

Insight

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Special Alert

Changes in Russian Banking Laws: Acquisition of Bank's Shares; Banking Groups and Banking Holdings; Risk Management

On 2 July 2013 the President signed Federal Law No. 146-FZ amending the Law on Banks and Banking Activity, the Law on the Bank of Russia and a number of other Russian laws.

Following the Strategy for the Development of the Russian Banking Sector through 2015, the amendments aim to:

- improve the legal framework for admitting capital into the Russian banking sector (the consent of the Central Bank will now be required in case of an acquisition of more than 10% of shares in a bank (decreased from a 20% threshold), as well as requirements as to the business reputation of acquirers have been introduced);
- tighten the requirements for bank managers (the requirements relating to the business reputation of managers have been elaborated, and a new rule has been introduced, which requires that the compensation of a bank manager is dependent on the operating results of the bank);
- improve the legal framework for supervising banks on a consolidated basis (the definitions of banking groups and banking holdings have been elaborated, and the scope of sanctions for breaches within banking groups and holdings has been extended); and
- limit the degree of risks incurred by banks, including the degree of risk concentration (the criteria for interrelationships between borrowers and between borrowers and banks have been specified, and requirements for the risk management systems have been established).

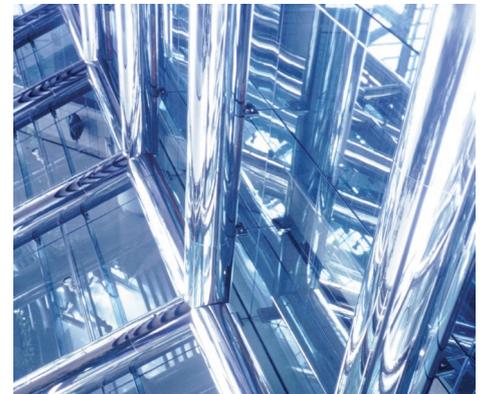
Below is a detailed summary of the abovementioned amendments. Note that the amendments will become effective on different dates: some will enter into force on 2 October 2013, whereas the others – on 1 January 2014 or 1 January 2015.

Acquisition of more than 10% of bank's shares requires the Central Bank's consent; the acquirers are to meet certain requirements as to their business reputation

- The Central Bank's prior consent is required for the acquisition of more than 10% of a bank's shares (participation interests) and for acquiring control over a shareholder (participant) holding more than 10% of a bank's shares (participation interests). If such consent is not obtained, the Central Bank will request that the breach is cured.

This update is a general summary of recent developments in Russian legislation and should not be treated as legal advice. Readers should seek the advice of legal counsel on any specific question. All translations of terminology in this update are unofficial.

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For more information, please contact:

Andrei Dontsov

Partner

adontsov@whitecase.com

Maya Melnikas

Partner

mmelnikas@whitecase.com

Natalia Nikitina

Partner

nnikitina@whitecase.com

White & Case LLC

Tel + 7 495 787 3000

Fax + 7 495 787 3001

whitecase.com

Until the request is complied with, the shares (participation interests) acquired in violation of the law will be deemed non-voting and will not be taken into account for defining a quorum of the general meeting.

- The acquirer of bank's shares or the person or entity acquiring control, as well as their sole executive body, are to meet certain statutory requirements as to their business reputation (please see below). Failure to meet such requirements will allow the Central Bank to refuse consent for the acquisition of either shares or control or, if the acquisition takes place at the time when the bank is being established, to refuse state registration of the bank.
- If non-compliance is detected with respect to the bank's current shareholders (participants) holding more than 10% of its shares (participation interests) or the persons (entities) controlling such shareholders (participants), the Bank of Russia will request that the breach is cured, that the stake is decreased to no more than 10% of shares (participation interests) or the termination of control. Until the request is complied with, the shareholders (participants) will be entitled to vote with no more than 10% of shares (participation interests), whereas the remaining shares (participation interests) will be deemed non-voting and will not be taken into account for defining a quorum of the general meeting.

