

client alert

CIVIL LAW | RUSSIA |

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CHANGES TO THE REGULATIONS OF FINANCIAL TRANSACTIONS IN 2018

Significant amendments to Russian regulation of financial transactions have been approved as part of the on-going reform of the Civil Code of the Russian Federation (the “**Civil Code**”).¹ The said changes (altogether, the “**Amendments**”) cover various matters, including:

- (1) loans and credit facility agreements;
- (2) the assignment of rights;
- (3) bank accounts and settlement (including new rules on escrow); and
- (4) factoring agreements.

The Amendments will enter into force on 1 June 2018 and will generally apply to contracts entered into after that date.

In this alert we aim to briefly highlight those aspects of the Amendments that are most relevant for financial transactions between legal entities, rather than changes primarily affecting financial arrangements for individuals.

LOAN AND CREDIT FACILITY AGREEMENTS

- Loan agreements with non-bank organisations (i.e. lenders which are not banks or other credit institutions) can now be entered into as executory contracts (or “*консенсуальные сделки*”):² the parties may agree on the provision of a loan in the future, whereas previously a loan agreement was regarded as a real contract and thus existing only once the lender had transferred the loan principal to the borrower. This Amendment has two important impacts:
 - (i) it significantly changes the perspective of the borrower’s claims under a loan agreement: the borrower is now able to demand the provision of a loan by the lender; and
 - (ii) it allows companies that do not qualify as “credit institutions” to participate in syndicated lending along with banks.
- Bank fees for a loan (other than interest) are to be construed as part of the loan principal and thus lawful and appropriate.

This Amendment changes the earlier practice where courts only recognized the legality of such fees if they were paid for a separate service provided by a bank or intended to compensate for expenses incurred by the bank.

¹ The legal basis for the Amendments is Federal Law No. 212-FZ dated 26 July 2017 “On Amendments to the First and the Second Part of the Civil Code of the Russian Federation as well as Other Statutes of the Russian Federation” (coming into force on June 2018).

² Earlier this was only possible for credit agreements, i.e. loan agreements with banks or other credit institutions.

- Securities may be the object of a loan.
- Interest rates applicable to a loan are by default equal to the key rates set by the Bank of Russia for the relevant periods.
- Parties may stipulate in a loan agreement that the loaned funds are to be provided by the lender to a third party designated by the borrower, and in that case the loan is to be regarded as having been granted directly to the borrower.
- This change apparently decreases the risks of a targeted loan being regarded as misused by the borrower and thus cancelled or sanctioned (as in many cases such agreements are entered into with a parent company as a formal borrowing entity, whereas the funds are in fact lent for its subsidiary, which is the actual borrower).
- If a loan (credit) agreement is entered into following a mandatory tender (i.e. in cases when, pursuant to the law, such agreement may only be entered by way of holding a public tender), the parties thereto may change the interest rates if the key rates set by the Bank of Russia are changed.

ASSIGNMENT OF RIGHTS

The Amendments abolish a debtor's ability to challenge a contractually prohibited assignment based on the assignee's awareness of such a restriction. At the same time, a similar prohibition continues to apply to the assignment of rights related to the performance of non-monetary obligations.

The parties to an assignment agreement will be authorised to limit the assignor's liability for the invalidity of the transferred contractual right: the limitations may extend to invalidity caused by circumstances (a) of which the assignor was not (and should not have been) aware of, or (b) about which the assignor warned the beneficiary (including rights to security provided for the obligation, rights to accrued interest, etc.).

Finally, the assignment of rights arising out of a contract entered into under a mandatory tender is now expressly allowed with respect to any rights to claim payment (monetary claims) under such contracts.

BANK ACCOUNTS AND SETTLEMENT REGULATIONS (INCLUDING ESCROW)

The most notable changes to the regime governing the letter of credit (the "LC") introduced by the Amendments are the following:

- the LC rules will thoroughly regulate relations between the issuing bank and the bank it is allowed to nominate (authorize) to pay the funds to the receiver (the "**Nominated Bank**"), as well as settlements between them (whereas previously it was relations between the issuing bank and its client that were the main focus of the Civil Code articles on the LC). In other words, the regulation will now be more detailed for cases where the LC is issued and paid by two different banks and not one and the same bank;
- the LC will be irrevocable by default:³ the issuing bank will not be allowed to change its conditions or cancel the LC without the prior notification of the recipient of the funds; in addition, if the LC has been affirmed by the Nominated Bank, it cannot be changed or cancelled without the latter's consent;
- the list of actions to be performed by the issuing bank for the performance of the LC is no longer closed: it is not limited only to making payments and/or accepting bills of exchange, but includes other actions to be performed, as prescribed by the conditions of the LC; this apparently enlarges the sphere of application of the LC in practice; and

³ Before the Amendments come into force, letters of credit are by default revocable.

