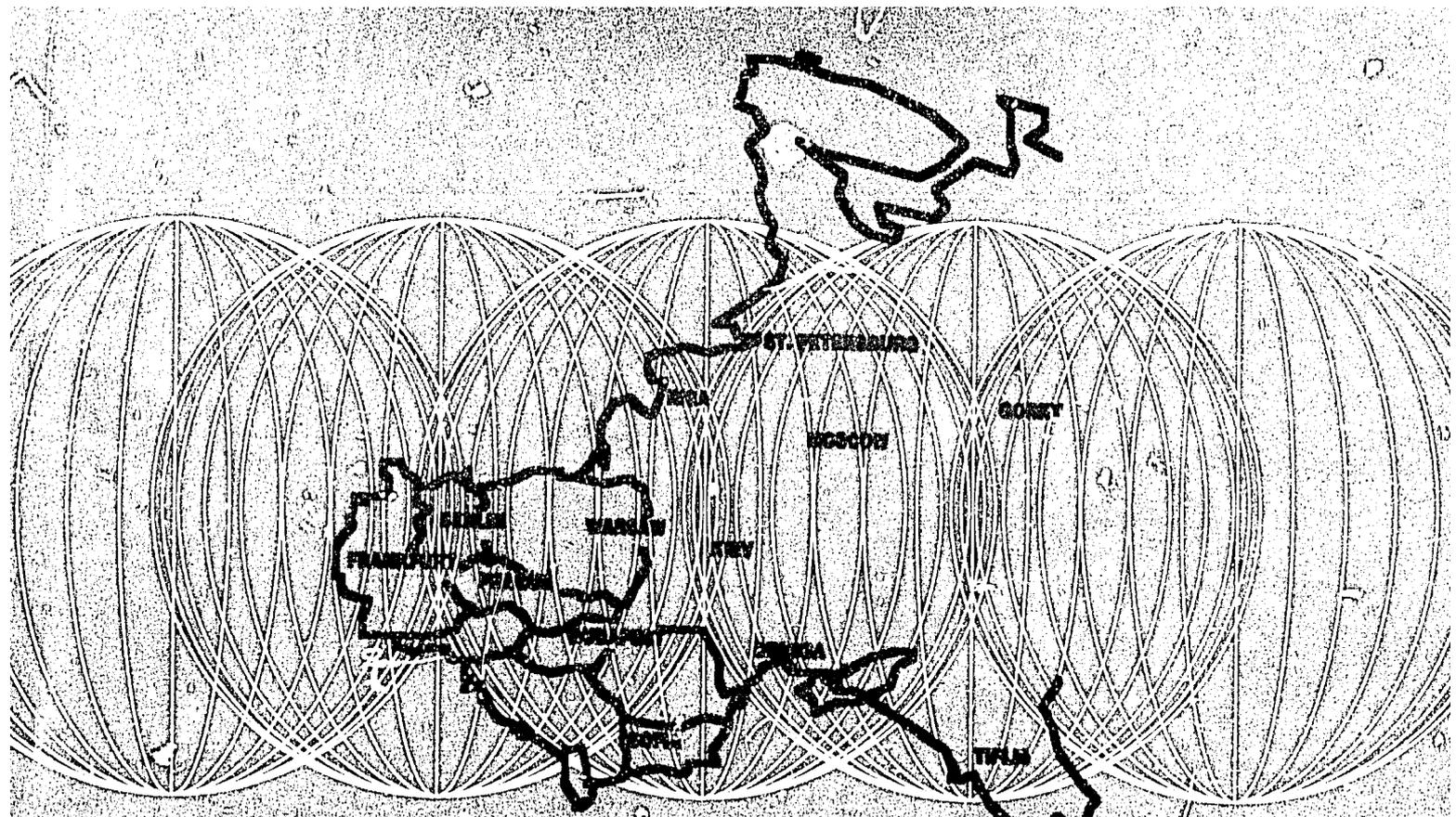


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AN INTERNATIONAL ACTIVITIES PROJECT

**FROM PLANNING TO MARKETS
HOUSING IN EASTERN EUROPE**



THE URBAN INSTITUTE
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**FUNCTION AND ORGANIZATION
OF A LEGAL DEPARTMENT FOR
MORTGAGE LENDING IN RUSSIA**

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A

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INTRODUCTION

Homeownership in Russia will be financed principally through private financial institutions, and those financial institutions will need to develop the systems, standards and personnel to deliver those financial services. Among the array of specialized personnel needed by such a financial institution will be attorneys, specially trained and organized for that purpose. This paper presents advice to financial institutions regarding the function and organizational structure of, and critical topics of interest to, its legal department.

The law codes concerning mortgage lending in Russia are in development and are likely to evolve rapidly over the next several years. This paper is not intended to reflect or comment upon the condition of Russian mortgage law.¹ It is the objective of this paper to comment on the structure of such legal departments, taking into account general principles of Russian mortgage law and the nature of mortgage lending and corporate law as practiced in the United States. Thus, a number of topics that are addressed in this paper are not yet germane to the operation of a financial institution involved in the mortgage lending business in Russia. For example, secondary mortgage markets are covered here even though they will not be relevant until the Russian system has developed over a period of years.

This paper assumes that many areas of the mortgage law in Russia will develop along lines similar to those in the United

1. For background, the author has relied on Stephen B. Butler, The Legal Basis for Residential Mortgage Lending in the Russian Federation (The Urban Institute, Washington, DC, 1993).

States. A mortgage lending lawyer spends a good deal of time being concerned with laws designed to protect consumers from lenders. Consumer protection laws respond to fundamental human nature and the resulting business practices in which some mortgage lenders have taken unfair advantage of borrowers. Thus, human nature having certain universal aspects and with mortgage markets in the United States and other countries as models, consumer protection law in the field of mortgage lending is likely to develop in Russia along international lines.²

We have also assumed that lawyers represent a significant talent pool in the development of mortgage lending institutions and that, because of the complex and uncertain nature of the developing mortgage law in Russia, lawyers will play an extraordinarily active role in the operation of the Russian mortgage lending institutions. Although certain functions, such as mortgage loan closings, will be handled principally by lawyers, lawyers will need to work closely with, and as advisors to, senior management and other specialized professionals throughout the institution, such as senior management, loan officers, accountants, economists, computer specialists, etc.

2. A good deal of the consumer protection law in the United States concerns itself with discrimination based on race, gender or other protected grounds; these concerns are not often seen in Russian urban areas, so we have been asked to assume that laws regarding fair housing and equal credit opportunity are less likely to develop.