Bank managers and members of the board of directors are to meet certain requirements as to their business reputation

- The sole executive body of the bank, his/her deputies, the members of the management board, the chief accountant and the deputy chief accountant of the bank, the head of a bank's branch and the chief accountant of the branch are to meet certain requirements as to their business reputation. Failure to meet such requirements will allow the Central Bank to refuse to consent to their appointment or, if the appointment takes place at the time when the bank is being established, to refuse state registration of the bank. If non-compliance is detected with respect to the current managers of a bank, the Bank of Russia is entitled to request their replacement.
- The non-compliance of shareholders (participants) of a bank and its managers with the requirements as to their business reputation is generally determined on the same grounds. The lists of such grounds are quite extensive and include, among others, the following: having a non-discharged record of conviction for a deliberate crime; being entitled to give mandatory instructions to, or otherwise define actions of, any bank that was found bankrupt; being a manager of any bank within a year of its bank license being revoked. In relation to managers only, there is an additional ground for non-compliance in case the manager is subject to disqualification. In relation to acquirers of a bank's shares (participation interests) only, there is an additional ground for non-compliance in case the acquirer was found guilty (within five years before an application for

the Central Bank's consent is filed) of causing damages to any company while being a member of the board of directors or a manager of such company.

- The members of the board of directors of the bank (as well as candidates for such positions) are to meet the same requirements as to their business reputation as managers of a bank. If a current member of the board of directors is convicted of a deliberate crime or is disqualified, he/she is deemed to have resigned immediately after the relevant court decision enters into force.
- The powers to dispose of funds held in bank accounts opened with the Central Bank, which are within the competence of bank managers and other aforementioned persons, may be vested in officers holding other positions in a bank, provided that such officers meet the requirements as to qualification and business reputation established for the aforementioned persons.

The Bank of Russia will maintain a database of managers, members of boards of directors and other persons whose actions caused damages to banks and/or who have breached banking laws. The database is to be maintained with an aim to prevent situations that threaten interests of creditors and depositors.

Banking groups and banking holdings

- A banking group is defined as a group of companies, where one or several companies are controlled or significantly influenced by a bank.
- A banking holding is defined as a group of companies, which includes at least one bank controlled by a non-bank company, as well as other non-bank companies (if any) that are controlled or significantly influenced by a parent holding company or that belong to banking groups of banks that are members of the holding, provided that at least 40% of the holding's activities constitute banking activity.
- The terms "control" and "significant influence" used in the definitions of a banking group and banking holding have the same meanings assigned to them in IFRS that are recognized in Russia.
- The parent bank of a banking group is obliged to comply with the mandatory economic ratios established for banking groups. In order to comply with the ratios, the parent bank shall adopt decisions regarding the banking group's activities and assets at its own discretion.
- The parent bank of a banking group and the parent company of a banking holding are required to disclose and submit their consolidated financial statements to the Central Bank. They shall also be required to submit to the Central Bank other information regarding their banking group's (banking holding's) activities contained in the list to be defined by the Central Bank.

- The banks that are members of a banking group or a banking holding are required to provide to their parent information relating to their operations and the operations of their clients and correspondents (in order for their parent to prepare consolidated statements). If a parent is located abroad, the information shall be provided to it under the condition that the level of data protection in the relevant foreign state is not lower than the level of data protection that is provided for by Russian law.
- In case the bank is in breach of banking laws, the Central Bank is entitled to limit its operations with the parent bank of the banking group (parent company of the banking holding) and other members of the banking group (banking holding) for up to six months. If a bank does not comply with the Central Bank's requests to cure breaches or if its breaches threaten interests of creditors and depositors, the Central Bank may ban certain banking operations with the parent bank of the banking group (parent company of the banking holding) and other members of the banking group (banking holding) for up to one year.
- The Bank of Russia is entitled to inspect overseas banks that are members of banking groups and banking holdings. In turn, foreign banking supervisory bodies may enter the premises of Russian banks that are members of banking groups whose parent is an overseas bank, as well as obtain access to information about such banks' activities (subject to a written consent of such banks).

