

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

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Content:

1. Insurance and Pension Funds	2
2. Capital Market and Securitization	2
3. Banking Law	4
4. Anti-money Laundering Legislation	6

1. Insurance and Pension Funds

Legislative Initiatives in the Field of Insurance

Bank Assurance Further Cooperation The Federal Antimonopoly Service (“FAS”) drafted a list of preliminary criteria for banks to select insurers. The criteria include, inter alia, compliance with the law, ratings above a specified level, balanced insurance portfolio structure, compensation payments between 30% and 50% of total insurance premiums, correspondence with the basic financial stability requirements, and absence of trials, all of which may affect the business.

FAS representatives expect that there should be developed a respective Government regulation on the basis of the above-mentioned criteria listed originally in the decision on the Rosbank case. Such regulation will provide transparency in the liasing between banks and insurers. The draft of such decree is expected to be prepared by October 2008¹.

New in the Regulation of Additional Insurance Contributions to Labour Pensions

The Pension Fund of Russia approved the form of the application for voluntary engagement in obligatory pension insurance relations along with the instructions on the filling thereof². The application may be submitted to regional offices of the Pension Fund of Russia for the pur-

¹ www.bankir.ru

² Regulations of the Management Board of the Pension Fund of Russia No. 225П of July 28, 2008. The document will enter into force on October 1, 2008.

pose of the payment of additional insurance contributions to labour pensions.

Additionally, in its Regulation No. 627 of August 18, 2008, the Government stipulated that the respective Rules for the submission of applications for voluntary engagement in obligatory pension insurance relations are to be approved by the Ministry of Health and Social Development of Russia and put into effect starting October 1, 2008.

2. Capital Markets and Securitization

New in the Regulation of the Securities Market

Clarification on Information Disclosure by Asset Management Companies³ The amendments introduced in the Regulations⁴ provide for detailed regulation, in particular, of the order of the publishing of reports on registrations with the Federal Financial Market Service (“FFMS”) on changes and amendments to the trust management rules for mutual funds, reports on early deadlines for the purchase, redemption and exchange of investment units, reports on net asset values and estimated values of investment units. Further, the document specifies cases when these new provisions should be applied. According to the amendments, the Regulations are not applied to incorporated investment funds and management companies of mutual funds for qualified investors.

Amendments to Mortgage Backed Securities Regulations The Decree on specialised mortgage collateral depositories and Regulations on the keeping of a mortgage collateral register⁵

³ FFMS Order No 08-25/ПЗ-Н of June 17, 2008

⁴ Approved by FFMS Order No 05-23/ ПЗ-Н of June 22, 2005

⁵ Approved by FFMS Order No 05-60/ПЗ-Н of November 1, 2005

are amended by stipulations regarding a „preceeding creditor“⁶.

A "preceeding creditor", i.e. a person who is a creditor under mortgage secured obligations, which constitute mortgage collateral, who entered into an agreement on an assignment in relation to such obligations with an issuer of mortgage backed bonds) is included in the proceedings related to the recording and storage of mortgage collateral, monitoring of the disposal of property constituting mortgage collateral, as well as maintaining a register of mortgage collateral and grounds for the termination of the maintenance of such registers.

New Edition of the Standard Trust Management Rules for Closed Mutual Funds⁷

The new edition provides, in particular, that there is the possibility in trust management rules to include a condition that the fund units are intended for qualified investors; regulates in more detail the timing of the formation of a fund; establishes a duty regarding the inclusion in the rules of a reference to such investment instruments, such as foreign securities; provides for the possibility of including items regarding the right of a management company to split investment units and issue additional investment units, to decide on an early termination of the fund without a respective decision of a general meeting of the owners of such investment units as well as a provision regarding the duty of a management company to insure property other than real estate.

FFMS Clarifications on Foreign Investment Instruments' Record Keeping⁸ Professional market participants carrying out depository activities are entitled to provide services on record keeping in relation to foreign financial instruments not being qualified as securities⁹ in a similar manner as they do in respect of the record keeping of the rights provided by securi-

ties. In this case, a separate record should be provided. This, according to the FFMS, means that securities' deposit account may not be used for foreign financial instruments which are not qualified as securities, for example, separate record registers, orders, excerpts and reports could be kept and executed according to depository recording principles.

The FFMS also emphasizes that providing records keeping services in relation to foreign financial instruments which are not qualified as securities, according to the actual legislation, is not a subject of depository agreements, as well as it can not be qualified as associated depository services. Thus, providing such services should be performed under additional agreements with clients.

Draft Laws regarding Changes to the Securities Market Regulations

FFMS Intends to Liberalize Derivatives Trading The governmental commission on lawmaking approved the concept of a bill drafted by the FFMS to change the rules of taxation on derivatives transactions. It is intended to approve amendments to the Tax Code in relation to VAT, personal income tax and profit tax provisions.

