

The reform of Russian security rights in movable assets

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Introduction

- Following remarks are made mainly in response to a **draft reform paper** proposed to the Duma Banking Committee in **2008** which has been translated into German
 - ‘Analysis of fundamental issues of Russian legislation on taking security in movable assets and some possible solutions’ (herein referred to as “**Analysis 2008**”)
- It takes into account a previous **draft reform paper** proposed to the Duma Banking Committee in **2007** in English language
 - ‘Directions for Improving Legislation on Pledge’ (herein referred to as “**Directions 2007**”)

Approach to legal reform

- Russian Government reform targets
- General reform issues
- Reform principles

Russian Government reform targets

- Introduction of **escrow accounts** to be held with banks (including foreign ones)
- Detailed provisions on the **pledge of rights in bank accounts**
- Abolition of the requirement to sell pledged property at public auctions and the introduction of a simple procedure for the **transfer of ownership** in pledged property from the pledgor to the pledgeholder
- Strengthening of the enforcement of mortgages in real estate in **out-of-court proceedings**, in particular on the basis of agreements certified by a public notary
- **Separation of pledged property** from a bankrupt's estate if the pledgor becomes insolvent

Source: *'Development Strategies for the Banking Sector of the Russian Federation for the Period until 2008', approved by Joint Declaration No 983p-P13 and No 01-01/16178 of the Government of the Russian Federation and the Central Bank of the Russian Federation respectively of 5 April 2005*

General reform issues

- **General goals** of secured transactions law
 - See next slide: “Reform principles”
- **Scope of reform**
 - Wholesale or piecemeal reform
 - Mortgage law just recently reformed
 - Legislative corrections of existing provisions e.g.
 - Several layers of Russian secured transactions law (Pledge Law, Civil Code [Mortgage Law])
 - Different or unitary approach to different types of assets (real estate, movable assets and receivables/rights)
 - Addition of missing issues of Russian secured transactions law, e.g.
 - Bank accounts
 - More detailed provisions on retention of ownership

Reform principles

	Current proposal	Comments
<div data-bbox="94 422 514 673">Interests of both pledgor and pledgeholder</div> <div data-bbox="94 738 514 1015">Interests of third parties</div> <div data-bbox="94 1071 514 1347">Interests of holders of additional pledges</div>	<ul style="list-style-type: none"> To be taken into account (see Analysis 2008) 	<ul style="list-style-type: none"> Legal assessment of involved parties' and third parties' interests necessary Consider, however, economic criteria for reform, in particular <ul style="list-style-type: none"> Security should reduce the risk of giving credit thus increasing availability of credit on improved terms If the secured debt is not paid the holder of security should be able to have the charged assets realised and to have the proceeds applied towards satisfaction of his claim prior to the other creditors See further EBRD Core Principles for a Secured Transactions Law Take into account local financing practice and distinguish between <ul style="list-style-type: none"> Consumer financing Local financing <ul style="list-style-type: none"> Bank financing Trade financing International finance (in particular bank syndicates, securitisation, bond agents)

Discussion of reform proposals

- Changes to substantive law
- Publicity of security rights
- Enforcement of security rights in movable assets

Changes to substantive law 1: Preferential rights

Enforcement, Art. 78, 111 Enforcement Law

- Distribution among creditors who have submitted **enforcement order** (“Vollstreckungstitel”) at time of distribution
- Claims in damages for an individual’s **death or injury** (including compensation for immaterial damage)
- **Salaries**, severance payments, copyright license fees
- [Unclear debts against **bank**: depositors’ claims if depositors are natural persons]

Insolvency, Art. 134 No. 4 Insolvency Law

- Claims in damages for an individual’s **death or injury** (including compensation for immaterial damage)
- **Salaries**, severance payments, copyright license fees
- Debts against **bank**: depositors’ claims if depositors are natural persons

