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Securitisation in Ukraine

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The concept of securitisation is not expressly defined under Ukrainian legislation and has yet to be tested in the Ukrainian courts. However, the Civil Code, the Economic Code and a number of laws in the area of mortgage lending permit Ukrainian banks and other companies to raise funds through domestic and cross-border securitisation transactions.

In the past few years Ukraine has launched a number of significant reforms in the area of mortgage lending. Thus, the Ukrainian Parliament enacted:

- Law 898-IV on Mortgages (June 5 2003, effective January 1 2004);
- Law 979-IV on Mortgage Lending, Transactions with Consolidated Mortgage Debt and Mortgage-Backed Certificates (June 19 2003, effective January 1 2004); and
- Law 3273-IV on Mortgage-Backed Bonds (December 22 2005, effective January 24 2006).

The Law on Mortgages introduced the notion of mortgage-backed securities, while the Law on Mortgage Lending and the Law on Mortgage-Backed Bonds developed a number of securitisation-related concepts. In particular, the Law on Mortgage Lending and the Law on Mortgage-Backed Bonds permit an originator – a Ukrainian commercial bank or an authorised financial institution – to form a 'consolidated mortgage debt' or 'mortgage assets' (ie, a pool of rights of claim under the originator's mortgage loans) and the related 'mortgage pool' or 'mortgage coverage' (ie, a pool of mortgages securing the underlying loans). A consolidated mortgage debt or mortgage assets may be sold by the originator to a special purpose company which would issue mortgage-backed certificates or mortgage-backed bonds.

Sale of receivables

Ukrainian legislation expressly recognises the concept of the sale of the rights of claim, including the rights of claim to money or payments (receivables). A sale is distinguished from factoring transactions or transactions creating a security interest in the rights to payment. As shaped by the nature of the rights to payment, their sale is carried out by way of assignment of such rights to the purchaser. The Civil Code provides that general rules governing assignment will also apply to the sale of the rights to payments, unless otherwise provided in the sale agreement or by the applicable legislation.

A sale of the rights to payment must be documented by an agreement in writing between the assignor and the assignee. Such sale agreement must follow the form of the underlying agreement that creates the rights to be assigned. Thus, if the underlying agreement was certified by a notary, the assignment agreement must also be notarially certified. If applicable legislation requires that the underlying agreement be registered with any state authority, the assignment agreement must also undergo such registration, except when otherwise specifically provided by applicable legislation.

Unlike in many developed jurisdictions, a contractual restriction on the sale or assignment of rights under an underlying agreement (an anti-assignment clause) is enforceable and will render any deviating sale or assignment invalid. In contrast, the validity of a factoring transaction does not depend on whether the underlying agreement prohibits or otherwise restricts the assignment of the relevant rights to payments. The assignor under such a factoring transaction may bear contractual liability to the debtor only for the breach of such prohibition or the other restrictions under the terms of the underlying agreement.

Ukrainian legislation does not require the originator to notify any of the relevant borrowers of the sale of its rights of claim under a loan agreement. As distinct from the loan claims, Ukrainian legislation requires that, within five days of the date of assignment of the originator's rights of claim under a mortgage agreement that secures the respective loan, the originator must

give written notice of such assignment to each of the respective mortgagors. Failure of the originator to give the borrowers and/or the mortgagors such notice does not affect the validity of the sale transaction. However, the purchaser of the claims bears any negative consequences of the originator's failure to give such notice. Thus, the respective borrower would have the right to:

- discharge its obligations in respect of the loan claims and/or the mortgage claims to the originator and not to the purchaser, unless and until the borrower has received such a notice;
- make such objections against the claims of the purchaser in respect of the loan claims and/or mortgage claims as the borrower would be entitled to make against the originator as of the date of receipt of such a notice or, in the absence of such receipt, as of the date when the purchaser makes such claims; and
- offset against the monetary claims of the purchaser certain of the borrower's monetary claims to the originator that have arisen from the grounds that existed at the date of receipt by the borrower of such a notice or, in the absence of such receipt, at the date when the purchaser makes such claims.

Taking into account the adverse consequences to the purchaser, it is recommended that the sale agreement require the originator to give such notice to each respective borrower and mortgagor promptly upon the signing of the sale agreement.

