



“New Act on Mortgage Bonds in Russia”

Budakov Dmitry

CB “Moscow Mortgage Agency”

General Director

Copenhagen, October, 2004



Main topics of the report

- Federal Law on Mortgage Securities, adopted in November, 2003, came into force in 2004
- 2 types of mortgage securities under the Law: mortgage bonds & mortgage certificates of participation
- Mortgage cover rules
- Mortgage agents & banks as the issues of mortgage bonds
- Special rules for mortgage cover control. Regulation for specialized depositories.
- Disclosure of information on mortgage bonds issues.
- New legislation, related to the mortgages.
- Perspectives of the mortgage securities' market in Russia



Necessity of specialized legislative framework for mortgage securities

- The project of Federal Law on Mortgage Securities was discussed by the market participants, the Government, Central Bank and the Parliament since March, 2002. It was adopted in November, 2003 and came into force in January, 2004
- Rapid development of the mortgage loan business of Russian banks and relative weakness of national securities market made it urgent to construct legal framework of issuing mortgage securities
- The Pension reform, started in 2003, demanded long-term and reliable financial instrument - to save pension money both by State Pension Fund and private pension system
- Existence of purposefully formed and legislatively regulated mortgage coverage – the way to improve qualitative characteristics and investment attractiveness of mortgage securities
- The development of the mortgage market was announced by Putin among ten key aims of his reforms for 2003-2006



Types of securities, regulated by Federal “Mortgage backed securities Law”

New law regulates two different types of securities:

- Mortgage bonds
- Mortgage certificate of participation

Both on-balance and off-balance mechanisms of mortgage securitization are the subject of the Law. Banking and non-banking institutions have equal access to the market.

Both the Government and the Central Bank of Russia are adopted by the Law as the key regulators and supervises of the mortgage securities market.



Mortgage bonds

Mortgage bond – a bond, which settlement of obligations are secured by mortgage cover

Mortgage bond:

- Can be issued only by banks or mortgage agents
- Can be issued in a paper or non-paper form under general rules of the Law on the Securities Market
- Must ensure the right of its owner on receiving face value and fixed income
- Gives its owner all the rights followed from the pawning of mortgage cover

Mortgage cover can be pawned as a collateral for two or more bond issues
Mortgage bond fixed income must be paid once a year or more often



Mortgage bonds (part 2)

- In case of the bankruptcy of the issuer the preferential right of the owner of mortgage bonds as a pledge creditor to other creditors is established. Exception is made for the demands of citizens for compensations on life and health damage, moral injury and demands in accordance with labor legislation and author rewards. For credit organizations the demands of the owners of mortgage bonds are to be fulfilled after demands of citizens on deposits and banking accounts
- The amount in mortgage cover, should be in excess of 80% of nominal value of the bonds and at the moment of state registration of the issue – in excess of total nominal value and the sum of interests on them.
- Real estate can be the part of mortgage cover of the bonds only as a result of mortgage loan recover, but only for 2 years
- Replacement of mortgages in mortgage cover of the bonds is allowed only in cases, determined in Art. 3 p.4 of the Law



Mortgage bonds (part 3)

The owners of mortgage bonds have the right to demand its **pre-term redemption**, if :

- the amount of obligations on the issued bonds exceeds the amount of mortgage coverage or
- the order of the replacement of assets in mortgage coverage is violated or
- the terms providing full and timely payments are violated or
- the issuer of the mortgage bond makes prohibited business or
- in any other cases, under conditions of emission prospectus

The issuer of mortgage bonds must inform the investors on their right of pre-term redemption not later 5 days after the event or action, which caused the appearance of such rights



Mortgage certificates of participation

Mortgage certificates of participation (MCP) certifies the equal amount of rights, also the equal share in a right of shared property for mortgage coverage.

- MCP has not nominal value
- The legal nature of the relations between the issuer of MCP and the owner of MCP – trust of assets.
- Mortgage cover is accounted by the trustee on a separate balance.
- The risk of not appropriate trust and market risk are accepted by the owners of MCP
- New type of mutual investment funds based on mortgage assets appeared in Russia as the alternative for MCP after the Law came into force



Special rules for mortgage cover control

- Mortgage cover can be formed with cash demands on mortgage loans, also certified by mortgages, MCPs, cash in Russian Roubles or foreign currency, and for mortgage bonds in some special cases treasury bills and real estate
- Mortgages can be included in mortgage cover if:
 - the face value of every mortgage do not exceed 70% of real estate market value, estimated by independent valuer
 - Mortgage do not allow any operation with real estate without permission of the mortgage creditor
 - Real estate must be insured from the risk of damage for all maturity of the mortgage
 - Private person – the mortgage debtor – must have life insurance
- Unnecessary detailed demands on mortgage cover (for example, establishing of necessity of simultaneous payments of principal and interest on excess of 50% of demands, included in mortgage cover)



Special rules for mortgage cover control (part 2)

- The value of mortgage cover is calculated as a sum of face value of the mortgages and the value of real estate and T-bills
- According **Art. 3 p.4 of the Law** mortgages are not included in the calculation of mortgage cover value if:
 - Failure to carry out mortgage obligation exceeds 6 months
 - The right for mortgage is lost
 - Court decision about the bankruptcy of mortgage debtor came into force
 - Court decision about breaking off mortgage came into force
- Any asset can be included in only one mortgage cover
- Mortgage demands and other assets, which form mortgage coverage, are accounted in cover register. The mortgage cover register is controlled by a specialized depository (custody).



