

Russia: changes to the Federal Law “On mortgage (pledge of immovable property)”

Law-Now Russia
10.02.2009

The end of 2008 was marked by two important events that took place within about a week from each other: on 22 and 30 December 2008 two federal laws were adopted and these led to considerable changes in the Federal Law “On mortgage”* (the “**Law**”).

The new legislation has considerably changed the regime regarding the use of a mortgage bond which, we believe, has become a much more attractive instrument since these changes were implemented. Another important new aspect is that the Law now provides for the possibility of concluding agreements on levying execution on mortgaged property without obtaining a court order (extrajudicial levy of execution) not only after the mortgagee becomes entitled to levy execution, but at the time of execution of a mortgage agreement or at any other time before the enforcement of the mortgaged property. Besides, a number of other more technical changes, which are summarized below, have been introduced.

1. Mortgage bond

1.1. The mortgage bond can now be used as an independent document governing all the relations among the mortgagor, the mortgagee and the debtor

The changes to the Law now make the mortgage bond an independent document that can regulate all the relations between the mortgagor and the mortgagee. The mortgage agreement, on the basis of which the mortgage deed is issued, now provides that from the issue date of the mortgage bond to the mortgagee, the mortgage agreement and the agreement the obligations under which are secured by the mortgage ceases to have any force and effect and that all the relations between the parties shall be governed by the terms and conditions of the mortgage bond. This change considerably simplifies the paperwork required for establishing mortgage relations and eliminates possible contradictions between the text of the mortgage bond and that of the mortgage agreement.

1.2. The mortgage bond has become more negotiable thanks to the possibility of its depository registration and storage

Being a security, the mortgage bond may be submitted to a depository for its depository registration and storage, which can be temporary or obligatory. In this case, the rights of the owner of the mortgage bond shall be confirmed by an extract from its depository account and certified with the signature of an authorized depository officer, whereas any transfers of rights to the mortgage

and any other transactions involving the mortgage may be carried out by making the required entries in the said depository account.

As a result of such changes, the mortgage bond owner is no longer required to register any changes to the mortgage owners with the state authorities.

2. Extrajudicial levy of execution (levy of execution without obtaining a court order)

2.1. It is now possible to enter into an agreement on an extrajudicial levy of execution at any time and such an agreement is no longer required to be notarized

Prior to the changes being made to the Law, the parties were allowed to enter into an agreement on an extrajudicial levy of execution on mortgaged property only after the mortgagee had become entitled to levy execution on such property. Banks and other creditors reasonably regarded the likelihood of such agreements being concluded as negligible.

The amended Law provides for the possibility to conclude an agreement on an extrajudicial levy of execution at any time, regardless of whether or not there exist any grounds for levying execution on mortgaged property. Such an agreement may be executed either by including the relevant provisions in the text of the mortgage agreement or as a separate agreement. The agreement proper does not require notarization, although this is required for the mortgagor's consent to an extrajudicial levy of execution on mortgaged property.

2.2. Detailed description of the extrajudicial procedure for the levy of execution and for the sale of mortgaged property

The procedure for the levy of execution and the sale of mortgaged property by an auction organizer and the mortgagee consists of several stages. The auction organizer or the mortgagor is first required to send a registered letter to the mortgagor notifying the latter of the need to fulfill an obligation. If the mortgagor refuses to fulfill the obligation or does not respond to the notification within 10 days of receipt thereof** by the mortgagor or within 45 days of the dispatch of the said notification (whichever is earlier), the auction organizer notifies the mortgagor and the mortgagee of its intention to hold an auction for the sale of the mortgaged property and publishes an announcement about the auction. The auction may not be held until 10 days have expired following the date of first publication of the auction announcement.

From the first publication date of the auction announcement the mortgagor is prohibited from carrying out any transactions involving the mortgaged property, except for transactions aimed at discharging the obligations secured by the mortgage. Any transactions carried out in contravention of this prohibition may be contested by interested persons by filing a lawsuit to

recognize such transactions as null and void.

If it is necessary to resort to the services of an appraiser (a list of potential cases is provided in the Law), the starting auction price is fixed at 80% of the value of the mortgaged property as determined by the appraiser. However, the parties have the right to establish other terms and conditions in their agreement on an extrajudicial levy of execution on mortgaged property.

3. Other changes

3.1. The criteria for a court's refusal to levy execution have been defined more precisely

Among the grounds for a court's refusal to issue an order on the levy of execution, the previous version of the Law stated the insignificance of a debtor's violation of an obligation secured by a mortgage and the obvious incommensurability of the value of the claim made by the mortgagee for the value of the mortgaged property. The Law did not specify the criteria subject to which the courts were to determine whether the aforementioned grounds were applicable, and this gave rather broad discretionary powers to the courts in resolving this kind of dispute. The amendments to the Law fill this gap in the legislation by establishing clear criteria for applying such grounds. The Law provides that a violation is considered insignificant and the claim - incommensurable if the amount of unfulfilled obligation is less than 5% of the estimated value of the mortgaged property under the mortgage agreement and if a period of delay in the fulfillment of an obligation is less than three months. Such criteria are identical both for the judicial and for the extrajudicial procedures for levying execution.

A court's refusal to levy execution does not constitute a ground for terminating the mortgage, nor does it prohibit the mortgagee from filing the same claim again if the grounds upon which its original claim was denied cease to exist.

3.2. Additions have been made to the list of property on which execution may be levied only judicially (i.e. by obtaining a court order to that effect)

The new version of the Law expands the list of property on which execution may be levied only judicially (i.e. by obtaining a relevant court order). This property includes: (i) residential premises owned by individuals; (ii) property owned by state or municipal authorities; (iii) property owned by an individual for whom the consent or authorization from another person or entity was necessary to obtain the mortgage.

3.3. Changes to the length of notice of public auctions

The time period within which a public auction organizer is required to give notification of a forthcoming auction has been changed in the amended version of the Law. Notification must now be given not earlier than 30 days (the former version indicated 60 days) and not later than 10 days (the former

version indicated 30 days) before the auction date. The new version of the Law also obliges the public auction organizer to provide information on the auction so that it can be published on the Internet.

3.4. The criteria have been specified for the mortgagee to be able to keep the mortgaged property in the event of the failure of a repeated public auction

If the first public auction fails, a repeated auction must be held. If the repeated auction also fails, the mortgagee shall have the right to keep the mortgaged property. The new Law provides that the mortgagee shall have one month from the date that the repeated public auction is recognized as having failed to submit a written statement to the auction organizer and to the court bailiff to the effect that it wishes to keep the mortgaged property. To register its ownership right to the mortgaged property, the mortgagee is required to submit the following documents to the registration authorities: a document (protocol) recognising the failure of the repeated auction, a statement that it wishes to keep the mortgaged property and a document confirming that the said statement has been sent to the auction organizer.

* Federal Law No. 264-FZ dated 22 December 2008 “On amendments to the Federal Law “On mortgage (pledge of immovable property)” and to certain legislative acts of the Russian Federation”; Federal Law No. 306-FZ dated 30 December 2008 “On amendments to certain legislative acts of the Russian Federation for the purpose of improving the procedures for levying execution on mortgaged property”.

** Please note that the new version of the Law contains some technical inaccuracies in the determination of the type of notices.

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