

SYNDICATED FACILITIES INSTITUTE OBTAINS LEGISLATIVE ACKNOWLEDGEMENT IN RUSSIA

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Legal Briefings - By **Dmitry Gubarev and Artjom Buligin**

On 31 December 2017 the President of the Russian Federation signed one of the laws which has been most discussed by the Russian banking and legal communities – Federal Law No. 486-FZ "On a syndicated facility (loan) and amendments to certain legislative acts of the Russian Federation" (the "**Law**") ([in Russian](#)). The Law came into force on 1 February 2018.

Currently our team participates in a number of projects which will be among the first deals governed by the Law. Therefore we are already working on the most seamless way to address the new problems which the Law has created and the existing issues which have not been solved by the Law, as well as adapting the existing Russian market standard form of syndicated facility agreement to reflect the changes brought about by the Law.

The adoption of the Law is definitely not the final stage of the development of syndicated financing legislation in Russia. On the contrary, it feels more like an interim step – work on the draft of the Law was carried out over several years with the aim to consider issues identified by the Russian law syndicated lending practice during the last 15-17 years. Unfortunately the Law does not include a number of important provisions proposed by the legal and banking communities on the basis of the experience gained from syndicated facilities entered into under Russian law in the past. As a result, the Law itself has created a number of issues.

EXPECTATIONS OF THE LAW

Initially an expert community aimed to solve the following issues:

legislative recognition of a decision-making mechanism in a syndicate of lenders;

regulation of the facility agent role (referred to in the Law as the "facility manager");

elimination of uncertainty in relation to receiving payments by a facility agent and a security agent (referred to in the Law as the "security manager") for their services and imposing such costs on the borrower;

removal of legal barriers to the development of the secondary loan market via facilitating the transfer of the rights (receivables) of creditors under secured and non-secured facilities (including, among other things, the possibility to enter into loan sub-participation transactions, which is currently not possible under Russian law);

elimination of uncertainties with respect to the status of the syndicate participants and the facility agent in the event of the bankruptcy of a borrower, pledgors, guarantors or sureties.

During the expert community's work on the draft Law it was decided that, instead of a legislative change aimed at solving the specific problems described above, a law governing syndicated lending in detail and at the same time eliminating such problems should be prepared. This was intended to make the Law at most discretionary, giving parties the opportunity to deviate from the provisions of the Law and regulate relations among themselves as they think fit from a commercial point of view. So what does the Law entered into on 1 February 2018 constitute?

WHAT PROBLEMS ARE SOLVED

Lenders' meetings and the 'majority lenders' principle

The Law states that decisions made by a majority of lenders (i.e. not all of them) will be valid and binding with respect to the parties to syndicated facility agreements. Prior to 1 February 2018 there was no clarity in the law in relation to this issue. The Law determines a majority not according to the number of lenders, but rather according to the share of the loan held by each lender, as is customary in international market practice. However, this rule is optional and may be amended by the syndicated facility agreement.

Contrary to fears which existed when the bill was prepared, the Law allows parties to a syndicated loan agreement to disapply the provisions of the Russian Civil Code that govern decisions taken in meetings (*решения собраний*). Parties may also exclude the requirement for the lenders to keep a record of decisions they make, as well as other relevant formalities in the Russian Civil Code. As a result, the Law significantly simplifies lenders' decision-making as well as the implementation of such decisions.

Independence of each lender's obligations to the borrower

The Law includes, as a general rule, the principle of the independence of each lender's obligation to provide a loan to the borrower. In particular, no syndicate participant will be liable for any other syndicate participant's default under their respective obligations to provide funds to the borrower.

The inclusion of this principle in the Law is a significant achievement given that a number of experts opposed it at the drafting stage of the bill.

The role and status of the facility manager

The Law introduces the concept of the facility manager and sets out its key functions, which are generally based on internationally accepted approaches to the function and status of the facility manager. The Law contains an exhaustive list of persons who may perform the role of a facility manager – credit institutions, foreign banks, international financial institutions or Vnesheconombank. A further requirement of the Law is that the facility manager must be one of the syndicate participants (aside from where a syndicated facility agreement or a decision made by the syndicate participants provides for the preservation of the facility manager's powers when it assigns its rights (receivables) with respect to the borrower).

The facility manager's powers must be set out in the syndicated facility agreement or determined by a unanimous decision of all the syndicate participants. The facility manager also has a duty to maintain a register of the syndicate participants.

The Law protects lenders from the risk of the facility manager acting beyond its powers by vesting in a syndicate participant, within three months from the day it became or should have become aware of any actions of the facility manager performed in breach of the terms of its powers in the syndicated facility agreement or a decision made by the syndicate, with the right to claim from the facility manager damages and payment of the penalties set out in the syndicated facility agreement. The Law also protects lenders from the risk of the borrower disputing the facility manager's actions by stating that the borrower can only refer to the lack of authority of the facility manager if the borrower is aware of the absence of such authority.