Company liquidation, Art. 64 Civil Code

- Claims in damages for an individual’s **death or injury** (including compensation for immaterial damage)
- **Salaries**, severance payments, copyright license fees
- Debts against **bank**: depositors’ claims if depositors are natural persons

Changes to substantive law 2: Preferential rights

Open issue	Current law	Proposal	Comments
<p>Priority of pledge in insolvency of pledgor</p>	<ul style="list-style-type: none"> Art. 134 No. 4 Insolvency Law provides for priority 	<ul style="list-style-type: none"> Priority should be clarified by law 	<ul style="list-style-type: none"> Preferential rights outside insolvency proceedings should be examined further
<p>Satisfaction of debts which are without preference to pledge</p>	<ul style="list-style-type: none"> Enforcement in the interest of the enforcing party (Art. 78 No. 7 Enforcement Law) May lead to the situation that debts without preference to pledge are enforced 		<ul style="list-style-type: none"> Procedural remedies for pledgeholder in enforcement proceedings should be provided

Changes to substantive law 3: Preferential rights

Open issue	Current law	Proposal	Comments
Preference of pledges created by law over those created by agreement, Art. 78 No. 9 Enforcement Law	<ul style="list-style-type: none"> ▪ Pledges created by law rank ahead irrespective of their time of creation 	<ul style="list-style-type: none"> ▪ Only ranking according to time of creation, Art. 342 No. 1 Civil Code ▪ Amend preference of pledges created by law currently provided by Art. 78 No. 9 Enforcement Law 	<ul style="list-style-type: none"> ▪ Statutory liens should not be given preferential status
Satisfaction of preferential rights by pledgor, Art. 78 No. 5 Enforcement Law	<ul style="list-style-type: none"> ▪ Pledgor must satisfy preferential rights if no sufficient assets are available 	<ul style="list-style-type: none"> ▪ This should apply only in insolvency proceedings 	<ul style="list-style-type: none"> ▪ Agree to position that this is issue of insolvency proceedings ▪ Leads to delay of enforcement of security rights
Equal treatment of several pledgeholders	<ul style="list-style-type: none"> ▪ No equal treatment of several pledgeholders 	<ul style="list-style-type: none"> ▪ Exclude enforcement against pledged assets by general credits 	<ul style="list-style-type: none"> ▪ Simply procedural remedies for pledgeholder in enforcement proceedings should be provided

Changes to substantive law 4: Securing of insubstantial debts

Open issue	Current law	Proposal	Comments
<div style="border: 1px solid black; border-radius: 15px; padding: 10px; text-align: center;"> <p>Securing of insubstantial debts</p> </div>	<ul style="list-style-type: none"> ▪ Value of pledged property must be “appropriate” only in the case of real estate, Art. 71 Mortgage Law ▪ Limited rights for release of pledge by satisfaction of debt by pledgors or creditors <ul style="list-style-type: none"> ▪ Art. 313 Civil Code <ul style="list-style-type: none"> ▪ Debt may be satisfied by third person ▪ Third person may satisfy debt if his right may terminate due to enforcement ▪ Art. 315 Civil Code (satisfaction of debts which are not yet due by debtor) 	<ul style="list-style-type: none"> ▪ Introduction of rule similar to Art. 71 Mortgage Law (minimum value of secured debt in comparison to value of enterprise) ▪ Introduction of right for creditor to satisfy debt if value of debt is insubstantial in comparison to value of pledged asset 	<ul style="list-style-type: none"> ▪ Relatively unrealistic scenario which does not merit legislative attention ▪ Value issue is creating uncertainty in secured transactions law

Changes to substantive law 5: Security transfer of ownership

Open issue	Current law	Proposal	Comments
<p>Introduction of security transfer of ownership</p>	<ul style="list-style-type: none">▪ No security transfer of ownership recognised	<ul style="list-style-type: none">▪ Security transfer of ownership under consideration for two reasons:<ul style="list-style-type: none">▪ Increased protection of securityholder▪ Facilitation of enforcement of security in comparison to current enforcement regime for movable assets	<ul style="list-style-type: none">▪ Security transfer of ownership prevents creation of security rights with different ranking (senior – junior right)▪ Enforcement issues can be solved by reform of enforcement law