SECTION ONE:

TOPICAL/ORGANIZATIONAL DISCUSSION OF LEGAL FUNCTIONS

1.1 General Corporate

The role of lawyers in a mortgage lending institution will extend well beyond the mortgage lending functions. Mortgage lending institutions will be subject to various laws applying to corporate entities generally and to financial institutions in particular. Corporate formalities will need to be observed and other legal issues involved in the general conduct of business will need the attention of lawyers. In a legal sense, the mortgage lending institution will be more than just a lender; it may be a landlord and a tenant, an employer, a purchaser and seller of goods and services, a plaintiff and defendant, and a borrower. This paper presents five examples of areas in which lawyers will need to be assigned to general corporate topics not necessarily having a direct connection to mortgage lending functions.

a. Corporate Governance.

One of the principal roles of the lawyer is to see that corporate formalities are observed. Mortgage lending institutions operate under a charter or other organizational document in which its basic powers and responsibilities are set forth. One or more lawyers will need to be assigned to monitor this chartering document carefully, to consider the scope of all corporate activities under that charter, including the mortgage

lending functions, and to advise management regarding the scope of its power and authority as management considers various activities and business plans.

Lawyers will need to attend, and maintain minutes of, meetings of the governing body or board of directors of the financial institution and critical committees of that governing body such as an executive or management committee, an audit committee, a finance committee or a credit or risk management committee. Formal records will need to be kept of the specific decisions made at meetings of the board of directors or its committees and those written decisions will become part of the body of internal guidelines governing the conduct of the institution's officers. Without such formalities, loan officers and other operating personnel will not have authority to carry out their daily responsibilities. Each step in the mortgage lending process, and each aspect of general corporate activity in the following paragraphs require that particular individual officers of the institution be given specific authority to carry out their responsibilities. The lawyer will prepare resolutions precisely stating the decisions that were made by the board of directors or its committee, prepare certificates of incumbency, delegations of authority and other evidence of authority so that officers can demonstrate to others the basis for their authority in acting on behalf of the lending institution. The resolutions and delegations may be broad or narrow. The lawyer will advise the board of directors and committees on how various resolutions

and delegations would function and whether broad or narrow delegations of authority to the lending institution's officers will meet the needs of the business of the institution and the mortgage lending market.

If the institution has shareholders, those shareholders may have certain rights, including the right to attend, and vote on critical proposals at, an annual meeting of shareholders. In a mutual form of institution, the depositors might have rights comparable to shareholders. Lawyers will be concerned with preparation for, the giving of notice regarding, and attendance at, such annual meetings. The lawyers will also need to be responsible for establishing appropriate agendas and keeping detailed minutes of such meetings. If the charter document or applicable law require certain types of annual reports to the shareholders or depositors, the lawyers will need to interpret those requirements and monitor the materials that are prepared in order to satisfy those requirements.

Specialized questions of concerning corporate formalities arising out of mixed public/private control of mortgage lending institutions are also of great interest to the Russian mortgage lending lawyer, but beyond the scope of this paper.

b. Human Resources.

Lawyers will need to be involved in a number of general corporate issues involving personnel management. The lawyers will need to evaluate and identify those laws that govern the way

in which any business enterprise, including mortgage lending institutions, treat their employees. These might include laws regarding formalities associated with hiring and firing of employees, the safety of their workplace, their compensation, retirement benefits, etc.

In a mortgage lending institution that will be handling a great deal of money and valuable papers, the legal department will also need to concern itself with issues of security involving dishonest employees.

c. Procurement.

A large business organization is constantly acquiring and disposing of various types of property and services. In a financial institution this might include real estate for its offices, office supplies, telecommunications equipment, computer hardware and software, and specialized services from other companies, such as financial services from correspondent banking institutions, secure courier services and computer services. Arrangements regarding the acquisition or procurement of these types of facilities, equipment and services will generally be governed by written agreements which will have legal effect and therefore will need to be prepared by, or at least reviewed in detail by, the legal department.

d. Finance.

A financial institution raises capital through a variety of financial transactions requiring the attention of

lawyers. As laws develop and evolve governing the issuance of equity and debt securities, careful attention by lawyers with expertise in those fields will be a necessity. The transactions that raise capital for banks in the United States are among the most complex and demanding areas of concern to banking lawyers. Even such seemingly mundane capital-raising activities as the opening, establishment and maintenance of deposit accounts for the public requires formalized documentation setting forth the terms on which the institution holds the deposits and pays a return on those deposits. The recent enactment of a "truth-in-savings" law in the United States has introduced new disclosure requirements requiring the attention of lawyers.

As the mortgage market develops and a secondary mortgage market arises, mortgage lending institutions will raise funds through the sale of its own mortgages. Each such transaction will involve legal agreements governing the purchase and sale of the mortgages, and the residual liability that the selling institution will bear for any deficiencies in the underwriting or documentation of the mortgages sold. Also of concern in the secondary mortgage market will be the agreement by which the originating mortgage lending institution agrees to service the mortgages for the benefit of the new owner of the mortgage loans. Alternatively, if the sale of mortgages carries with it the simultaneous "release" or sale of the mortgage servicing, or if the mortgage lender elects to sell the servicing to a third-party independent of the mortgage, that transfer of

servicing will also involve complex legal agreements. Upon repetition, secondary mortgage market agreements will have certain routine aspects to them; however, even in the comparatively complex world of secondary mortgage markets in the United States, each transaction carries with it subtle differences that require the attention of lawyers as well as sophisticated business people.

Finally, lawyers should be called upon routinely for their interpretation of tax laws. The interpretation of tax codes, as well as the supervision of appropriate filings, and advice to corporate leadership as to legitimate tax reduction techniques, are all in the province of specialized lawyers.

e. Legislative/Government Relations.

The business of a mortgage lending institution will, by its nature, be influenced by extensive legislation and government regulation. These laws and regulations will tend to be complex and dynamic. It should be the obligation of lawyers to monitor, review and advise management regarding the content of proposed legislation and proposed government regulations and the manner in which such proposals could affect any area of the operation of the mortgage lending institution. Once the impact of potential legislation or regulation is recognized and evaluated by leadership of the financial institution, the institution may seek to influence, by legitimate means, the outcome of the deliberations of the legislators or the regulators. By preparing position papers, making live presentations, or conducting or

assisting with educational meetings, lawyers are likely to play an active role in relations with government officials regarding proposed laws and regulations. The legal department should be similarly involved where the mortgage lending institution takes the initiative to encourage new or revised laws or regulations.