- the *transferable LC* is to be brought under legislative regulation (instead of being acknowledged as an international trade custom). Under the amended Civil Code, a transferable credit is a LC that may be performed in favour of a person(s) designated by the recipient of funds, provided that the Nominated Bank has granted its consent. The recipient of funds may determine a list of documents to be provided by such second beneficiary in order for the LC to be performed in its favour.

The regulation on the transferable LC does not yet cover all of the important terms of its transfer and performance. For example, it is not clear whether the recipient of funds may 'transfer' only part of the credit to a second beneficiary, or whether it may allocate the credit in different shares between several beneficiaries (or whether multiple beneficiaries must have equal shares, etc.). In other words, it remains to be seen how the new provisions on the transferable LC will work in practice.

As mentioned above, the Amendments also set out regulations applicable to escrow accounts and widen the sphere of their potential use, in particular:

- (a) an escrow mechanism is now available for various types of movable property (including cash, certificated securities) as well as non-cash funds and book-entry securities (i.e. securities title to which is evidenced through an entry in a special register rather than holding a physical certificate to such securities);
- (b) the functions of an escrow agent may be performed by any person and not only by a bank.

At the same time, the legislation remains silent as to the requirements to be complied with by an organisation intending to act as an escrow agent; such as the licensing regime or other governmental control procedure. In other words, it remains to be seen whether and how the status of escrow agents will be regulated;

- (c) it is determined who has title to the escrowed movable property: as a general rule, the escrow depositor holds the title until the date on which the escrow release conditions occur; after that date the title transfers to the beneficiary (where the escrow agent is generally responsible for any loss of or damage to the escrowed movables as a custodian);
- (d) the escrow of book-entry securities is to be conducted by the making of an appropriate entry in the register of the securities by a competent person (authorized registrar, etc.);
- (e) if escrowed property is non-cash funds and the escrow agent is not a bank, the funds will be deposited in the agent's nominal account; the receiving party of the funds from such an account will be the depositor – before the escrow release conditions occur – or the beneficiary – after the occurrence of those conditions; and
- (f) the term of validity of escrow agreements is limited to a maximum of 5 years and is subject to notarisation (unless the escrowed property is non-cash funds or book-entry securities).

The Amendments also provide that escrowed property will be immune in the event of the bankruptcy of the escrow depositor. It is stipulated now that:

- (a) escrowed property will not be included in the bankruptcy estate of the escrow depositor;
- (b) the bankruptcy trustee will not be allowed to dispose of the escrowed property of the debtor;
- (c) the bankruptcy of the escrow depositor will not impede the transfer of escrowed property to the beneficiary by the escrow agent for the purpose of performing the depositor's obligation towards the beneficiary; and

- (d) if the escrow release conditions do not occur within six months following the initiation of the bankruptcy liquidation procedure, the escrowed property will be included in the bankruptcy estate.

In addition, the Amendments provide that escrowed property may not be forfeited due to enforcement proceedings against the escrow depositor, the beneficiary or the escrow agent. However, it is possible to apply judicial enforcement procedures to the depositor's or beneficiary's right of claim against the escrow agent.

FACTORING AGREEMENTS

The Amendments significantly widen the 'area' of factoring agreements:⁴

- (a) Factoring no longer covers all assignments of rights for consideration. The law sets out that entities may also enter into other agreements under which the assignment of rights is subject to another entity's performing certain actions. This change will, presumably, facilitate the further development of securitisation and related instruments.
- (b) The list of the types of monetary claims which may be factored has been expanded. Now it includes:
 - (i) rights arising out of any kind of contract, including licence agreements (whereas before the Amendments only rights under supply or service contracts could be factored); and
 - (ii) rights from contracts entered into at a tender, including contracts (previously, the factoring of rights under such contracts was prohibited).
- (c) Rules on consideration for the assignment of rights in factoring arrangements have also been articulated. Whereas previously it was only possible to provide monetary funds as consideration, the Amendments now allow the factor to choose and conduct **any** two of the following activities:
 - (i) granting money (including as a loan or advance payment);
 - (ii) keeping records to monetary claims of the client against third parties (debtors);
 - (iii) exercising rights to monetary claims of the client (including demands for their payment, receipt of payments and related settlements); and
 - (iv) exercising rights under security agreements with respect to debtors' obligations.
- (d) The further assignment of rights by the factor is no longer prohibited, unless otherwise agreed in the factoring contract.



⁴ A factoring agreement is generally an agreement under which one person undertakes to assign certain rights (rights to claim) to another person and the latter undertakes to pay for such assigned rights (rights to claim).

The Amendments aim to expand the scope of current regulations applicable to financial transactions and to make such regulations more practical and effective, thereby providing the parties with a broader range of options to achieve their business objectives. For example, the possibility to enter into executory loan agreements makes lending available for any company (not only banks) and strengthens the position of borrowers; reducing the grounds for challenging an assignment makes this instrument more stable and less dependent on the will of the debtor; and the update and clarification of the regulations on LCs may spark interest in this means of payment.

At the same time, to function effectively, the Amendments will likely require the future adoption of certain governmental acts regulating a number of practical (mostly procedural) aspects of the relevant commercial arrangements.

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