The FFMS's representatives suppose that the concept should clarify that VAT is not to be paid in relation to non-deliverable commodities derivatives. In relation to personal income tax, it is intended to provide more efficient taxation, in particular – to calculate P&L resulting from derivatives and from underlying transactions. Further, the order of the identification of the market value of OTC instruments is suggested to be defined on the basis of limited deviations of a transaction price from an estimated price according to FFMS methodology.

The draft law is expected to be presented to the Government in the course of October 2008. According to publicly available information, the concept was approved by the Ministry of Justice, the Ministry of Economic Development and the Ministry of Finance, however, the latter has a slightly different perspective, in particular, in relation to the right of taxpayers to define a transaction with deferred payment as a deriva-

⁶ FFMS Order No 08-28/ПЗ-Н of July 03, 2008

⁷ Government Regulation No. 651 of September 01, 2008

⁸ FFMS Letter No 08-BM-03/13851 of July 3, 2008

⁹ According to FFMS Order No 07-105/ПЗ-Н of October 23, 2007

tive transaction and, thus, to handle such transaction as having preferential tax treatment¹⁰.

3. Banking Law

New in the Regulation of Bank Activity

Central Bank of the Russian Federation (“CB RF”) May Set Additional Control over Interbank Financing The CB RF elaborated a project for a new form of reporting related to interbank financing¹¹. In accordance with the document, banks will be required to report currency and money markets transactions relative to interbank lending on a daily basis, as well as to provide information on REPO transactions with other banks. Banks will, inter alia, be obligated to disclose information about their counterpartents, rates of loans and the terms thereof. As suggested by experts, the approval of this form will allow the CB RF to be more flexible and responsive to the needs of the banking system, to control inflation through market operations and to tighten control over the financial state of credit organizations. However, bankers consider the implementation of the new reporting form as a costly procedure since additional personnel will need to be involved in order to procure the preparation of such daily reports. All the suggestions and comments regarding the new reporting form will be considered by the CB RF till December 2008.

The CB RF Plans to Increase the Minimum Capital Amount of Banks The CB RF has presented for the consideration of the State Duma of the Russian Federation a draft of amendments to the Federal Law “On Banks and Banking Activity” stipulating the new requirements relating to the equity capital of credit organizations: starting from January 1, 2012, the minimum amount of a bank’s capital must be at least the ruble equivalent of 5 million euro. Currently, the minimum capital requirement of 5 million euro is applied only for newly

established banks, while the capital of existing banks, which may be less than 5 million euro, can not be lower than the capital amount which the bank had as of January 1, 2007. If the proposed amendments are approved, the new requirement on the capital size will be applied to existing banks as well, which, thus, may lead to the cancellation of the licenses of those banks which will not be able to comply with the new requirements.

New in the Regulation of Foreign Currency Cash Transactions In its Instruction №2054-U¹², which entered into force on September 1, 2008, the CB RF clarifies the procedure of foreign currency cash transactions. This document regulates the conduct of foreign currency transactions with cash money, including banknotes, treasury notes and coins. In particular, it stipulates the order of cash withdrawal by clients, instructions on working with questionable notes and coins, i.e. notes which indicate counterfeiting, defective notes and coins. Banks are to approve the respective regulations regarding the transportation, encashment, packing, etc. of foreign currency as well as the procedure of the verification of banknote falsifications within 3 months following the date of entry into force of the above-mentioned document. The Regulation shall not apply to foreign currency transactions with cash and cheques performed with individuals via exchange offices.

Appraisal of Financial Status of Banks and Non-bank Credit Organizations According to the Instruction of the CB RF No. 2045-U of July 15, 2008, the appraisal of the financial status of banks shall be performed in accordance with the new procedure of economic status bank appraisal as provided by the CB RF Instruction No. 2005-U of April 30, 2008. The appraisal of the financial status of non-bank credit organizations shall be performed under the respective CB RF normative act setting forth the criteria for the appraisal of the financial status of credit organizations.

Changes in Registration and Licensing Requirements Following the newly esta-

¹⁰ www.bankir.ru

¹¹ http://www.cbr.ru/analytcs/standart_acts/projects/

¹² Regulation of the CB RF No. 2054-U of August 14, 2008

blished procedure of economic status bank appraisal¹³, the CB RF in its Instruction No. 2043-U of July 15, 2008 adjusts the procedure of taking decisions on the registration of credit organizations and issuing of bank licenses. The Instruction stipulates that a bank founder must fall into the 1st or 2nd classification group. For expansion into banking activity by obtaining the appropriate licenses, credit organizations are to comply, inter alia, with the following new requirements: obligatory reserve requirements, no overdue financial obligations before the CB RF and be within the 1st or 2nd classification group (for banks) or to fall into the category of financially stable credit organizations (for non-bank credit organizations). Regarding the reorganization of credit organizations in the form of merger, the opinion of the regional division of the CB RF is no longer required for credit organization reorganization, however, additional regulations were introduced on the provision of information in respect of a bank's overdue financial obligations before the CB RF.