The lawyers will also need to be involved with government agencies that are charged with supervising or monitoring the activities of the financial institution. This may involve interaction with examiners from central bank or other government agencies when they conduct their examinations and to help analyze and respond to their findings. It may also involve efforts to seek clarification of regulations or approval of certain types of activities that require such approval.

The lawyers will also need to interact with government officials to assure that the mortgage lending institution is and remains approved and licensed to carry on all of its various lines of business as the law, and the mortgage lending institution's plans, evolve.

f. Dispute Resolution.

In the United States, a large mortgage lending institution may have one or more lawyers who work full-time keeping track of court litigation, legal disputes being arbitrated out of the court system, and active threats of litigation. Major disputes are usually handled by private law firms on a fee basis, but sometimes the legal department has the expertise and time to handle a court suit on its own. The

potential subject matter of these disputes is practically unlimited, but frequently involves claims by consumers arising out of mortgage loan transactions. While careful preventive law techniques on the part of the legal department may minimize legal disputes, such disputes are probably inevitable in a complex and growing industry and should always be anticipated.

1.2 Lending Operations

The essential area of business of the mortgage lending institution is the area that will likely take up the most time and attention of its lawyers. The following sections deal with various aspects of mortgage lending operations, taken in chronological order, and will be followed by a separate discussion of mortgage servicing. While lawyers will be involved in many facets of the process, this paper is not intended as a comprehensive description of the process itself.³

a. Advertising.

In order to attract potential borrowers, mortgage lending institutions will undoubtedly be involved in various types of advertising. Although this area is somewhat far afield from the typical activities of the lawyers, there are several key aspects of the advertising function that should be a part of the legal department's functions. As discussed above under

3. For a comprehensive proposal for the mortgage lending process in Russia, see Michael Rosenberg, Residential Mortgage Loan Manual Developed for Russia (The Urban Institute, Washington, DC, 1993).

procurement, significant contracts with media, such as newspapers, television, advertising agencies and graphic artists may all be subject to review by, and advice from, the lawyers. One can assume, as has been the case in the United States, that advertisements produced by financial institutions, particularly mortgage lenders, will be governed by various legal standards. The most fundamental of these standards will be a requirement that the advertisements be truthful and that they avoid deception by presenting vital information in a format that is likely to be understood by a prospective borrower. The accuracy of these advertising disclosures, particularly once the standard for such accuracy is articulated in the law codes, should be the subject of review by the legal department.

Where the law requires that specific types of disclosures be made in advertising, such as the "truth-in-lending" law requires in the United States, lawyers must be involved in careful evaluation of the law and the proposed advertising. Advertising for these purposes includes all variety of media including radio, television, newspaper and other printed advertisements, as well as promotional literature that is made available through the real estate industry, or handed out to customers in offices of the mortgage lending institution.

b. Broker Relations. Mortgage loan applicants generally deal directly with employees of the mortgage lending institution. In some situations, independent intermediaries, or brokers, actually "find" the mortgage loan applicant and bring

him or her to the lending institution. The activities of these brokers are increasingly popular, and highly regulated, in the United States, and an entire subspecialty of mortgage banking law has grown up among lawyers in this field. Generally, the activities of a broker with respect to a lending institution is governed by an agreement between them. Real estate sales agents will frequently refer potential loan applicants directly to the lending institution. These types of referral arrangements may also be the subject of written agreements. All of these types of agreements should be reviewed by the legal department.

A mortgage lending institution that acts through brokers has a significant interest in assuring itself that the brokers are complying with various laws regarding accurate disclosures and fair dealing with consumers that might, if violated, result in liability to the mortgage lending institution itself. Therefore, a financial institution should closely monitor the advertising materials, procedures and practices of the brokers from whom it receives loan applications. This type of compliance review is frequently conducted with the support of the legal department.

Because brokers are generally paid only when their loans are approved and closed, they will often raise questions or controversies with the mortgage lending institution regarding its procedures, standards and, most importantly, credit decisions (especially adverse credit decisions). With the support of the legal department, the mortgage lending institution needs to be in

a position to respond to these types of inquiries and controversies in dealing with brokers.

Where the mortgage lending institution receives a loan application through a broker, there may need to be a legal document assigning each application to the lending institution. Lawyers should be involved in the development of the forms to accomplish this type of transfer of applications and monitor the process by which those applications are converted from applications to a broker into applications directly to the financial institution. For example, the institution may want the applicant to acknowledge in writing that it is applying for a mortgage loan, affirm as correct all of the information it had previously given to the broker and waive any claim it might have against the broker arising out of the broker's handling of the loan application up to that point.

c. Loan Applications and Disclosures.

The form of loan application is a critical document and should be developed and revised with the help of the legal department. The loan application should call for information about the proposed security property and the prospective borrower and should set forth certain of the terms of the mortgage credit for which he or she has applied. It should also capture basic facts regarding the applicant's ability to repay the debt. The application should also provide a mechanism for the fact-gathering necessary for the mortgage lending institution to properly evaluate the credit of the loan applicant; this should

include the applicant's authorization to the lending authorization to seek and obtain information from important third-party sources of information such as employers, former landlords, etc. Finally, the application should close with a statement, signed by the applicant, acknowledging the consequences of lying to a financial institution.

In the United States, the process of taking and completing a loan application also involves the production by the lending institution and delivery to prospective borrowers of an array of disclosure information regarding credit terms. While the disclosures given in the United States are sometimes criticized as being too complex and extensive for the typical loan applicant to comprehend, the underlying principal is well accepted that mortgage lenders must give applicants accurate and timely disclosure of relevant information regarding the prospective loan. This includes disclosure statements setting forth estimates of the likely cost of the credit to the borrower, as well as a detailed explanation to the borrower as to the various steps and timing involved in the processing of the application and the underwriting of the credit. Finally, the disclosures explain key terms of the loan documents that the applicant may be required to sign at an eventual closing. The forms for these disclosures should be reviewed by lawyers to be sure they satisfy the requirements of any applicable law and regulation and also to assure that they accurately portray the legal features of the application process and the loan terms.

Lawyers should also review disclosure forms in order to minimize any potential ambiguity in the disclosures so as to avoid controversies at a later date with the borrower should the terms of the credit be misunderstood.