Risk management, capital management and internal control systems

- The risk management, capital management and internal control systems of a bank (banking group) must comply with the nature and scope of the bank's (banking group's) operations, the level and combination of incurred risks. In case of non-compliance, the Central Bank may establish individual mandatory economic ratios for the bank (banking group).
- A bank (parent bank of a banking group) may apply the bank's own risk management policies and quantitative risk assessment models for calculating the mandatory economic ratios. Such banking policies may be applied by a bank (parent bank of a banking group) only if the Central Bank has issued a permit following such bank's application for it.
- The head of the risk management department, the head of the internal audit department or the head of internal control department of a bank (parent bank of a banking group) are to meet certain qualification requirements that are established by the Central Bank and the same requirements as to the business reputation that are established for bank managers.
- The approval of the risk management strategy of a bank and the procedure for applying a bank's own risk management policies has been assigned to the competence of the bank's board of directors.

Remuneration of bank managers and of members of the board of directors

- The approval of compensation policies, including the procedures for determining compensation and incentive payments to bank managers and other officers whose decisions may entail situations which threaten interests of creditors and depositors, has been assigned to the competence of the bank's board of directors.
- The compensation policies are to meet certain requirements. In particular, they need to provide for the possibility of decreasing or eliminating compensation and incentive payments to bank managers, members of the board of directors and other officers whose decisions may entail situations which threaten interests of creditors and depositors in case of negative financial results of a bank as a whole or certain areas of its business.
- If a bank does not fulfill the Central Bank's request to cure breaches of the banking laws or the breaches threaten interests of creditors and depositors, the Central Bank may (among other things) request that the bank limits compensation and incentive payments to its managers and members of the board of directors for up to three years.

Mandatory economic ratios, related parties

- A new mandatory economic ratio will apply: there will be a maximum permitted exposure to related parties (group of related parties) of a bank. Such exposure may not exceed 20% of a bank's net worth (capital) (a related party is defined as a person or entity controlling or having significant influence on a bank; an entity whose activity is subject to control or significant influence by a bank; as well as members of the board of directors, managers and other persons whose decisions may affect the bank's compliance with the mandatory economic ratios). The Central Bank is entitled to recognize a person or an entity as a related party of the bank on the basis of a reasoned decision.
- The term "group of related borrowers" (used for the purposes of calculating the ratio of maximum exposure per single borrower or group of related borrowers, which may not exceed 25% of the bank's net worth (capital)) is defined as follows: borrowers, one of which controls or has significant influence over another borrower; borrowers subject to control or significant influence by a third party; as well as borrowers that are related in a way that the worsening of the economic position of one person or entity may entail failure of another person or entity to perform obligations owed to a bank.
- If a bank's shareholder (participant) enters into a transaction with a bank which results in the bank violating the mandatory economic ratios, the Central Bank will request the shareholder (participant) to cure the breach. If the request is not complied with, the shareholder's (participant's) voting rights are deemed suspended, i.e., the shares (participation interests) will be non-voting and will not be taken into account when defining the quorum.

Miscellaneous: limitation of interest rates for deposits

- If a bank does not perform the Central Bank's request to cure breaches or if the breaches threaten the interests of creditors and depositors, the Central Bank is entitled to limit the interest rates payable by the bank on individual deposits (however, such rates being no less than 2/3 of the Central Bank's refinancing rate for ruble deposits and no less than LIBOR for foreign currency deposits) for up to one year.

The Law will enter into force on 2 October 2013, save for certain positions, which will enter into force on different dates (in particular, the provisions on banking groups and banking holdings, risk management systems and compensation policies will enter into force on 1 January 2014, and the provisions on related parties will enter into force on 1 January 2015).