Publicity of security rights 1: Forms of publicity under Russian law

■ Current law

■ Immovable assets

- **Registration** with the Federal Registration Service, Art. 11 (1) Mortgage Law

■ Movable assets

- **Possession**: no requirement for creation of a pledge, effect against third parties or priorities that possession is transferred to pledgeholder, Art. 338 (1) Civil Code
 - **Identification** of movable assets if possession is kept by pledgor possible (but not necessary), Art. 338 No. 2 Civil Code; identification in two forms:
 - Lock (“Verschluß”) and seal of pledgeholder
 - Marking of pledged asset
 - Recording in privately held record: **pledge book** required to be kept by registered “entrepreneurs”, sec. 18 Pledge Law
 - Can be regarded as having been modified by Art. 357 (3) Civil Code (lex posterior) which requires mandatory pledge book only if pledged assets are goods in circulation
 - In practice no entries appear to be made
- ### ■ Receivables, rights
- **No notice** requirement for the creation of pledges in receivables

Publicity of security rights 2: Forms of publicity under Russian law










- **Reform proposal** for introduction of registration/filing
 - **Vehicles**
 - Cars seem currently to be exempt from registration
 - See special decision of the Supreme Arbitration Court of 7 April 1998 (No. 3081/97)
 - Registration in special register for cars could be introduced as new requirement in Art. 339 No. 5 Civil Code
 - See Analysis 2008
 - **All types** of movable assets
 - If pledge in movable assets is created without transferring possession to pledgeholder (i.e. without publicity) it may create impression of “**false wealth**” (Philip Wood) thus enabling
 - **Transfer of ownership** by pledgor to third parties in pledged assets without notice of pledge
 - **Creation of pledges** in pledged assets by pledgor for the benefit of third parties with a prior ranking

Publicity of security rights 3: Registration of security rights in comparative law

- Filing
 - **US-American law:** security interests under Art. 9 Uniform Commercial Code require filing as a requirement for third party effect
- Registration (or notice filing)
 - **Law of England and Wales:** Registration of charges and mortgages of a company at companies register as a requirement for third party effect
- No registration or filing
 - **German law:** no registration of pledges in movable assets, of security transfers of ownership in movable assets and retentions of ownership

Additional reference: Philip R Wood, *Maps of World Financial Law*, 5th ed. (London 2005), pp. 89-105

Publicity of security rights 4: General Principles - Comparison of EBRD 'guiding principles for the publicity of security rights' and Analysis 2008

EBRD	Analysis 2008	Status
<ul style="list-style-type: none"> 1. A regime for secured credit should provide for effective publicity of charges. 	<ul style="list-style-type: none"> 1. Publicity of pledges in movable assets under consideration mainly for cars. 	
<ul style="list-style-type: none"> 2. As a result of publicity it should be possible to find out what charges are claimed over a person's assets and their chronological order of ranking. 	<ul style="list-style-type: none"> 2. No statement. 	
<ul style="list-style-type: none"> 3. Publicity is best achieved by registration, most often against the person granting the charge. 	<ul style="list-style-type: none"> 3. It is considered that registration of pledges in cars will be made against the asset. 	
<ul style="list-style-type: none"> 4. Failure to publicise a charge makes it ineffective against third parties. 	<ul style="list-style-type: none"> 4. Pledgeholder may hold pledge against third persons only from time of registration; however, pledge exists between pledgor and pledgeholder. 	
<ul style="list-style-type: none"> 5. The system for giving publicity and for accessing the publicised information should be simple. 	<ul style="list-style-type: none"> 5. No statement. 	
<ul style="list-style-type: none"> 6. The system for giving publicity and for accessing the publicised information should be fast and inexpensive. 	<ul style="list-style-type: none"> 6. The register should be fast and inexpensive. 	
<ul style="list-style-type: none"> 7. The register should be accessible for all persons and all registered information should be public. 	<ul style="list-style-type: none"> 7. The register should be accessible for all interested persons and there should be a system for the whole country. 	
<ul style="list-style-type: none"> 8. The method of recording, storing and accessing information should protect against error, abuse and fraud. 	<ul style="list-style-type: none"> 8. The register should protect against unreliable information. 	
<ul style="list-style-type: none"> 9. The registry should be operated and managed transparently as a public service. 	<ul style="list-style-type: none"> 9. No statement as to whether public service; corruption of the system should be avoided. 	