While it is critical that lawyers review and give advice concerning the forms of application and disclosure, the lawyers should not need to review each completed application and disclosure statement as it is processed if the lending institution's staff have been trained and are following a set of policies and procedures developed with the assistance of the legal department.

Certain types of information may be prohibited to the lender so that it does not consider that information in evaluating credit. For example, in the United States, the child-bearing intentions of a female loan applicant are, by law, not permitted as the basis for evaluating her creditworthiness. The legal department should monitor the loan application process to assure that no such information that might be prohibited finds its way into the loan application package.

d. Loan Processing.

Once the completed loan application has been received by the mortgage lending institution, information contained in that application must be verified and presented for underwriting in a timely fashion.

The legal department should assure that relevant time limits are taken into account by the loan processing department.

Even if the law does not impose time limits, the lawyers should be sure the lending institution is keeping its promises to applicants in terms of processing time; otherwise, unhappy applicants may seek to recover from the lending institution for damages they suffer due to unreasonable delays. For example, the lending institution should take into account the terms under which the applicant is purchasing the security property and the fact that the loan applicant may default under a purchase contract and forfeit a deposit if the purchase transaction is not closed by a specified date.

Verification of income and employment are very important aspects of credit underwriting, and are frequently the subject of falsification. In order to prevent fraud, the legal department should be involved in the development of forms and procedures concerning the written verifications. Such forms may include an oath by the third party giving the verification, and the procedures might include steps to assure that the applicant has no contact with the verification form and to spot-check the authenticity of verifications by telephone calls or personal visits to the individuals who completed those forms.

Where loan processors suspect fraud or irregularities in the documents verifying employment or income, the legal department should be consulted and an investigation conducted to determine whether a fraud against the financial institution has been committed. If criminal prosecution for such activity is a possibility, a lawyer should be involved in order to monitor the

collection of evidence that may be turned over to prosecutors at a later date and to assure the legal integrity of any investigation before the prosecutors become involved.

e. Credit Underwriting.

The decision whether or not to make a particular loan is obviously one of the most important decisions that a lending institution can make.

Standards for credit approval should be considered at the highest level of management, and reflected in clearly written resolutions and other written evidence of approval by directors and other senior managers. The legal department, in its general corporate role, described above, should have been closely involved in the adoption and careful articulation of loan approval standards. These standards might include financial factors governing underwriting for each of the various types of loan programs. They might also set forth the authority of various individuals to act at various stages in the credit approval process, including the establishment of a loan committee with the power to approve loan applications meeting these standards. If these authorizations and standards are set forth clearly, the general corporate lawyers will have done their job. Although by attending loan committee meetings, the lawyers can help assure that credit approval standards and procedures are being followed, compliance with credit standards is principally the responsibility of authorized loan officers.

Another important area of attention for the legal department involves the monitoring of the requirements of various outside parties that may influence the loan operations of the institution. These may include large scale employers providing credit support for their employees' mortgage loan applications or insurance companies or other organizations that will provide credit enhancement such as mortgage guaranty insurance or that will guaranty pools of mortgages sold in the secondary mortgage market.⁴ Another outside group that will impose its own set of standards on the lending institution will be secondary market investors. In the United States, the loan underwriting standards of the two principal governments sponsored secondary mortgage market institutions, the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) are an integral part of every lending institutions credit underwriting standards. If a lending institution did not incorporate the Freddie Mac and Fannie Mae standards into its own, the lending institution might lose the critical flexibility of selling its loans to these secondary market agencies. Another outside party whose published underwriting standards might need to be taken into account are rating agencies. Once an active private secondary mortgage market has developed in Russia, some pools of mortgages may be sold in the form of securities, and the

4. This type of credit support or enhancement, whether from an employer or third-party insurer or guarantor, is discussed again below in sections dealing with loan closings, delinquent accounts and foreclosure.

securities may carry with them a rating from an agency comparable to Standard & Poor's in the United States. These ratings tell independent investors about the quality of the underlying mortgages in the pool without the investor having to conduct its own detailed evaluation of the loans. Credit enhancers, loan guarantors, secondary market investors and rating agencies publish standards that should be of great interest to mortgage lenders who intend to sell their mortgage loans in these secondary markets. Lawyers should support loan officers in monitoring these standards, as they become relevant and available, to assure that they are reflected, where appropriate, in the lending institution's own standards.

f. Property Underwriting.

The decision to grant mortgage credit is approached in two parts: (1) a determination as to whether the borrower has the financial ability to repay the loan, and (2) a determination that the property offered as collateral will have sufficient value to satisfy the debt if the borrower fails to pay. Evaluation of an appraisal or a purchase contract raises issues for the legal department that are parallel to the discussion above regarding credit underwriting: faithful adherence to internal standards and consideration of the standards of outside parties.

The legal department should also be alert to the potential for abuse in determining the value of the collateral property. The legal department should pay close attention to any

concerns that arise in evaluating appraisals provided to the mortgage lending institution on determining the validity of purchase contracts for the proposed security property, and should be alert to the need for any investigation of an appraisal or an appraiser on the truthfulness of a purchase contract in this regard.

g. Condominium and Homeowners Associations. In determining the value of the property, the lending institution will be concerned with more than the traditional appraisal issues: location, physical condition and other factors of "market value". The "legal condition" of the property will also be of significant concern in Russia. Because most private housing units are apartments, the value of an apartment is affected by the rights and privileges of other owners or tenants in the same building. Financial institution lawyers must become knowledgeable as to the documents and the law regarding condominiums and similar homeowners associations.

Of particular interest will be the provisions made in the condominium or homeowners association documents for the rights of secured mortgage lenders. Obviously, lending institutions should be very reluctant to lend on the security of apartments located in buildings where lenders are prevented from realizing on their collateral or where the process by which they can realize on their collateral is unnecessarily lengthy, complicated or uncertain. Another issue of tremendous importance to a lending institution, and one which necessitates close

attention of its legal department, is an analysis of the adequacy of replacement and repair reserves for the building and the procedural steps needed to perform emergency maintenance.

Mortgage loan documents should give the lender the right to make emergency repairs or spend money on an emergency basis to assure or preserve the value of the collateral where the borrower is unwilling or unable to do so. In order to do this, the lender must have a fair level of comfort that it will be able to add such sums to the unpaid balance of its loan and to collect those amounts in the same manner that it would have otherwise collected its loan balance.