Mitigation of Requirements on Merger Approval In accordance with the amendments¹⁴ to Government Regulation No. 335 dated May 30, 2007, the preliminary approval of the FAS is no longer required for the merger (in the form of amalgamation or accession) of credit organizations if the total value of the assets of credit organizations does not exceed 14 billion rubles. Only the requirement of post-notification of the FAS on such transactions is necessary to be complied with. It should be noted that the previous limit was 10 billion rubles.

Additionally, the amount of assets of the credit organization, the shares (participatory interest) and/or property of which is to be contributed into the charter capital of the newly established commercial organization, upon which exceedance FAS preliminary approval is required, was raised from 3 to 4 billion rubles. The same limit on the assets of the credit organization was set in relation to the requirement of FAS approval for

¹³ Instruction No. 2005-U of the CB RF of April 30, 2008. Please see also our previous Bulletin (July 2008) in this respect.

¹⁴ Government Regulation No. 571 of July 28, 2008

transactions with shares (participatory interest), assets or rights in respect of the credit organization.

Additional Requirements for Reorganized Banks The CB RF Instruction No.2044-U of July 15, 2008 sets forth the obligation of credit organizations reorganized by merger to disclose information about persons that may affect the credit organization's activity. Within 3 business days following the decision on the state registration of such reorganized credit organizations and the issuance of a license, the CB RF will send each such reorganized organizations a telegraph notification of the obligation to publicly disclose certain information on persons that may affect (directly or indirectly) the procedure of management decision-making in such credit organizations in cases in which the reorganized credit organizations has existed less than two years and the credit organization applies for a license for attracting funds from natural persons for deposits.

Changes in the Deal Passport Execution Procedure In its Instruction No. 2052-U of August 12, 2008, the CB RF introduced changes in the procedure of issuing (re-issuing) deal passports for currency transactions between residents and non-residents. The amendments, inter alia, provide that all the documents required for a deal passport issue must be provided within the period agreed with the bank, not later than the first currency transaction or the fulfillment of any other obligation under the contract (loan agreement), depending on which arises first. The provisions relating to the special bank accounts for the purposes of foreign currency transactions were excluded.

4. Anti-money Laundering Legislation

Bank Executives May Face Penalties for Money Laundering The Financial Action Task Force ("FATF,") has presented Russian regulators with an action plan to implement its recommendations. If that plan is adopted, bankers may face tougher penalties for violating the anti-money laundering legislation. The plan

provides for the authorisation of the CB RF to conduct unlimited inspections of banks and fine their top managers.

The FATF has proposed making an amendment to the Law on the Central Bank of the Russian Federation increasing the fines the CB RF can impose on banks for violating anti-money laundering legislation and the CB RF's relative normative acts, and for supplying incomplete information on the suspicious operations of their clients. Currently, the fine amounts of up to 0,1% of the minimum share capital of a credit organization¹⁵, that is 5,000 euro . According to the FATF's recommendations, the increase of the above-mentioned penalty will be determined by the CB RF. The FATF suggested authorising the CB RF to impose fines not only on credit organisations as legal entities, but also on bank directors and senior executives personally.

Additionally, the FATF suggests increasing the frequency of the regulators' inspections by cancelling the current restriction of inspecting a bank on the same issue only once a year.¹⁶

New Procedure of Provision of Information to Rosfinmonitoring In its Regulation No.321-II of August 29, 2008, the CB RF sets forth a new procedure for credit organizations on formation and the provision to the regulatory authority of information on operations subject to obligatory control in accordance with the anti-money laundering legislation. In particular, it clarifies the procedure of using reference data for the preparation of reports in the form of electronic messages. The Regulation will enter into force on January 1, 2009.

Additional Control over Operations on the Transfer of Funds Abroad In the course of its supervisory activity, the CB RF highlighted that huge amounts of funds were recently transferred by legal entities/residents to their foreign accounts. Such operations may be noted for their transit nature, with no taxes paid from the accounts used for such transfers, as the amount of funds transferred per month exceeds 100 times the amount of charter capital of the re-

spective legal entities. In its Letter No.111-T of September 3, 2008, the CB RF recommends that banks pay special attention to such operations, request from the legal entities performing such operations documents confirming the sources of funds kept at their accounts and their rights pursuant to goods or other assets realized in Russia. Should the operation be considered suspicious, the bank shall notify Rosfinmonitoring thereof in accordance with the anti-money laundering legislation.

¹⁵ A current ruble equivalent of 5 million euro

¹⁶ <http://kommersant.ru/doc.aspx?DocsID=1010069>

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This BBH Bulletin is to serve as a general piece of information in respect of certain important news and events taking place in the area of the financial, capital and banking markets. The contents hereof do not, and shall not, serve as legal advice of any kind.

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