Functions of specialized depository

Accounting and keeping of assets, which form mortgage coverage:

- Keeping of a register of mortgage coverage
- Keeping of documents, which confirm mortgage backed demands and demands on other assets, accounted in a register of mortgage coverage. - The problem of a bank's operations privacy.
- Keeping of a securities in certificate form in exception of treasury bills, formed mortgage coverage

Controls over operations with assets mortgage cover:

- Monitoring the observation by the issuer of mortgage bonds the demands of legislation and issuing prospectus
- Approval of specialized depository for operations with assets, which form mortgage coverage

If a specialized depository violates its duties, it becomes jointly responsible together with mortgage bond issuer for the results of the violation



Specialized depository

Specialized depository – a commercial organization with a license of a special depository for investment funds and private pension funds and a license for professional depository activities on the securities market

Specialized depository can not be affiliated with the issuer of mortgage bonds

Specialized depository has no right to operate with the assets, included in mortgage cover of the bonds

Specialized depository must inform the mortgage bonds' investors on their right of pre-term redemption not later than 10 days after receiving documents, proving the event or action, which caused the appearance of such rights and if it is not proved, that the issuer of the bonds have already informed them

Specialized depository must inform the Federal supervision authorities on any violations made by the issuer of mortgage bonds not later than 3 days after its determination



Banks as the issues of mortgage bonds

- Credit organization can issue mortgage bond if it corresponds with all the rules, established by the Central Bank of Russian Federation (CBRF) for commercial banks. CBRF under the Law must establish additional norms and special values of some existing obligatory ratios for banks, issuing mortgage bonds.

Additional ratios:

- Minimum value of the ratio of the amount of issued mortgage bonds to capital
- Minimum value of the ratio of the amount of mortgage coverage to the face value of issued mortgage bonds
- Maximum value of the ratio of total liabilities of the credit organization for creditors, who have in accordance with the law priority right for satisfaction of their demands to owners of mortgage bonds – to capital



Banks as the issues of mortgage bonds (part 2)

The Central Bank of Russian Federation (CBRF) under the Law has the right to establish special order of calculations and values of existing banking ratios:

- Norm of own capital adequacy
- Liquidity ratios
- Value of interest and currency risk

CBRF also defines additional disclosure rules for banks-issuers of mortgage bonds

No bank can issue mortgage bond, if it do not correspond any above mentioned limits



Mortgage agents as the issues of mortgage bonds

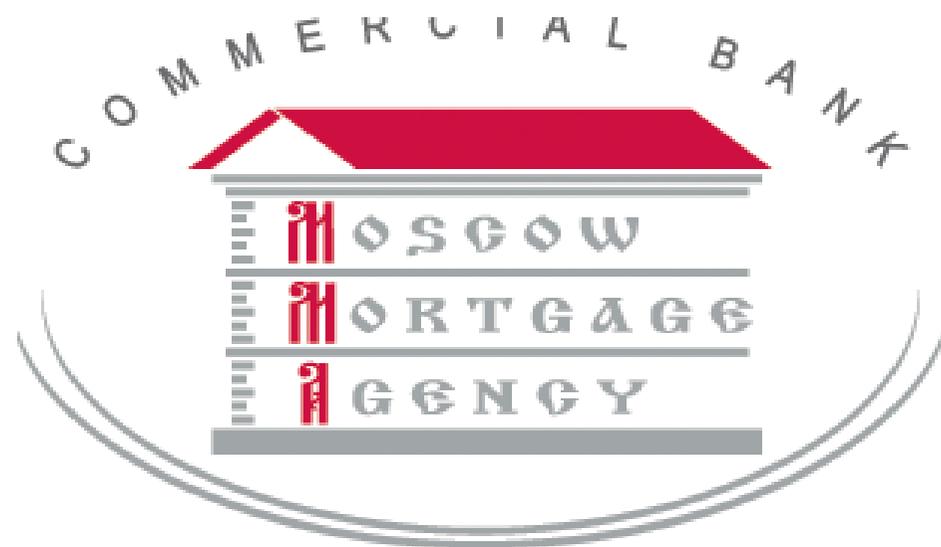
Mortgage agent (MA) – a specialized commercial organization, the only business of which is purchase of loans, secured by mortgages, and which has a right for issuing mortgage bonds

- MA has no staff
- Power of personal executive body should be transferred to another commercial organization.
- Accounting of MA operations should be kept by a separated commercial organization
- Mortgage agent – Russian equivalent of SPV
- MA activity is not yet adopted for other branches of legislation, particularly, tax legislation (asset taxes, profit taxes and VAT)



Perspectives of the development of mortgage securities in Russia

- 27 new laws are under work aiming the development of house building, including mortgage loan markets and mortgage securities
- 8 new laws are already adopted
- Decrease of the payments to notaries
- Tax relief for yield from mortgage securities (6% for legal entities and 9% for individuals) and individual mortgage loans debtors
- Tax relief for persons, selling and buying flats
- Credit history centers
- Exemption of mortgage cover from the banking bankruptcy procedures
- Using of reserve living funds for mortgage loan defaulters



+7 - 095 - 721 - 19 - 27
dbudakov@mia.ru
www.mia.ru