Ideally, buildings will not need emergency repairs because the association of homeowners has maintained a fully funded reserve account for anticipated repairs and replacements. The adequacy of such reserves will generally be an issue for non-lawyers, and particularly those with financial and economic expertise. However, the legal department should scrutinize homeowner association documents carefully to assure that adequate provision is made for the collection of those reserves and for their safekeeping, and for an expeditious and effective method for their expenditure to assure that the condition and, therefore, value, of the apartments in the building remain strong.

To the extent that condominiums adopt uniform homeowners association documentation that is evaluated in advance by lending institutions and found to be favorable to their

interest, the process of review by the mortgage lending institutions' legal department in each instance in that building can be minimized. However, mortgage lending institutions should be careful that they only lend on the collateral of apartments in buildings whose documentation regarding replacement reserve is satisfactory to the legal department.

Once it has been established that the underlying documentation for replacement reserves is in a form acceptable to the institution and that the sums currently held are sufficient for the purposes intended, then it should also be the concern of the legal department that the corporate formalities of the homeowners association are being adhered to. If the corporate formalities of an existing homeowners association have not been followed with diligence, then it could be argued by certain homeowners, the state, other lenders or other third party suppliers, that the funds apparently available for the purpose of replacement reserves are subject to other claims.

The legal department, together with the non-lawyer experts described above, may need to evaluate each building, taking into account its constituent documentation, physical condition, level of reserves, level of cooperation of its homeowners association and other property underwriting concerns, before making its first loan in that building. Initially, however, this is probably impractical given the mixed public/private status and deferred maintenance of many buildings as well as the general lack of cash reserves.

h. Loan Commitments.

Once a complete loan application has been obtained, supporting information has been gathered by the loan processors, the credit and property underwriting have been accomplished, and loan committee approval achieved, it is time for the lending institution to communicate its decision to the applicant. The form of mortgage loan commitment is another vital piece of paper in the chain of documents governing the relationship between the lender and its borrower, and should be developed with careful review by the legal department. A well drafted mortgage loan commitment should communicate the approved loan terms to the borrower and, upon its acceptance, to communicate to the mortgage lending institution that the loan terms are acceptable. The loan commitment is also important in articulating any special conditions which are placed on the approval of the loan application, and all of the other general conditions that are prerequisites to the loan closing. These special and general conditions may include items of credit or property underwriting which are unique to the particular transaction, borrower or property, or may be items of general applicability that are important to the mortgage lender in every transaction, such as certain assurances regarding title to the property and priority of the mortgage lien, satisfactory execution of the lender's standard form of loan documents, etc.

The form of commitment needs to be drafted very carefully and its completion in each instance needs to be

reviewed and monitored very carefully. While the development of the form itself should involve the active participation of the legal department, the completion of the form in each instance need not involve the legal department so long as a trained loan officer carefully supervises the process. Nonetheless, as a matter of legal risk, it is vitally important that the form be completed accurately to avoid obligating the mortgage lending institution to loan terms it did not approve.

i. Loan Closings.

Lawyers will play a significant role in a number of key operational aspects of mortgage lending institutions in Russia. The heaviest concentration of this activity is likely to be in the area of mortgage loan closings. This pattern is more or less consistent with that in the United States. Although mortgage lending institutions in the United States frequently employ non-lawyers in mortgage closing departments, lawyers are often heavily involved, on an independent fee basis, on behalf of the lenders. In most United States jurisdictions the closing, and related title recordation or registration functions, are performed by or under the direct supervision of lawyers through title agencies or independent escrow companies. Although these lawyers are not members of the lending institution's legal department, they work for and are paid directly or indirectly, by the lending institution itself. This paper assumes that virtually all of the closing functions in Russia will be handled in-house by the mortgage lending institution's legal department.

The legal department's largest concentration of lawyers will be involved in the loan closing function.

If title registry searches at the local Bureau of Technical Inventory ("BTI") or other relevant agency are to be conducted by outside vendors on a fee basis, it would be the responsibility of the mortgage lending institution's lawyer to place the order with that vendor and conduct a detailed review of the report that is provided. Alternatively, the lawyer may personally travel to the relevant local agency and conduct the search, retaining suitable certificates and other documentation to support his or her findings.

The nature and content of the loan documentation to be used for mortgage lending in Russia is an entire topic worthy of separate extensive discussion, and is not dealt with here. Nonetheless, it would be the responsibility of the in-house lawyer to assure that the proper forms of loan documentation are adopted by the institution, that they have been reproduced faithfully as form instruments or, if produced on an automated basis for each transaction, assuring that they are faithful reproductions of the correct master forms and that the particular data elements, such as borrower's name, loan amount, property description, interest rate information and critical dates, are inserted into the documents correctly, and are consistent with the terms of the loan commitment.

In addition to the critical loan documents (e.g., the note or loan instrument, the guaranty, the security instrument or

mortgage, etc.) the attorney handling the closing for the mortgage lending institution should be responsible for preparation of a closing statement which identifies the sources and uses of all funds which are the subject matter of the closing. In the United States, the Real Estate Settlement Procedures Act ("RESPA") prescribes a specific form of closing statement. Typically, however, a closing statement would provide an itemization of the entire approved loan amount, credit for any prepaid fees whether provided by borrower to the lender prior to the settlement for processing of the application, costs of closing including registration fees and the like, or amounts to be held by the lender in escrow for the payment of taxes, homeowners association fees, etc. The typical closing statement would show deductions from the amount of the loan proceeds for such purposes as paying the current title holder the balance of the purchase price owed to him or her as a condition of conveying title to the borrower. If the purpose of the loan is to simply refinance the borrower's existing ownership of the property, then the deductions from the loan amount would reflect the amount necessary to satisfy all existing debts of the borrower that must be paid off in order for the new lender to obtain a first lien.

In order to assure that the amount necessary to pay off an old lender is correct, it would be the responsibility of the attorney handling the closing to obtain a written payoff instruction from that lender. That payoff instruction must be in a form that can be relied upon by the new lender in obtaining the

release of its lien once it receives the funds that it claims to be owed. As the practice develops, the legal department would need to establish relationships with other lenders whose mortgages it would be paying off from time to time so that it could achieve a high level of confidence that such written instructions could be relied upon.

