

Recent Amendments to Russia's Mortgage Law

On 7 March 2012 various amendments to Federal Laws No. 102-FZ¹ (the Mortgage Law), No. 122-FZ² (the Registration Law) and No. 229-FZ³ (the Enforcement Law) entered into force as a result of Federal Law No. 405-FZ⁴, dated 6 December 2011 (the Law).

The most important changes introduced by the Law are summarised below.

Out-of-Court Foreclosure

Types of Foreclosure

The Law confirms that there are two types of foreclosure: court orders and out-of-court foreclosures. Both can be implemented through either i) an auction or ii) an acquisition of the collateral by the mortgagee for its own use. The direct sale of the mortgaged assets to third parties is no longer allowed.

Out-of-Court Foreclosure Provision in a Mortgage Agreement

Pursuant to the Law, it is no longer necessary to:

- Enter into a separate agreement to deal with out-of-court foreclosure: or
- Obtain a notarised consent of the mortgagor for out-of-court foreclosure.

From now on, mortgage agreements need to provide for an out-of-court foreclosure provision or methods and order of a court foreclosure.

Separate agreements on court foreclosure can be entered into in relation to agreements involving a mortgage by operation of law, provided that it is duly registered in the Unified State Register of Rights to Immovable Property and Transactions Therewith (the EGRP).

It is also now necessary to repeat the out-of-court and court foreclosure provisions in any letter of hypothecation.

Mandatory Court Order

The cases in which a foreclosure must be implemented by court order have been entirely revised and now include one of the following:

- The mortgaged property is a residential property owned by a natural person;
- The mortgagor cannot be located;

¹ Federal Law No. 102-FZ, "On Mortgage (pledge of immovable assets)", dated 16 July 1998.

² Federal Law No. 122-FZ, "On the State Registration of Rights to Immovable Property and Transactions Therewith", dated 21 July 1997.

³ Federal Law No. 229-FZ, "On Enforcement", dated 2 October 2010.

⁴ Federal Law No. 405-FZ, "On Amendments to Certain Laws of the Russian Federation Regulating Procedure of Foreclosure of the Pledged Assets", dated 6 December 2011.

- The mortgaged property is subject to a previous or subsequent mortgage providing for different types of foreclosure;
- The mortgaged property is collateral for different obligations of several co-mortgagees;
- The mortgaged property is undeveloped agricultural land;
- The mortgaged property is agricultural land, owned by a natural person and is used for personal housing purposes;
- The mortgaged property is a state or municipal owned property;
- The mortgagor's title is not registered in the EGRP; or
- The mortgaged property is of historical, cultural or artistic value.

Out-of-court foreclosure is therefore now generally available against enterprises and properties owned by a natural person, while it was previously enforceable only by court order.

Notarisation of Mortgage Documents

Although not expressly specified by the Registration Law, out-of-court foreclosures seem to be available only in respect of notarised agreements. As a result of the new procedure, the parties should notarise mortgage agreements if they want to have the following additional advantages as compared to a simple agreement:

- The registration period is reduced to five days; and
- The notary guarantees the legality of the transaction and validity of the documents submitted. Also, a notary's professional indemnity insurance cover is not less than 5,000,000 RUR.

The existing requirement to register a mortgage agreement in the EGRP remains in place.

State Registration

State Registration of Mortgage Agreement

The Law clearly confirms that a mortgage agreement and the encumbrance it creates on the mortgage property are effective from the date of state registration of the mortgage agreement in the EGRP.

The period within which a mortgage agreement must be registered has been reduced to:

- 15 business days – general term; or
- five business days – in the case of a notarised mortgage agreement.

The parties, jointly, or the notary (if the agreement was notarised) can file the documents for registration.

State Registration of Transfer of Rights

Article 25.4 of the Registration Law specifies that different documents are required to register the transfer of property rights in the case of a court order or an out-of-court foreclosure by notary executory endorsement.

Discrepancy Between Mortgage Law and Registration Law

There is a discrepancy between the Mortgage Law and the Registration Law in relation to any mortgage by operation of law. On one hand, the Mortgage Law provides that the agreement creating a mortgage by operation of law shall be filed with the state registration office by the mortgagor, the

mortgagee or a notary. On the other hand, the Registration Law provides for such a filing only by a joint application of the mortgagor and the mortgagee or by an application by a notary. The practice adopted by the state registration office will clarify which text must be used.

Execution Proceedings

The Enforcement Law prohibits the award of pre-award relief to unsecured creditors with no statutory priority right.

Land Plot and Buildings Inherency

The encumbrance created by a mortgage covers not only the land plot but also existing and future buildings located on it, provided that they are both owned by the same person.

Order of Mortgagor Claims Discharge

The Law amends the order of distribution applied to the sums generated from the foreclosure of mortgaged assets:

- Subsequent mortgagee claims are discharged after prior mortgagee claims; and
- Penalties (including interest accrued and forfeits) under any secured obligation are paid only after the principal debt amount has been repaid in full.

This alert is intended only to provide a general overview of the issues covered.

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