Source: *EBRD, Publicity of Security Rights, Guiding Principles for the Development of a Charges Registry (London 2004)*

Source: *Analysis 2008*

Publicity of security rights 5: Additional issues to consider when introducing general registration/filing

Scope of registration

Current proposal

- Only if possession is kept by pledgor
- or**
- in “all cases” (i.e. also if possession is transferred to pledgeholder)

Comments

- If possession is transferred to pledgeholder this provides sufficient publicity of possible existence of pledge
 - EBRD model law as well as Art. 9 UCC allow for possession as alternative means of publicity
- However, registration even in these cases appears to be equally valid option
 - Analysis 2008 favours this approach as well

Publicity of security rights 6: Additional issues to consider when introducing general registration/filing

	Current proposal	Comments
Registration body	<ul style="list-style-type: none"> ▪ Body to be chosen in accordance with principles identified in Analysis 2008 (see previous slide) ▪ Possible candidates: <ul style="list-style-type: none"> ▪ Post offices ▪ Notaries public ▪ Sberbank 	<ul style="list-style-type: none"> ▪ Notaries public have been chosen in Hungary and Slovakia ▪ UK and US are using independent registration offices ▪ See also UNIDROIT experience (private company performing registration services)
Form of pledge agreement and its assessment (“procedure”)	<ul style="list-style-type: none"> ▪ Notarised pledge agreement <ul style="list-style-type: none"> ▪ Assumes checking of pledge agreement by public notary ▪ Written pledge agreement 	<ul style="list-style-type: none"> ▪ Notarised pledge agreement creates unnecessary restraints for commerce (in particular financial institutions)

Publicity of security rights 7: Additional issues to consider when introducing general registration/filing

	Current proposal	Comments
Documents to be submitted to register	<ul style="list-style-type: none">▪ It seems to be assumed that pledge agreement has to be presented	<ul style="list-style-type: none">▪ Internationally a distinction is made<ul style="list-style-type: none">▪ Registration (or notice filing) = submission of a registration form▪ Filing = submission of the security agreement (possibly a form as well)
Pledge assessment by registrar	<ul style="list-style-type: none">▪ To be defined▪ No legal assessment by registrar of pledge agreement (and agreement concerning secured debt)	<ul style="list-style-type: none">▪ Registration should be a simple process

Publicity of security rights 8: Additional issues to consider when introducing general registration/filing

	Current proposal	Comments
Contents of registration	<ul style="list-style-type: none">▪ Based on contents of pledge agreement, Art. 339 (1) Civil Code, i.e.<ul style="list-style-type: none">▪ Essential terms of pledge agreement▪ Pledged asset▪ Asset valuation▪ Secured debt (nature, amount, due date)▪ Possession of pledged asset▪ Parties (pledgor, pledgeholder, debtor of secured debt if different from pledgor)	<ul style="list-style-type: none">▪ Asset valuation not needed
Good faith acquisition of pledges or ranking of pledges	<ul style="list-style-type: none">▪ No proposal	<ul style="list-style-type: none">▪ Good faith acquisition not necessary element of registration system (in particular if no assessment by registrar)

Publicity of security rights 9: Additional issues to consider when introducing general registration/filing