On the day of the loan closing, it will be the responsibility of the attorney handling the closing to present the loan documents to the borrower and explain their meaning. While the borrower may be accompanied by its own attorney, this is not common in most United States jurisdictions and probably will not become the general practice in Russia. Thus, the only attorney at the closing table will often be the attorney representing the lender. He or she will describe the closing process, present the loan documents for execution and notarization, and describe the elements of the closing statement. That attorney will also be responsible for explaining the title instrument and reviewing it in final form if the loan proceeds are being used to purchase the security property. Another document that might be presented at closing and that would have to be reviewed by the attorney on behalf of the lending institution is some form of acknowledgement agreement or other evidence of approval from the governing body of the condominium or homeowners association.

Where credit enhancement for a loan is a condition of closing, the approval of that credit enhancer will have to be

obtained by the attorney handling the closing. This might include mortgage insurance as it is known in the United States or it may include a form of guaranty or other documentation from the borrower's employer or other organization providing credit support.

Where the loan commitment permits subordinate or subsidy financing in the nature of a "soft second" mortgage (bearing little or no interest) or other subordinate lien on the same property, it is the responsibility of the attorney handling the closing to review and collect the documentation for that financing and to take the responsibility for seeing that it is registered. While it may receive this documentation together with a written instruction from the subordinate lender that would obligate the financial institution to duly register that subordinate financing, it is in the interest of the lending institution to retain control of that process to assure that the mortgage lending institution ends up with a superior lien priority.

Summary of Closing Attorney Work Flow

Accepted loan commitment
received from borrower

↓

Transfer file to
Legal Department Closing Attorney

1. Conduct title review
2. Prepare loan documents
3. Prepare settlement statement
4. Conduct settlement
5. Lien registration at local agency
6. Disburse loan proceeds
7. Secure credit enhancement
8. Servicing set-up

↓

Transfer file to
Servicing Department

j. Post-Closing

Following the closing, it is the responsibility of the lending institution's lawyer to see that appropriate registration of the security instrument is accomplished. That attorney would also be responsible for seeing to it that all incidental taxes and charges associated with that registration are paid.

Presumably the cost of such items would have been provided for in the settlement sheet and withheld from loan proceeds or paid separately to the lender by the borrower at closing.

The attorney must also see that all payoffs are accomplished and the appropriate release of lien is obtained for registration.

Where some form of title assurance or a title certification is to be obtained, the attorney handling the loan closing on behalf of the mortgage lending institution must be responsible for seeing to it that the documentation of such insurance or certification is obtained in proper form following title and lien registration.

Where credit enhancement, mortgage insurance or third party guaranty is provided, the attorney handling the closing on behalf of the lending institution must be responsible for seeing to it that those instruments are in proper form and are retained by the lending institution and any confirmations to those parties is issued and delivered.

Finally, the attorney must see that all original loan documentation is delivered to a vault or other appropriate safe

place and that the closing documents are transferred to the mortgage servicing department for the purpose of opening the servicing file.

1.3 Mortgage Servicing

Several functions of the mortgage servicing department will require the occasional or periodic review by the legal department. It is not unusual at mortgage lending institutions in the United States for specialists within the legal department to concentrate on issues that arise in connection with mortgage servicing. The following sections describe the various aspects of mortgage servicing which most often require the attention of the legal department.

a. Application of Payments.

Lawyers need to be involved in a variety of problems that can arise out of the seemingly simple act of collecting and keeping track of the borrower's payments. Complex variable rate and payment adjustment features, as are contemplated in the Russian mortgage lending market, require very careful monitoring for compliance. Initially, lawyers should be involved in monitoring the establishment of the data processing and accounting functions necessary for non-lawyers to manage this function. Beyond that, lawyers will be needed on a periodic basis to assure compliance in the event of any changes in the various formulae or systems, or where a question or controversy arises. In recent years, controversies and lawsuits brought by

borrowers under complex variable rate programs have become a significant problem for mortgage loan servicers in the United States. In these controversies borrowers accuse servicers of inaccurately calculating adjusted rates and payments, thus, overcharging entire classes of borrowers. The attention of lawyers will be necessary to assure that payment and rate changes are calculated in a manner that is consistent with the provisions of the loan documents, accurate and timely notice of those changes is given to borrowers, and mortgage loan payments are applied in a manner that is consistent with these formulae.

While payments in the United States are virtually always made in check or electronic form, this will not be the case in Russia for some time. Whenever cash is being handled in connection with mortgage payments, careful attention is needed in connection with security concerns and the process of giving accurate receipts, and the legal department should give advice on setting up and maintaining these systems.

Good mortgage servicing practice, if not applicable law, calls for annual statements to be given to each borrower setting forth the amount of interest and principal paid during the year, the remaining principal balance, the amounts paid into and out of escrow accounts, and so forth. The form used for such notices should be scrutinized carefully by lawyers to assure that they comply with the obligations of the lending institution in giving these notices, whether they are self-imposed under the loan documents or imposed by code or regulation.

It is the experience of many mortgage loan servicers in the United States that major difficulties and costly litigation arise from what first appear to be innocuous questions from individual borrowers. If early signs of difficulties with processing systems, accounting procedures or the like are not handled expeditiously, and with thoughtful courtesy, small disputes with customers can erupt into major disputes involving large numbers of borrowers. In the United States, a recent federal law requires that mortgage loan servicers respond to inquiries from borrowers in a specified manner and during a certain fairly short time period and some states require that lenders retain copies of all written customer complaints in a central file so that the supervising regulatory agency can easily review them and determine whether an investigation of that servicer's behavior is called for. Lawyers should be involved in monitoring patterns of disputes and borrower complaints, however minor, and controversies where borrowers challenge or dispute the mortgage lending institution's interpretation of the loan documents or servicing practices.

b. Payoff and Release.

When the mortgage loan is to be paid off and the lien released, there are several steps in the process that require thoughtful and often quick review by lawyers. The issuance of a payoff instruction or payoff letter, as discussed in connection with the closing process above, raises several potential legal dangers. When a lender issues a letter stating a payoff amount,

it must be careful that it is not only accurate but that it sets forth the various terms on which the lender will agree to release its lien in exchange for the delivery of certain sums of money. The amounts calculated must be accurate, although that responsibility lies principally with financial personnel. The written payoff instruction should make clear that payment of the payoff amount obligates the lender to release its lien only upon satisfaction of all of the terms in that letter. Those terms may include a requirement that additional interest be added to the amount of the payoff after a certain date, that payment must be made in a certain form, at a specified place or prior to a particular hour. The payoff letter must also accurately account for any escrow amounts being held, and give appropriate credit toward the payoff for those amounts. Lawyers should also be involved in the preparation of the instrument of release and supervise the process of either delivering it to the closing of the new loan or seeing to its registration at the proper local BTI. In several United States jurisdictions, laws have been adopted that require lenders who are paid off to issue release instruments in the proper form and deliver those to proper authorities within a specified number of days after the receipt of the payoff on the loan or suffer severe penalties. Failing to do so could cause severe problems for the owner of the home, who is unable to provide "clear" title because the old lender is slow in releasing its interest once it has been paid. The instrument of release is a legal document, the accuracy of which is critical

to the mortgage lender. Although the owner, BTI officials and new lender are likely to scrutinize it carefully, it should nonetheless be prepared under the supervision, or with the careful review of, an attorney.

c. Escrow Accounts.

