

Acquiring Shares in Banks and Other Credit Organizations in Russia

Notice and Approval Requirements of the Central Bank and Federal Antimonopoly Service

Given the state of the financial services market worldwide, the regulations governing investments in banking institutions have recently attracted the attention of a much broader audience. Unlike in the United States, in Russia there is no “source of strength” principle that effectively makes a bank’s significant shareholders guarantors of bank losses. Accordingly, private equity and other investors have been active in the Russian market for some time now. Nonetheless, in addition to the challenges posed by ordinary commercial investments in Russia, there are regulatory hurdles investors need to understand before investing in Russia’s financial sector. This Quick Reference Guide highlights the key triggers and concepts associated with obtaining governmental approvals to invest in banks and other credit organizations in Russia.

Acquisitions of significant assets, material equity positions (direct or indirect) and control positions in “credit organizations” (e.g., banks, insurance companies, stock or currency exchanges, management companies or specialized depositaries of investment and pension funds and certain types of leasing companies) may require notification or prior approval of the Central Bank of the Russian Federation (Central Bank) or the Federal Antimonopoly Service of the Russian Federation (FAS).

Central Bank Preapproval and Notification

According to Federal Law No. 86-F3, “On the Central Bank of the Russian Federation,” dated 10 July 2002, as amended (the Central Bank Law), the acquisition or receipt in trust by a person (natural or legal) or a group of persons of shares or membership interests representing more than 1 percent of the voting shares or membership interests of a credit organization requires notification of the Central Bank. Notifications of acquisitions of more than 1 percent and less than 20 percent of the share capital of a credit organization must be made within 30 days of the acquisition of such shares.

Prior consent of the Central Bank must be obtained for acquisitions of more than 20 percent of the voting shares of joint stock companies, and thereafter for any additional acquisitions, if as a result of such subsequent acquisition the acquiring entity’s ownership exceeds 25, 50 or 75 percent or equals 100 percent of the voting shares. If the bank is organized as a limited liability company the triggering thresholds are 20, 33.3, 50, 66.6 and 100 percent of the membership interests. Thus, an acquirer that previously received approval to acquire 25 percent of the voting shares of a credit institution can thereafter acquire additional shares from

time to time without receiving additional Central Bank approval, provided it does not acquire more than 50 percent of the voting shares, unless the Central Bank sets a lower threshold in its original consent to the acquisition.

Approval is also required if the Central Bank previously approved an acquisition of a defined threshold and the acquirer wants to exceed that threshold or the putative acquirer fails to conclude an approved transaction prior to expiration of the Central Bank’s approval. Approvals are valid for one year from the date of their issue by the Central Bank.

The Central Bank has 30 days to approve, deny or request supplemental information after receiving a petition for approval to acquire shares of a credit organization.

In evaluating whether one of the enumerated triggering ownership thresholds has been exceeded, the Central Bank looks at not only individual entities but also *groups of persons* (as that concept is defined and interpreted under the Competition Law [see below]).

In addition to direct acquisitions of shares, the Central Bank’s notice and approval requirements may be triggered by indirect transfers that influence control, such as the acquisition of majority stakes in entities with the power to exert *significant influence* over a credit organization. Moreover, while it is unclear if approval is required to acquire such rights, it is clear that such rights may not be exercised without receiving Central Bank approval if the applicable thresholds are triggered. Accordingly it is highly recommended that prior approval be sought in connection with the acquisition of convertible notes, options, warrants or similar rights. Otherwise, those rights ultimately may prove to be unenforceable.

Significant influence is defined as “the power to control the decisions made by the managerial bodies of the bank.” A person, or group of persons, is deemed to have control if it can, directly or indirectly: (i) appoint or control the election of the sole executive body, (ii) appoint or control the election of more than 25 percent of the collective executive body, (iii) control the election of more than 25 percent of any board of directors or supervisory board of the bank or (iv) direct the actions of a person (or group of persons) capable of exerting direct significant influence on the actions of the bank.

The Central Bank Standard of Approval

Under Federal Law No. 395-I, “On Banks and Banking Activities,” dated 2 December 1990, as amended (the Banking Law), the Central Bank is entitled to withhold

Acquiring Shares in Banks and Other Credit Organizations in Russia

Notice and Approval Requirements of the Central Bank and Federal Antimonopoly Service

approval for the acquisition of shares of a credit organization if it determines that:

- The financial position of the acquirer of the shares is unsatisfactory;
- The acquisition would result or has resulted in a breach of the Competition Law (i.e., FAS approval is required but has not been obtained);
- The applicant is the subject of a final judgment finding, among other things, past participation in illegal acts in connection with the bankruptcy of a credit organization; or
- The acquirer has been found guilty of causing a loss to any credit organization when holding the office of a member of the board of directors, sole executive body or any supervisory board or collective executive body of a credit organization.