	Current proposal	Comments
Liability of registrar	<ul style="list-style-type: none">▪ To be considered	<ul style="list-style-type: none">▪ Liability of registrar should be element of registration system
Consequence of registration in civil proceedings	<ul style="list-style-type: none">▪ Registration should not serve as “evidence” (in the sense of “procedural assumption” [Vermutung])	<ul style="list-style-type: none">▪ Logical if no check of underlying transaction is performed by registrar

Enforcement of security rights in movable assets 1: Procedures

	Current law	Proposal	Comments
<p>Court procedure, Art. 349 No. 2 Civil Code</p>	<ul style="list-style-type: none"> ▪ Court order as basis for enforcement, Art. 78 No. 1 Law on Enforcement Proceedings 	<ul style="list-style-type: none"> ▪ No change proposed. 	
<p>Out-of-court procedure provided by agreement, Art. 349 No. 2 Civil Code</p>	<ul style="list-style-type: none"> ▪ Agreement on enforcement can be made at the time of entering into pledge agreement ▪ No court order necessary for enforcement, Art. 78 No. 2 Law on Enforcement Proceedings ▪ No further specification of procedure in legislation ▪ In practice no further specification in agreement 	<ul style="list-style-type: none"> ▪ Provide by law <ul style="list-style-type: none"> ▪ What has to be done if pledge is enforced although it is not enforceable ▪ Extent of secured debt ▪ Grounds for rejecting enforcement, Art. 348 (2) Civil Code 	

Enforcement of security rights in movable assets 2: Sale of pledged assets in court procedure

	Current law	Proposal	Comments
Sale based on public tender by court	<ul style="list-style-type: none"> Already provided for real estate, Art. 56 No. 1 Mortgage Law 	<ul style="list-style-type: none"> To be implemented for enforcement of movable assets 	
Auction by court	<ul style="list-style-type: none"> Already provided for real estate, Art. 56 No. 2 Mortgage Law, Arts. 447-449 Civil Code 	<ul style="list-style-type: none"> To be implemented for enforcement of movable assets 	
Sale in public exchange	<ul style="list-style-type: none"> Not yet provided 	<ul style="list-style-type: none"> To be implemented for enforcement of movable assets 	

Enforcement of security rights in movable assets 3: Sale of pledged assets in out-of-court procedure

	Current law	Proposal	Comments
Sale based on public tender	<ul style="list-style-type: none"> Already provided for real estate, Art. 56 No. 1 Mortgage Law 	<ul style="list-style-type: none"> To be implemented for enforcement of movable assets 	
Auction	<ul style="list-style-type: none"> Already provided for real estate, Art. 56 No. 2 Mortgage Law 	<ul style="list-style-type: none"> To be implemented for enforcement of movable assets 	
Sale in public exchange	<ul style="list-style-type: none"> Not yet provided 	<ul style="list-style-type: none"> To be implemented for enforcement of movable assets 	
Purchase of pledged assets by pledgeholder for itself or for benefit of third person	<ul style="list-style-type: none"> Already provided for real estate, Art. 55 (2) No. 3 Mortgage Law 	<ul style="list-style-type: none"> Unclear whether this should also be implemented for enforcement of movables 	

Enforcement of security rights in movable assets 4: Sale of pledged assets in out-of-court procedure

	Current law	Proposal	Comments
Automatic transfer of ownership in pledged asset to pledgeholder (“Verfallklausel”)	<ul style="list-style-type: none"> Already provided for real estate, Art. 49 (3) No. 2 Mortgage Law 	<ul style="list-style-type: none"> To be implemented for enforcement of movable assets Agreement on price or determination of price needed 	
Sale of pledged asset by pledgeholder to third person	<ul style="list-style-type: none"> Already provided for real estate, Art. 49 (3) No. 3 Mortgage Law 	<ul style="list-style-type: none"> To be implemented for enforcement of movable assets 	