As a part of the handling of loan closings, an attorney should supervise the process of calculating and collecting initial deposits for taxes, homeowners' association fees, insurance premiums, ground rents, if any, reserves for replacements, etc. that takes place at the mortgage loan closing. The lawyer will need to be familiar with the law and regulation in each jurisdiction and potentially within each building, to understand which items must be included.

The lending institution must be careful, in the course of its mortgage servicing process, to fulfill the various obligations that arise out of its handling of escrowed funds. If funds are held to pay property taxes, the lender must know when those taxes are to be paid and assure itself that it pays the proper amount from escrow on a timely basis. This same obligation applies in the case of any obligation for which funds are escrowed. At the same time, the lender must be careful to hold those funds safely and securely. In effect, these funds are held in trust for the benefit of the borrower and should be spent by the lender only to satisfy the obligations for which they are held.

As a part of its obligation to report to borrower periodically, as described above, the lending institution should also report to the borrower on the balances in the various escrow accounts and provide an itemized report as to all activity in those accounts including all payments received from the borrower as well as an itemization of those obligations which were paid from the account. Sometime during the annual cycle, perhaps at the time as the annual report on the escrow accounts, the mortgage servicer should conduct an analysis to determine whether it is holding sufficient funds to satisfy the various obligations on a timely basis. If it is holding more than enough funds, it should make arrangements to reimburse the borrower and, if holding less than enough funds, it must make demand on the borrower, in proper form, to pay additional sums either at once or spread out over the next year, to make up for this deficiency.

The legal department should be closely involved in the processes that lead up to escrow reporting and payment of various obligations from the escrow accounts. For example, care should be taken to assure that all bills submitted to be paid from the escrow account come from a proper source, are in proper form and appear to be for a justifiable amount. Lawyers should be involved in establishing procedures to see that this happens, and to consider controversies or difficult questions that might arise in carrying out that procedure.

d. Delinquent Accounts.

Lawyers should be closely involved in developing and maintaining a form letter or a series of form letters to be sent to borrowers to give notice of late payments. Given the relative lack of experience on the part of most Russian borrowers with managing such obligations, these notices should be sent out quickly and be worded carefully. Thus, the lawyers should play an active role in the collection of delinquent payments, particularly in the early years of the mortgage servicing process.

To the extent that the mortgage servicer contacts delinquent borrowers directly and confronts them personally regarding late payments, lawyers should be consulted to assure that the practices to be followed by the lending institution do not violate any laws concerning fair debt collection practices. This has become a problem in the United States because of over zealous efforts to collect loan accounts. Legal department attorneys should closely monitor the procedures that are in place to assure that these collectors are not abusive or disrespectful of borrowers.

In the event that a borrower seeks to reinstate a mortgage loan and to make arrangements for special payments in order to "catch up" with the payment schedule, care must be taken to consult the lawyers in drafting any agreements with the borrower to memorialize these "workout" arrangements. Any written agreements, or even unwritten agreements, entered into

with a borrower for these purposes, can act to modify the underlying loan documents and potentially compromise the rights of the mortgage lending institution upon the occurrence of subsequent defaults.

Special care must be taken, generally under the supervision of a lawyer, to assure that nothing in a workout or reinstatement agreement violates the requirements of a secondary mortgage market investor or credit enhancer. Those requirements might call for immediate notice to it of any loan default. When faced with a delinquent borrower, it becomes vital for the lender to assure itself that any guarantor or credit enhancer is in place and continues to be obligated to perform. A carelessly worded interim "work-out" agreement with the borrower could compromise these rights and relieve the guarantor or credit enhancer of its obligations.

Because of the relative lack of experience on the part of most Russian borrowers with these types of credit arrangements, a relatively high incidence of credit counseling might be called for. If professional credit counseling can be provided, whether in-house or through third-party vendors, it would be appropriate for the legal department to review the procedures to be followed by the credit counselors to assure that the arrangement does not compromise vital interests of the lending institution. Any agreements with an outside credit counseling service is a procurement and should be reviewed carefully by the legal department.

e. Foreclosure.

When credit counseling or other discussions with a borrower regarding delinquency are fruitless, it may be necessary to take action to seize the collateral property and satisfy the obligation to the mortgage lender. The first step in this process involving the lawyers should be a careful evaluation of alternative remedies and which of those remedies should be elected. For example, it may be possible to take action against the borrower personally for repayment of the debt out of its other assets or income, or against the property to take title by foreclosure and dispose of the property to satisfy the debt, or alternatively, to go directly to a guarantor or other credit enhancer to satisfy the loan. The question has become complex in several jurisdictions of the United States because of limitations on the rights of lenders concerning the sequence of remedies that they may elect. The legal department should be closely involved in developing these strategies.

If the foreclosure is to be by a judicial proceeding, it will be necessary for the lawyers to become highly involved in the preparation of legal pleadings and presentations to appropriate tribunals in order to receive authority to gain approval to conduct a foreclosure sale. If, on the other hand, a non-judicial or "notice" technique is permitted, it will also be necessary for the lawyers to be heavily involved in preparing the appropriate forms of notice that are prerequisites to any public auction. In either event, the lending institution should see

that the lawyers are closely involved in managing the process of foreclosure. Although non-lawyers with financial and economic backgrounds and corporate authority would be making decisions regarding alternative remedies, they should do so after careful review and advice from the legal department.

