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New Russian Securitisation Legislation and its Impact

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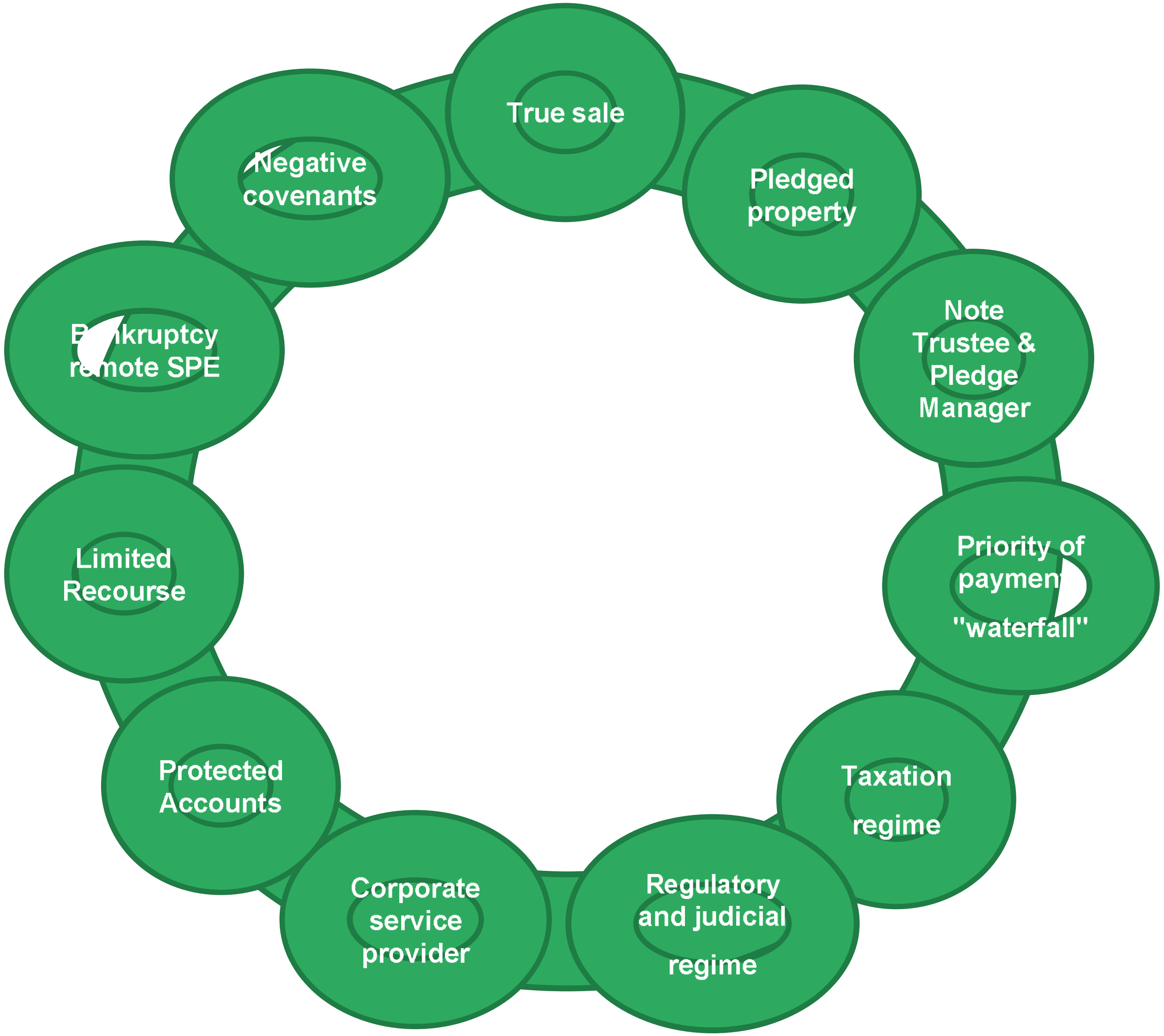
Overview

New Legislation enacted on 21 December 2013

- Comprises series of Amendments to 17 Legislative Acts
- Introduces two new types of SPV
- Provides statutory criteria supporting Bankruptcy Remoteness of the special purpose entity (SPE)
- Outlines the roles of Noteholder Representative, special purpose vehicle (SPV) Manager
- Improves registration of rights to the securitised collateral
- Provides support to a range of waterfalls

New Platform is a Major Development in Russian Structured Finance

Key Elements of the new Platform



Key Elements of the new Russian Structured Finance Platform

True Sale

» True sale isolates securitised assets from the insolvency estate of the seller

» The law limits the possibility of securitisation of assets that contain “no assignment” clauses. Additional measures may include:

- Eligibility Criteria
- Reps & Warranties of the Seller
- Portfolio review by third party (e.g., agreed-upon procedures or AUP)

» The New Law removes doubts regarding assignment of bank-originated assets to a non-credit institution

» Newly introduced register of serviced receivables will minimise commingling risk

New Law Adds Clarity to the Asset Transfer Provisions

New Types of Pledged Property

» The new securitisation legislation facilitates issuance of securities (notes/bonds) backed by pledges of cash receivables. Such cash receivables explicitly include future receivables, leasing agreements and rent agreements

» Cash on the accounts can also be subject to pledge

» The newly enacted legislation strengthens two elements which are important for the securitisation of assets backed by movable property:

» the legislation improves the ease of registration of rights to the securitised collateral and

» the legislation improves access to information relevant to the pledge of collateral in the form of movable property

» The legislation also improves the protection of bona fide purchasers (such as SPEs acquiring assets from an originator) against claims of third parties. The two elements mentioned above are particularly important for the securitisation of assets secured by movable property

New Law Supports Securitisation of a Broad Range of Assets

Priority of Payment Waterfall

» Payments under a claim can be made only upon full repayment of the more senior ranking claims

» The order of payments and allocation of losses must be reflected in the “decision on issuance” document

» In contrast to mortgage agents, the securitised portfolio is not removed from the bankruptcy estate of an SPE, and therefore creditor claims collateralised by the securitised portfolio will be considered non-preferential (third priority) claims

» Only 70% of the collateral proceeds may be paid directly to the noteholders and other secured creditors

» However, if an SPE is set up as a sufficiently bankruptcy remote vehicle, the risk of claims from the first and second priority creditors is likely to be negligible

New Law Supports Variety of Payment Waterfalls

Representative of the Noteholders – “Note Trustee”

- The noteholders may appoint a representative in the form of a note trustee acting on behalf of all noteholders and on instruction of the majority noteholders via the general noteholders’ meeting
- From 1 July 2016, this note trustee role will have to be part of all issued publicly traded notes
- We note growing demand for parties able to perform this role – any shortage may affect new issuance
- The note trustee will have to be registered with the Central Bank of Russia
- The obligations of the SPE towards noteholders are considered to be discharged upon transfer of the amounts to the account of the note trustee
- All amounts transferred to the account of the note trustee must be paid to the noteholders within three days of their receipt
- The creditors of the note trustee will not have recourse to funds held for the benefit of noteholders in such a protected account

We Anticipate That Most Transactions Will Utilise the Role of Note Trustee

New Tax Regime for SPEs

- The Russian model of SPE taxation is based on a tax exemption rather than on pass-through accounting
- The core of this model has already been applicable to mortgage agents in Russian onshore residential mortgage-backed securitisation (RMBS) transactions and, as a result of the New Legislation, will also apply to SPEs
- According to the mortgage-backed securitisation (MBS) legislation, property – including cash receivables and/or proprietary rights acquired by a mortgage agent in connection with activity prescribed by its charter – is exempt from any income tax
- In contrast with the favourable tax regime for newly established onshore SPEs, in cross-border securitisations the withholding income tax may be applicable to foreign SPEs receiving Russian-sourced income which is not attributable to the SPE's permanent establishment in Russia

SPE Taxation is Using Existing Approach

The Role of the Central Bank of Russia

Central Bank of Russia’s (CBR) securitisation-related powers include:

» Criteria for disclosure of assignment-related information by the SPE

» Criteria for SPV Management Companies Sole Executive Body (SEB)

» The CBR determines the types of property and receivables that can secure the issued bonds

» Standards applicable to pledge-accounts and other pledge records

» Asset/Liability ratios for banks assigning receivables to SPVs

» Activity of the representative of the noteholders

CBR Plays Very Important Role

Management Company – Sole Executive Body

» The Sole Executive Body (SEB) is similar to a corporate services provider in other established structured finance jurisdictions

» SEB can be an investment fund manager, unit investment fund manager, non-state pension fund manager or some other entity approved by the central bank

» A register of SEBs will be maintained by the CBR

» The ongoing efforts to create a standard SEB agreement may promote general compliance with the new legislation and improve overall clarity of key contractual provisions

» The statutory criteria and controls accorded to SEBs are in line with, and, in some aspects, more stringent than comparable corporate services provider models used in established structured finance jurisdictions

Our Analysis Will Take Into Account the Profile of the SEB

Protected Accounts – Escrow and Nominal Accounts

» The escrow account provides protection against the use of collected cashflows for purposes other than those agreed in the context of a securitisation transaction

» A nominal account can be opened by the account owner for financial operations with funds owned by other parties, i.e., the beneficiaries. Many features of the nominal account are similar to a trust account although the trust concept, as it is known in common law, does not exist under Russian law.