The key element of the test is the assessment of the acquirer's financial position, which requires a thorough understanding of Instruction No. 130-N of the Central Bank of Russia, "On Obtaining Prior Consent of the Bank of Russia for Acquisition and/or Receipt in Trust Management of Shares of a Credit Organization," dated 21 February 2007 (the Central Bank Instruction), and Regulation No. 337-P of the Central Bank, "On the Procedure and Criteria for Evaluating the Financial Position of Legal Entities – Founders (Participants) in Credit Organizations," dated 19 June 2009 (the Regulation) if the acquirer is a legal entity. Other regulations apply to natural persons. The Regulation came into effect on 9 August 2009 and substantially amended the operative criteria for evaluating an acquirer's financial position.

The Central Bank Instruction provides that a legal entity that desires to acquire shares of a credit organization "must be in operation for no less than three years, have net assets sufficient to pay for the shares of the credit organization and also have a satisfactory financial position." Although stated separately these requirements all relate to the minimum acceptable financial wherewithal of the acquirer or acquirer group (see below).

Three Year Requirement

In order to satisfy the three year requirement an entity must have been in existence for three years and in those three years have engaged in a type of commercial activity listed in the Russian Classifier of Economic Activities. However, if "from the presented information one may reach the conclusion that there is a lack of fixed assets, proceeds from the sale of goods,

production, work or services during the last three financial years" the financial position of the acquirer may be found unsatisfactory. Thus, use of an aged shelf entity alone cannot meet this standard.

Net Asset Requirement

The net asset requirement specifies that the acquirer, whether individually or together with certain affiliated entities, must have net assets equal to or greater than the purchase price.

Satisfactory Financial Position

The Central Bank has broad discretion to determine the acceptability of an acquirer's financial position. The assessment of the financial position of the acquirer involves a fact-intensive analysis of various economic and financial indices and other subjective factors. The Regulation sets forth a multitude of applicable financial ratios and metrics (e.g., financial stability, solvency and liquidity) that the Central Bank must consider in concluding its analysis. Notably, the Regulation dispenses with minimally acceptable financial ratios set forth in the old regulations and grants the Central Bank broad discretion to determine whether an acquirer's financial position is satisfactory based on specific facts and circumstances including market conditions affecting the acquirer, regional conditions within Russia and the significance (e.g., size and reputation) of the acquirer. Notwithstanding the broad discretionary grant of power, the Central Bank is instructed to determine optimal financial ratios and apply them consistently to similar types of organizations.

The bases for determining an unsatisfactory financial position include bankruptcies, unpaid taxes and other government debts, overdrafts and pending litigation that may impact solvency.

Acquirer Group

At the request of the acquirer, the Central Bank also may consider the net assets of other related entities when evaluating the acquirer's financial position. Those entities include:

- An entity owning more than 50 percent of the charter capital of the acquirer, provided there are no other members (shareholders) who hold more than 20 percent of the membership interests (shares);
- An entity owning more than 50 percent of the votes, when the charter of the acquirer establishes a disproportional voting regime, provided there are no other members (shareholders) who hold more than 20 percent of the voting rights;
- An entity owning more than 50 percent of the charter capital of the acquirer and all the other

Acquiring Shares in Banks and Other Credit Organizations in Russia

Notice and Approval Requirements of the Central Bank and Federal Antimonopoly Service

members (shareholders), provided each of them owns more than 20 percent of the membership interests (shares) of the charter capital of the acquirer and the entity is a member (shareholder) of the credit organization;

- All members (shareholders) who individually own more than 20 percent but no more than 50 percent of the membership interests (shares) in the charter capital of the acquirer, provided their aggregate share of the charter capital of the acquirer is more than 50 percent;
- The target shareholder if, in each of the foregoing instances, the acquirer is acquiring shares or membership interests in a shareholder of the bank rather than the bank itself; and
- An entity (entities) that exerts (through a third party) *indirect significant influence* on the decisions taken by the executive bodies of the credit organization.

The acquirer must submit the same documentation for each person it wishes the Central Bank to consider in making its financial position analysis.

Consequences of Noncompliance

A failure to notify the Central Bank of an acquisition of shares of a credit organization or to obtain approval for such acquisition from the Central Bank may result in the Central Bank ordering compliance, the imposition of a fine in an amount of up to 0.1 percent of the minimum amount of the authorized capital of the credit organization, and most significantly, the imposition of restrictions on the operations of the credit organization for a term of up to six months.

FAS Preapproval and Notification

Separate and apart from Central Bank approval, FAS approval may be required to conclude an acquisition of interests in a Russia-based commercial organization. Federal Law No. 135-F3, "On the Protection of Competition," dated 26 July 2006, as amended (the Competition Law), establishes criteria for determining whether such a transaction is subject to FAS notification or preapproval. The FAS rules applicable to credit organizations differ from those applicable to other commercial enterprises (see Quick Reference Guide No. 1, "[Asset and Share Acquisitions in Russia: When Do I Need to Obtain Approval or Notify the Federal Antimonopoly Service?](#)").