Back-up

- Receivables financing
- Comparative overview of security rights in movable things
- Reform activities
- Bibliography

International reform activities 1

BACK-UP

■ European Bank for Reconstruction and Development (EBRD)

- Model Law on Secured Transactions (1994)
 - Drafted by John Simpson and Jan-Hendrik Röver
 - See in particular amendment of Slovak Civil Code (2002)
- Core Principles for a Secured Transactions Law (1997)
- Publicity of Security Rights (2004/2005)
- Mortgages in transition economies (2008)

■ UNIDROIT

- Convention on International Interests in Mobile Equipment, Cape Town 16 November 2001
- UNIDROIT Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Aircraft Equipment, Cape Town 16 November 2001

International reform activities 2

BACK-UP

■ UNCITRAL

- Convention on the Assignment of Receivables in International Trade (2001)
- Security Interests: Draft Legislative Guide on Secured Transactions
 - Drafting not yet completed
- Legislative Guide on Insolvency Law (2005)

■ Study Group on a European Civil Code

- Team on security rights led by Ulrich Drobnig
- See generally www.sgecc.net
- See specifically on secured transactions
www.mpipriv-hh.mpg.de/deutsch/Forschung/Kreditsicherheiten.html

Comparative overview of national security rights in movable things

BACK-UP

■ US

- Security interest under Art. 9 UCC

■ Law of England and Wales

- Charge
 - Fixed charge
 - Floating mortgage
- Mortgage
 - Fixed mortgage
 - Floating mortgage – virtually inexistent in practice
- Pledge
- Simple retention of title

■ German law

- Pledge in movable things
- Security transfer of ownership in movable things
- Retention of ownership (simple, extended to other debts, extended to future property)

■ Refinancing register for mortgage backed securities in Germany

- The German non-accessory land mortgage creates difficulties in the context of MBS (= mortgage backed securities) transactions in which a portfolio of loan obligations secured by a non-accessory land mortgage is transferred to a special purpose vehicle that finances the purchase by issuing bonds. This requires the transfer of both secured debts as well as non-accessory land mortgages
- See now the refinancing register pursuant to §§ 22a-o Banking Act (KWG):
 - Secured debts and non-accessory land mortgages are registered in the refinancing register that is normally kept by the refinancing company, § 22a KWG
 - This is controlled by the administrator of the refinancing register who is installed by the Financial Services Authority (BaFin), § 22e KWG
 - The registration allows separation of the registered assets (secured debts pursuant to § 47 InsO in the insolvency of the special purpose vehicle, § 22j KWG

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- Jan-Hendrik Röver, *Vergleichende Prinzipien dinglicher Sicherheiten. Eine Studie zur Methode der Rechtsvergleichung* (Munich 1999)
- Jan-Hendrik Röver, *Secured Lending in Eastern Europe* (Oxford 2007)
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- Jan-Hendrik Röver, *Realsicherheiten und Direktvereinbarungen*, in: Ulf R. Siebel/Jan-Hendrik Röver/Christian Knütel (eds.), *Rechtshandbuch Projektfinanzierung und PPP* (Köln, München 2008), pp. 762-812
- Philip R. Wood, *Comparative Law of Security Interests and Title Finance*, 2nd ed. (London 2007)

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 - Mortgages in transition economies. The legal framework for mortgages and mortgage securities (London 2008)

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- Hugh Beale, Michael Bridge, Louise Gulliver and Eva Lomnicka, *The Law of Personal Property Security* (Oxford 2007)
- Sir Roy Goode, *Commercial Law*, 3rd ed. (London 2004)
- Gerard McCormack, *Secured Credit Under English and American Law* (Cambridge 2004)
- The Law Commission, *Registration of Security Interests: Company Charges and Property other than Land* (Consultation Paper No. 164) (July 2002) (www.lawcom.gov.uk)
- The Law Commission, *Company Security Interests* (Consultation Paper No. 176), (August 2004) (www.lawcom.gov.uk)
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