» As is the case with escrow accounts, funds held in a nominal account may not be segregated from the bankruptcy estate of the account bank upon the bank's insolvency

» Upon insolvency of the SPE, the funds held for the benefit of the noteholders or the trustee on the nominal account would not be seized

Introduction of Escrow and Nominal Accounts is Credit Positive

Protected Accounts – Pledge Account

» Prior to the introduction of this amendment, cash held on the account was not considered a part of the tangible property that can be subject to a pledge. As a result, amounts held on collection accounts at any point in time could be available to general creditors of an insolvent account holder

» According to the new legislation, the cash receivables held on a Russian pledge account are among several types of collateral that can be pledged as collateral securing the issuance of notes

» If different tranches are secured by different collateral, the relevant cash receivables must be paid to different pledge accounts

» However, as is the case with escrow and nominal accounts, funds held in a pledge account may not be segregated from the bankruptcy estate of the account bank upon the bank's insolvency

Pledge Account is an Important Developments in new Law

Added Options to MBS Transactions

- The new legislation provides for the emergence of onshore SFE-issued MBS transactions as an alternative to the traditional mortgage agent-issued onshore residential mortgage-backed securities (RMBS) transactions that are currently dependent on the MBS legislation with its specific concepts and criteria
- Given that restrictions imposed on the portfolio composition by the MBS law do not apply to the SPE-based MBS issuance, the latter can support the securitisation of portfolios with a broad range of characteristics such as loan-to-value ratios, maturity of the assets, size of the loans, concentration to particular sectors. Mortgage portfolios, for example, may attract smaller originators that cannot compete with the market leaders in the low loan-to-value “prime” segment
- A mortgage agent does not qualify as an SPE. The extent to which the new legislation applies to mortgage agents is expressly stated; otherwise, the MBS law remains the main governing statute for mortgage agents

New Law was Drafted Mainly for non-MBS Transactions

Negative Covenants (Pledges) and Limited Recourse

» Non-petition covenants limits the risk of petition by transactional against the SPE. Limited recourse limits the claims of the SPE creditors to the assets in the pool

» Under the new legislation, if transaction counterparties (other than noteholders or the note trustee acting on behalf of the noteholders) undertake to petition for the insolvency of an SPE, they will be prevented from doing so by law

» We anticipate that for most asset classes the transaction documents will conform to a new standard range of non-petition provisions for Russian SPEs

» The terms and conditions of the notes as well as other transactional documentation may prescribe that "*even if upon enforcement of the pledged collateral the proceeds of the enforcement are insufficient to fully satisfy creditors' and noteholders' claims, the obligation of the SPE towards such creditors and noteholders will be deemed to be discharged in full*"

New Provisions are in Line With International Standards

New Bankruptcy Remote SPVs

- Two new types of SPE - Specialised Financial Entity (SFE) and the Specialised Project Finance Entity (SPFE)
- The purpose and activities of the new SPEs are diverse, the SPE can accommodate complex structures
- Identification of the SPE must be clear
- SPE issuance cannot be backed by collateral that also secure claims of third parties
- A mortgage agent does not qualify as an SPE. The extent to which the new legislation applies to mortgage agents is expressly stated; otherwise, the MBS law remains the main governing statute for mortgage agents

SPE Framework is Consistent With SPE in Established Markets

Risk Retention

» 20% vs 10% vs 5%

» Retained by the last assignor

» Latest developments - further bylaws introduced by the CBR, clearer defined range, Vertical Slice is unlikely

» Risk retention can create an alignment between the interests of the noteholders and the interests of the originator/servicer that retain the risk

» Risk retention is not a “Rating Requirement”

» Potential impact on the issuance - key role of the regulator

Risk Retention can be Credit Positive

Remaining Challenges and Continuing Development

» Several bylaws are being finalised

» Considerable market activity designed to remove any remaining obstacles

» Efforts for the standardisation of eligibility criteria and documentary framework

» Continuous executive support for securitisation

» Accumulation of transactional experience in the market

» Emerging candidates for several key roles e.g., representative of the noteholders

» Impact of volatility on financial markets and “de-offshorisation” efforts

Russian Structured Finance Continues to Develop

Conclusion

- New law represents a significant step in the development of Russian onshore securitisation and Russian structured finance in general
- The law provides multi-faceted support for two new types of the bankruptcy-remote SPE
- Although developed largely with SMEs in mind, the law facilitates securitisation of a broad range of assets
- Standards of the key elements are on a par with the developed structured finance jurisdictions
- Sustained efforts are under way to implement several bylaws and to remove residual obstacles to higher issuance levels

Questions?