

## Methods of Securing Transactions for Project Financing

Currently, many financial institutions, involved in project financing in the Kyrgyz Republic, are interested in refundability of their investments. In respect thereof, questions on the legal ways to ensure the investments refundability arise.

However, unfortunately the legislation of the Kyrgyz Republic for implementation of the project financing does not provide for such protective measures such as a pledge of receivables based on a bank account, escrow account agreement, nominal account, security deposit and other types of protective measures that are commonly used in the world banking practice.

If to refer to the legislation of the Russian Federation, it clearly specifies legal regime of each type of the above mentioned provisional measures. Thus, Article 358.9 of the Civil Code of the Russian Federation (hereinafter the “CC of the RF”) dated November 30, 1994 No. 51-FZ regulates the regime of the pledge account, Article 860.7 of the CC of the RF regulates the escrow account regime, Article 860.2 of the CC of the RF - the regime of the nominal account, Article 381.1 of the CC of the RF - the security deposit regime.

As for the bank world experience, the following legal institutions are commonly used for the project financing transactions, ensuring safety and refundability of the investment: setting up of a special purpose entity (Special purpose vehicle), mechanism of decision making by “majority of creditors”, collateral management, escrow account, shareholders’ agreement and others, which, unfortunately, are not provided for in the Kyrgyz law.

A shareholders’ agreement, regulating the following issues, is commonly used in the world practice:

- the procedure, terms of investment in the capital of the project company;
- the restriction of the right of sponsors to dispose shares/participatory interest of the company and the possibility of transferring shares/participatory interest as a collateral;
- the sponsor’s participation in additional financial issues;
- the dividend policy;
- the cases and consequences of one of the shareholders’ default;
- the termination of and amendments to the agreement.

The Participants of the project can specify covenants that should be complied with during the project implementation and for execution of which specific participants to the transaction (creditors, borrowers) are liable for. The covenants frequently used in practice are as follows:

- Restrictions to make changes to the control/ownership structure of the project company;
- Prohibition to undertake other types of business, to sell or otherwise dispose substantial assets of the project company;
- Prohibition of pledges for the project company, restriction of the borrower’s ability to encumber his/her assets in other unspecified manner;
- Compliance by the borrower with certain financial indicators.

Protection of the interests of investors can be ensured by the mechanism of payment by a letter of credit.

According to Article 2 of the Law of the Kyrgyz Republic dated July 23, 2002 No. 123, *the letter of credit is a conditional monetary obligation of a bank issued by it on behalf of a client in favor of the client's counterparty under a contract whereby the bank that opened the letter of credit (issuing bank) makes payment to the supplier or authorizes another bank to make such payments in case of submission of the documents stipulated in the letter of credit, and provided that other conditions of the letter of credit are strictly fulfilled.*

The letter of credit mechanism is slightly identical to the escrow account mechanism. But under the letter of credit, the bank disclosing the amount of payment to the payee is usually focused solely on formal verification of specific documents specified beforehand in the agreement between the bank and the payer. And in case of formal inconsistency, the Bank is obliged to return money to the payer (the founder of the letter of credit), which makes it difficult to use the letter of credit in practice.

Other types of securing the creditors' interests may be used in the project financing transaction, which may include:

- assignment of government permits (licenses) issued for the implementation of the project in favor of creditors;
- assignment of rights of claim upon contracts;
- use of insurance products for insurance of risks arising in the course of the transaction;
- and other ways.

The legislation of the Kyrgyz Republic provides for only a pledge of cash as an object of property relations (real rights). Article 29 of the Law of the Kyrgyz Republic dated March 12, 2005 No. 49 "On Pledge" provides that *money can be pledged only by transferring them to the possession of the pledgee. Interest accrued on this amount belongs to the pledgor. A bank that has a client's account has the right to take from this customer the funds on his/her account as collateral to secure the bank's loans to the client (pledgor) or a third party by agreement of the parties. Such a pledge is considered to be (is) a mortgage. The funds that are the subject of the pledge cannot be paid from the client's account in the bank (mortgagor) without the pledgee's consent if the bank was informed by the pledger and the pledgee in writing regarding the pledge of funds on the client's bank account and there is a written confirmation of the bank.*

Thus, in the banking practice of the Kyrgyz Republic to ensure the fulfillment of obligations, the Bank along with the pledge of real estate, surety (as a rule, most often used as means of securing the fulfillment of obligations) accepts as a security the funds on the settlement or deposit account of one or another Borrower,

In this connection, it became necessary to introduce amendments and additions to the banking legislation of the Kyrgyz Republic in the Kyrgyz Republic that define the legal regime of the above-mentioned institutes of interim measures to protect the interests of investors in the project financing and ensure the returnability of the funds invested by them.

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