Pursuant to recent amendments to the Competition Law FAS should be notified of acquisitions of shares or assets of a credit organization or the rights with respect to the latter within 45 days of closing if the aggregate

book value of the assets of the acquirer(s) exceeds a specified amount. As of the date of this Quick Reference Guide, that threshold had yet to be established.

In the case of preapproval, FAS can consider the petition for a period of up to 30 days, in which it must either request additional information necessary to conclude its assessment or expressly approve or deny the petition.

Triggering Transactions Test

The following transactions involving credit institutions are subject to FAS preapproval (each a "triggering transaction"):

- Acquisitions of assets of a credit organization with a value exceeding 10 percent of the book value of all of the assets according to the latest balance sheet;
- Direct acquisitions of voting shares of a credit organization (a financial organization)/joint stock company in amounts equal to or greater than 25, 50, 75 or 100 percent of the voting shares of the target;
- Direct acquisitions of membership interests of a credit organization (a financial organization)/limited liability company in amounts equal to or greater than 33.3, 50, 66.6 or 100 percent of the membership interests of the target; and
- Acquisition of (direct or indirect) rights to (i) define the terms and conditions of a Russia-based credit organization's (financial organization) business activities or (ii) perform the executive functions of a Russia-based credit organization (financial organization).

Note: Many transactions involving a change of control of Russia-based entities are effected through the use of offshore vehicles and are captured under this trigger. Moreover, absent qualification for transparency exemptions (described below), triggering transactions among entities of the same group are subject to FAS approval, even if there is no change in the ultimate controlling entity.

Book Value Test

FAS preapproval also is required if the book value per the most recent balance sheet of the target exceeds:

- 4 billion rubles, with respect to banks and other credit institutions;
- 200 million rubles, with respect to insurance companies (apart from insurance medical organizations), mutual insurance societies,

Acquiring Shares in Banks and Other Credit Organizations in Russia

Notice and Approval Requirements of the Central Bank and Federal Antimonopoly Service

insurance brokers and credit consumers' cooperatives;

- 100 million rubles, with respect to stock or currency exchanges, management companies of investment funds or private pension funds, specialized depositaries of unit investment funds or private pension funds, leasing companies and professional participants of the securities markets (apart from the registrars); or
- 50 million rubles, with respect to registrars, insurance medical companies and pawnshops.

Group of Persons

The Competition Law defines a "group of persons" to include:

- **Parent and Direct Subsidiaries:** A company and each person (legal or natural) holding the right to more than 50 percent of the votes of the company and any other company in which such a person holds more than 50 percent of the votes;
- **Shared Management and Company:** A company and its sole executive authority (e.g., general director) and any company managed by the same sole executive authority;
- **Binding Authority and Company:** A company and any person (legal or natural) with the right to give binding instructions to the company and any other company that is subject to binding instructions of the same person;
- **Nominator of Management and Company:** A company and any person (legal or natural) who proposed the candidacy of the sole executive authority (e.g., general director) or more than 50 percent of the collective executive authority or board, if their candidates were appointed, and any other company whose sole executive authority, or more than 50 percent of its collective executive authority or board, was appointed upon proposal of the same person;
- **Overlapping Board and Companies:** Companies whose collective executive authority or boards are made up of more than 50 percent of the same individuals;
- **Family Members:** Natural persons and their spouses, parents, adult children (natural or adopted) and siblings (whether whole or half blood) who are shareholders, board members or sole executive officers or have any rights to give binding instructions to another company;
- **Members of Other Groups:** A person (legal or natural) who is a member of a group is also a

member of any group of which members of its group are a part; and

- **Parent, Intermediaries Under Common Control and Company:** A company and its shareholders who are under common control of a third party and that third party, if those shareholders collectively hold the right to more than 50 percent of the votes of the company.

Transparency Exemptions

FAS' prior approval is not required for transactions involving shares or assets of a credit organization if such transactions are entered into by and between persons (natural or legal) belonging to the same group of persons in the following cases:

- The respective group is composed on the basis of ownership of the right to more than 50 percent of the votes of the company; or
- The list of natural persons and legal entities belonging to the respective group was disclosed to FAS and remained unchanged by the time of execution of the transaction (in this case a notification on the transaction should be filed with FAS).

Consequences of Noncompliance

Failure to obtain FAS approval for a transaction when such approval is required under the Competition Law may result in:

- Fines of 1,500 to 2,500 rubles assessed against natural persons;
- Fines of 15,000 to 20,000 rubles assessed against officials;
- Fines of 300,000 to 500,000 rubles assessed against legal entities; and
- FAS seeking an order declaring the transaction void.

Accordingly, careful analysis is required.

For More Information

Contact Ivan A. Trifonov, Managing Partner, David M. Wack or Patrick J. Brooks at +7.495.258.5250

The contents of this update are not intended to serve as legal advice related to individual situations or as legal opinions concerning such situations. Counsel should be consulted for legal planning and advice.

©Squire, Sanders & Dempsey L.L.P.
All Rights Reserved
2009