Registration of pledges securing syndicate lenders' claims

The Law introduces a number of important changes to the legislation on pledges.

With regard to securing the performance of obligations under a syndicated loan agreement involving movable property and non-documented securities in respect of which provisions for security management apply, only information on the security manager must be noted in the relevant registers (no information on lenders-pledgees needs to be provided). As with pledges over participation shares in an LLC and immovable property, information about all the pledgees as well as information on the security manager must be included in the register. However, in the latter case, if the composition of lenders entering the syndicate changes, no action will be required from the lenders-pledgees, as the Law vests in the facility manager all the relevant powers. As a result of a heated discussion during the drafting stage of the bill, the Law facilitates the assignment of lenders' claims for secured loans.

Consent to lenders to transfer their obligations

The Law provides the possibility to include in the syndicated facility agreement the consent of the borrower to the transfer of the lenders' obligations to provide a loan. This is especially important with respect to credit lines that provide a long availability period for the provision of funds to the borrower. Prior to this rule being adopted, the borrower's consent was required to change the composition of the lenders in respect of loan agreements where the borrower could still request a loan. As a result there were limits on the secondary lending market.

WHAT PROBLEMS ARE NOT SOLVED

Unfortunately the Law omits at least two important issues that were in the text of the bill prepared by the expert working group for the second reading in the State Duma.

Insolvency issues

The Law does not include any provisions regulating lenders' relations in the case of the insolvency of the borrower and the security providers under a syndicated facility. The intention was to set out, among other things, the scenarios in which lenders would have a right to file independent claims as well as the roles of the facility manager and security manager. Therefore, several insolvency issues remain unresolved which will inevitably lead to difficulties in the exercise of lenders' rights. In practice, each member of the syndicate will have to file an independent claim, which will go against the goal of consolidating lenders into a syndicate. This is a significant drawback of the Law.

We expect that the legislator, following the expert community, will realise the need to resolve this issue and introduce relevant amendments to insolvency law.

Loan sub-participation

Unlike the mechanism of sub-participation used in international practice, currently Russian law does not provide an efficient structure for "silent" subparticipation in loan facilities. The need to introduce such a structure into Russian legislation has long been recognised by the banking community; the expert working group developed the relevant section of the bill, but this section was excluded from the final text.

In our opinion, the lack of such a mechanism significantly limits the development of the lending market in Russia.

WHAT PROBLEMS ARE CREATED¹

As with any new legislation, the practice of applying the Law is yet to be seen. However, future difficulties created by the Law are already apparent. We discuss two of these issues below.

Syndicate members

Unfortunately the Law limits the composition of possible syndicate members despite the fact that from 1 June 2018 amendments to the Civil Code of the Russian Federation come into force which will make it possible for any legal entity to provide a loan. Moreover, the Law refers to a syndicated credit facility **or loan**, however only persons specifically referred in the Law² can be syndicate members. This rule ultimately restricts the opportunities of Russian market participants to a greater extent than foreign ones.

At the same time, it appears that syndicate members may also be persons which do not meet the criteria specified above if such persons have acquired rights (receivables) but not obligations under a syndicated facility agreement from original syndicate members.

Payment of the facility manager fee

Contrary to current market practice, the Law states that syndicate members must pay a fee to the facility manager. However, the Law does not include an express provision that this obligation to pay the fee may be assigned to the borrower, and this legal uncertainty obviously adversely affects the development of the syndicated loan market.

CONCLUSION

The Law came into force on 1 February 2018 and applies to syndicated facility agreements signed after this date. With respect to syndicated facilities which were agreed before 1 February 2018, the relevant parties will have to assess the advantages and disadvantages of extending the application of the Law to these agreements.

The Law is undoubtedly an important step in the development of the syndicated facility market in Russia. However, to ensure that the market functions properly, further legislative improvement and the positive application of the Law are needed.

We would be happy to answer any questions you may have in connection with this e-bulletin, as well as discuss any provisions of the Law and its enactment in more detail.

In addition, we will keep you updated on compliance practices relating to the Law and potential changes in the market approach to the structuring, documenting and administration of syndicated facilities.

¹ At the drafting stage of the bill, the application of rules on partnership to syndicated facility agreements was also discussed. The result of this approach could have been a multitude of tax and legal issues for borrowers and lenders. The final version of the Law does not contain such provisions.

² The Law contains the following exhaustive list of syndicate members: (a) credit institutions and Vnesheconombank, (b) foreign banks, international financial organisations, foreign legal entities that, in accordance with their personal law, have a right to enter into facility agreements, (c) non-state pension funds, managing companies of investment funds, share investment funds and non-state pension funds, specialised depositories of investment funds, share investment funds and non-state pension funds and (d) other Russian legal entities in the instances stipulated by a federal law (e.g. specialised project finance entities, public funds for development of industry, development institutes of the Far East, etc.).

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.



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