- 'Factoring' is defined as a transaction under which the originator would receive financing from the factor at a fee payable by the originator to the factor, such financing being either:
- provided in the form of the purchase price payable by the factor to the originator under the receivables sale agreement between the factor as purchaser and the originator as seller; or

- a loan extended by the factor to the originator and secured by a pledge (or security assignment) of the receivables, granted by the originator to the factor.

Only a bank or a financial institution can be the factor under a factoring agreement, and factoring itself is viewed as a type of financial services.

True-sale and bankruptcy-remoteness issues

A true sale of the rights of claim can be achieved under Ukrainian law, provided that the relevant agreement between the originator and the purchaser is:

- clear as to the intent of the parties to transfer unconditionally, completely and irrevocably (assign in exchange for a monetary consideration or sell) the receivables from the originator to the purchaser, rather than to collateralise the receivables as security for the financing extended by the purchaser to the originator; and
- otherwise compliant with the legal requirements governing assignment agreements and sale-purchase agreements.

Accordingly, the proper and careful drafting of the sale agreement, and structuring of the transaction generally, is crucial to ensure its favourable treatment under Ukrainian law.

During the originator's temporary administration and bankruptcy-related liquidation proceedings a temporary administrator or a liquidator may apply to a Ukrainian court for the invalidation of the originator's receivables sale agreement based on certain specific grounds (which are additional to the generally applicable civil law grounds for the invalidation of agreements).

Grounds that may potentially apply to the receivables sale agreement during the originator's temporary administration include the following:

- The transfer of the receivables and/or the payment by the originator to the purchaser under

the sale agreement has taken place within the six months preceding the appointment of the temporary administrator, and such transfer and/or the payment to the purchaser is regarded to have been made with the purpose of ensuring a privileged position of the purchaser as compared to the other creditors of the originator (ie, the asset transfer was not carried out on an arm's-length basis and/or was carried out on preferential terms as compared to other creditors of the originator);

- The value of the receivables transferred to the purchaser is regarded to have been significantly higher than the purchase price paid by the purchaser to the originator and such transfer took place within the three years preceding the appointment of the temporary administrator; or
- The transfer of the receivables to the purchaser is seen to have been made with the purpose of concealing the originator's assets from the other creditors or with the purpose of violating the rights of the originator's creditors, and such transfer took place within three years preceding the appointment of the temporary administrator.

In bankruptcy-related liquidation proceedings such potential invalidation grounds would include situations, among other things, where the sale agreement is regarded to be a loss-making transaction for the originator or where the transfer of the receivables to the purchaser is regarded to have put the purchaser in a privileged position compared to the originator's other creditors, if such transfer has taken place within six months preceding the institution of the liquidation proceedings. If the court declares the receivables sale agreement invalid, the originator would be required to repay to the purchaser all amounts received from the purchaser under the sale agreement and the purchaser will be required to return the transferred assets and all proceeds thereunder to the originator or, if such return is not possible, pay to the originator the value of such assets.

Transfer of security relating to receivables

Ukrainian legislation is unclear as to whether the sale (and assignment) of the rights of claim under an agreement which is secured by a mortgage would result in the transfer to the assignee of the assignor's rights under such mortgage. Thus, it is practically prudent to expressly provide for such transfer in the sale (assignment) agreement. However, Ukrainian legislation provides a fair basis for the argument that the sale (and assignment) of the rights of claim under an agreement which is secured by a pledge of movable property would result in the incidental transfer to the assignee of the assignor's rights under such pledge, subject to the timely registration of the change of pledgee in the State Register of Encumbrances over Movable Property.

Ukrainian legislation governing mortgages requires that information on the transfer of the mortgage claims be registered "pursuant to the procedure established by applicable legislation". At present, Ukrainian legislation provides a procedure for the registration of such information only in the State Register of Mortgages. Ukrainian legislation establishes no time period within which such registration must be made and no specific legal consequences for the failure to carry out such registration. A fair reading of the applicable legislation suggests that any absence of or deficiency in such registration should not affect the validity of the transfer of the mortgage assets under the relevant sale agreement, but may affect the priority of claims of the issuer as mortgagee in respect of the property under the affected mortgages. Accordingly, it is recommended that the relevant sale agreement require the originator to complete such registration within a reasonable time after the signing of the sale agreement.

