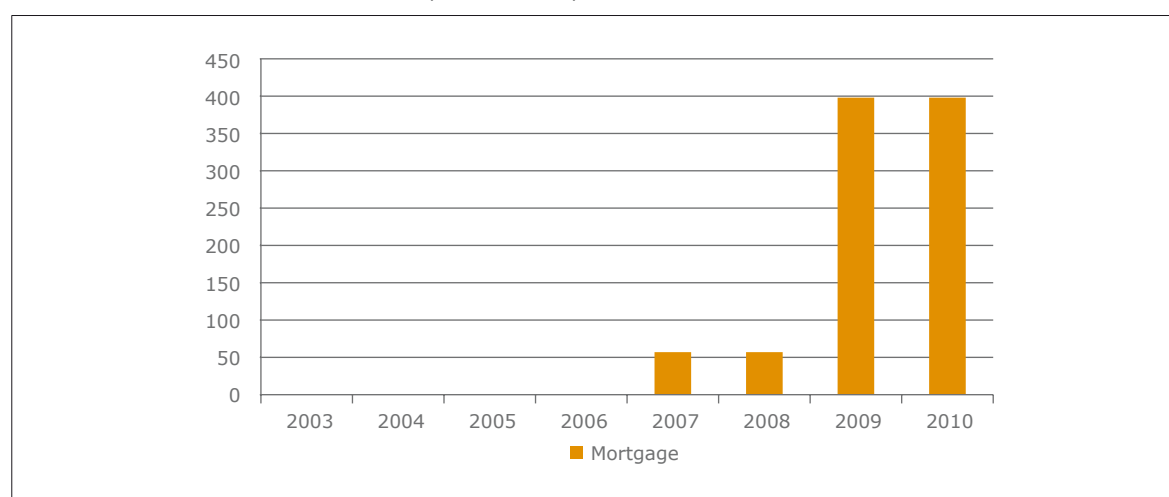
<sup>87</sup> Pt. 1.8; 2.2 Instruction CBRF No 2134-U/2008. The same applies for obligations of the federal Agency for restructuring housing mortgage loans (www.arhml.ru), pt 1.8 Instruction CBRF No 2134-U/2008.

- > The obligations for payments under the mortgage obligations are guaranteed
  - by the Russian Federation, or
  - joint surety of the federal Agency for housing mortgage lending (AIZhK<sup>88</sup>).

Only fulfilling these criterias, the CBRF can take a decision of inclusion of a concrete issue into the Lomard list.<sup>89</sup>

## **X. COVERED BOND STATISTICS AND ISSUERS**

> FIGURE 1: COVERED BONDS OUTSTANDING, 2003-2010, EUR M

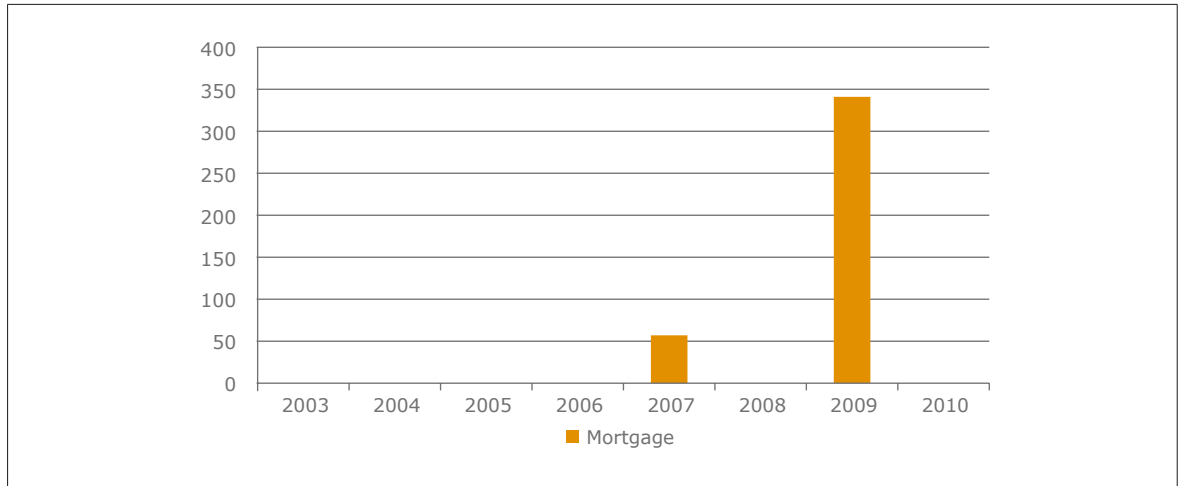


Source: EMF/ECBC

<sup>88</sup> www.ahml.ru.

<sup>89</sup> All non-federal state securities need a decision of the CBRF to be included in the Lomard list, after fulfilling respective criterias, pt 2 Instruction CBRF No 2134-U/2008.

> FIGURE 2: COVERED BONDS ISSUANCE, 2003-2010, EUR M



Source: EMF/ECBC

The Commercial Bank "Moscow Mortgage Agency" (OAO) issued the first Russian covered bond already 11 October 2007. Second issue took place on 16 December 2009: Bank VTB 24 (ZAO)<sup>90</sup> issued the first large issue of a covered bond by a credit organisation: A bond on 15 bln RUB.<sup>91</sup>

In March 2011 ZAO Commercial Bank DeltaCredit<sup>92</sup> registered an issue of 5 bln RUB<sup>93</sup>, which will be distributed during 2011.

90 [www.vtb24.ru](http://www.vtb24.ru)

91 On issuing date ~ 499 mln USD / ~ 341 mln EUR.

92 [www.deltacredit.ru](http://www.deltacredit.ru).

93 On 15 March 2011 ~ 174,43 mln USD / 125,20 mln EUR.