There is a risk that the assignee will not obtain legally effective and perfected first-ranking claims under the pledges over movable property unless and until the information on pledges registered in the State Register of Encumbrances over Movable Property as at the date of the sale agreement is amended by registering the assignee as pledgee instead of the assignor (the originator). In this regard, Ukrainian

legislation requires that any change of a pledge's registration in the State Register of Encumbrances be registered within five days of the date on which the change occurs. Due to a significant number of the pledges under any securitisation transaction, in practice it may be difficult to complete all the required amending registrations within such a short time period. Various structuring and operational solutions to this issue should be sought when contemplating the securitisation of receivables secured by pledges of movable property (eg, securitisation of auto loans).

Transfer of information relating to receivables

Ukrainian banks are required to preserve banking secrecy – that is, the secrecy of information relating to their clients and such clients' accounts, deposits and transactions. In addition, Ukrainian banks are prohibited from an unauthorised disclosure of any personal data relating to their clients. However, any client information falling under the banking secrecy or personal data protection can be disclosed by the bank to the extent that the relevant client has consented in writing to such disclosure. In addition, even in the absence of such client consent, a limited disclosure of information on the client and the pertinent agreements (eg, loan, pledge or mortgage agreements) by the bank to the purchaser in the context of a sale of the receivables by the bank to the purchaser would be permissible. Ukrainian legislation expressly requires an assignor to provide the assignee with the documents evidencing the assignor's rights of claim, as well as to disclose information which is relevant for the exercise by the assignee of its rights with regard to the debtor.

Mortgage-backed securities

The Mortgage Law provides for two types of mortgage-backed security: mortgage-backed certificates and mortgage-backed bonds.

Mortgage-backed certificates are regulated primarily by the Law on Mortgage Financing, which recognises two types of mortgage-backed certificate: fixed income certificates and participation certificates.

An owner of a fixed income certificate has the right to receive the nominal value of such fixed income certificate plus a fixed rate interest and is entitled to obtain, upon default, recovery from the underlying mortgaged assets before the other creditors of the issuer of the fixed income certificate. An owner of a participation certificate has the right to obtain a share of payments generated by the underlying pool of mortgage loan assets and, upon default, satisfy its claims from the value of the related mortgaged assets. Fixed income certificates and participation certificates also differ in that, in the case of fixed income certificates, the mortgage loan assets as well as payments thereunder are owned by the issuer of fixed income certificate, while in case of participation certificates the relevant mortgage loan assets would be in the trust ownership of a trust manager. The concepts of trust management and trust ownership are new to Ukrainian legislation and, unlike common law trusts, do not imply the transfer of legal ownership.

Mortgage-backed certificates may be issued only by a bank or other financial institution. The issuance of mortgage-backed certificates is subject to registration with the State Commission on Securities and the Stock Market of Ukraine. Mortgage-backed certificates may be issued in both documentary and non-documentary form. Unlike fixed income certificates, participation certificates are registered securities.

Mortgage-backed bonds are regulated by the Law on Mortgage-Backed Bonds, which provides for two

types of mortgage-backed bond: common mortgage-backed bonds and structured mortgage-backed bonds.

Mortgage-backed bonds are bonds secured by a mortgage coverage (a pool of mortgage assets which secure the loans). An owner of mortgage-backed bonds is entitled to receive the nominal value of such mortgage-backed bonds, plus a fixed or floating interest. Similarly to fixed income certificates, mortgage-backed bonds entitle the owner, upon default, to obtain recovery from the underlying mortgage coverage before the other creditors of the issuer of such mortgage-backed bonds. Similarly to mortgage-backed certificates, the issuance of mortgage-backed bonds requires registration with the Securities Commission. Mortgage-backed bonds are registered securities and may be issued in non-documentary form only.

Common mortgage-backed bonds may be issued by the originator only, while structured mortgage-backed bonds may be issued by a special mortgage institution (ie, the purchaser) after its acquisition of the underlying mortgage assets from the originator. Common mortgage-backed bonds and structured mortgage-backed bonds also differ in that the owner of common mortgage-backed bonds may obtain, upon default, recovery from the assets of the originator in addition to the mortgage coverage, while the owner of structured mortgage-backed bonds may satisfy its claims from the value of the mortgage coverage only.