Once title to the security property has been obtained by foreclosure, it will generally be necessary to dispose of the property in order to realize on its value. The disposition of that property will be in the nature of a real estate transaction involving the sale of the property, and should be handled under the supervision of an attorney. The proceeds of the disposition of the property need to be applied to the unpaid balance of the loan, the costs of sale, any unpaid interest, and negative escrow balances. Because the defaulted borrower may still be liable for any shortfalls in the application of these amounts to his or her loan, it is important that these accounting adjustments be made in strict conformity with the terms of the loan instrument, and upon consultation with a lawyer. If the proceeds of disposition of the security property are not sufficient to clear the borrower's account with the lending institution, then the law may provide, as it does in most United States jurisdictions, for the lending institution to take legal action against the individual personally or against the credit enhancer or guarantor if those alternative remedies were not elected at the outset. If more than enough money is realized from the disposition of the security property to satisfy the obligation to the lender, then

the excess amount may, depending on the law in effect, be returned to the borrower. Unfortunately, the handling of foreclosures may become a specialty with the legal department. These procedures are not only complex on their own, but the various legal defenses of the defaulted borrower must be anticipated and resisted if raised.

f. Possession.

In the United States, one of the most difficult and politically sensitive aspects of the foreclosure process is the means by which the lending institution reclaims possession of the property. Removing an unwilling borrower from his or her home can be an extraordinarily contentious and sensitive process and one which requires careful planning and scrupulous adherence to the technicalities of the law code that governs this distasteful but necessary process. The law in Russia appears not to allow eviction in almost all circumstances. Where circumstances may allow the mortgage lending institution access to the security property, the legal department should also be closely involved to assure compliance with the technicalities described above.

SECTION TWO:
GUIDELINES AND PROCEDURES

The generic activities engaged in by lawyers in connection with the functioning of the mortgage lending institution fall into the following categories:

1. Advise management and staff in connection with the design and drafting of suitable board of directors resolutions, delegations of authority, procedures and forms.

2. Train staff regarding those procedures that have legal implications, so that non-legal staff can carry out their duties as independently as is reasonably possible.

3. Respond to questions and controversies regarding compliance with procedures, whether those questions and controversies are internal or external.

4. Counsel management of changes that should be made to procedures and forms in response to changes in the legal environment, such as:

- i) in the enacted law and regulations affecting mortgage lending,
- ii) in interpretations of existing law and how it is applied by courts, regulators or other authorities,
- iii) in the pattern of conduct of customers based on economic or other political factors, and
- iv) in related procedures having "ripple" effects in other areas of mortgage lending and servicing operations.

5. Represent the institution in connection with those functions for which the legal department takes primary

responsibility, such as loan closings, litigation, negotiation with outside third-parties in connection with contracts and dispute resolution, and other official corporate responsibilities typically handled by lawyers.

SECTION THREE:

TABLE OF ORGANIZATION AND JOB DESCRIPTIONS

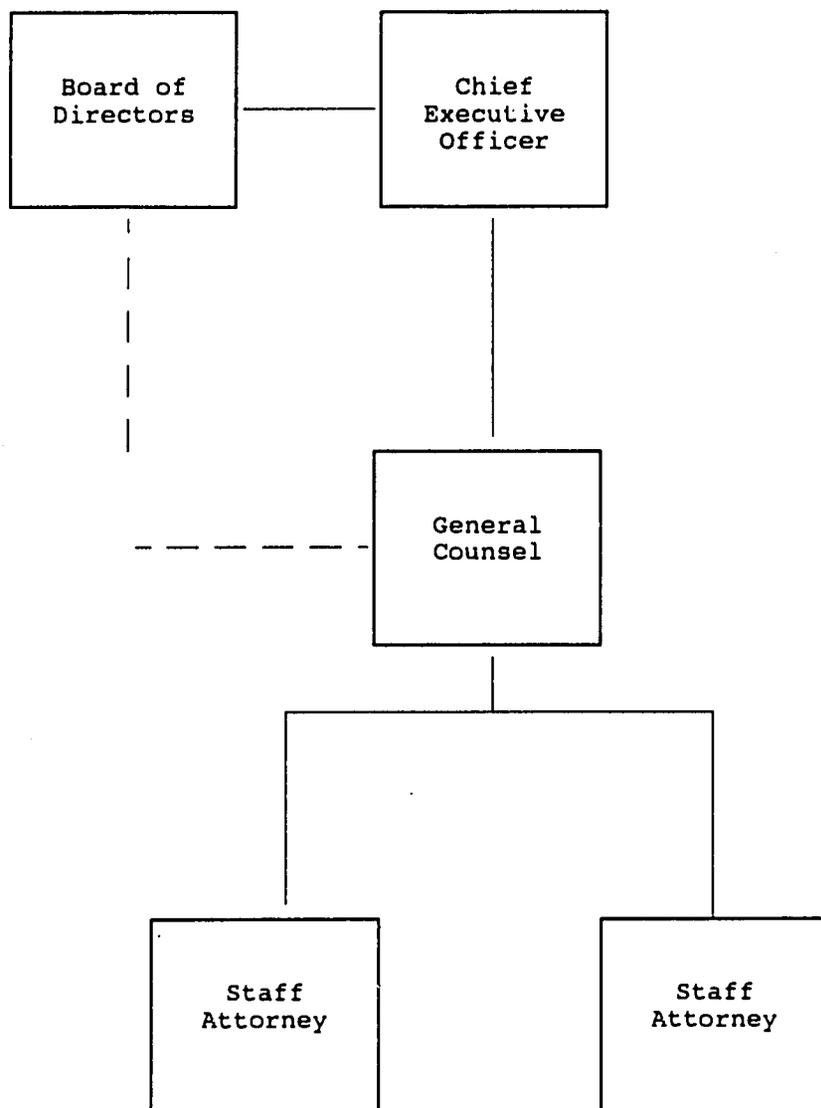
In the early years of operation, the lawyers and the legal department will be heavily concentrated on mortgage operations, most typically mortgage closing operations. In later years that concentration is likely to shift into corporate matters and areas of mortgage loan operations not connected to closings and mortgage servicing. This shift will occur because, as loan portfolios grow and mature and secondary market functions become more prominent, those functions will involve greater levels of activity and those functions will take on greater importance to the organization. At the same time, the mortgage closing process will, as experience is gained, become more efficient and each attorney will be able to handle a larger case load and rely more heavily on non-lawyer assistants to maintain that case load.

3.1 Low Volume Assumption

This table of organization assumes ten or fewer mortgage loan closings each month and that the entire department will be made up of three lawyers operating at a fairly low level of efficiency. At the same time, it contemplates a very small servicing portfolio and virtually no defaults or other servicing difficulties. The assumptions underlying this table of organization will probably not be valid for more than a year or two after mortgage loan operations commence.

1. General Counsel. This individual will personally handle all general corporate and loan operations and servicing issues and will supervise two staff attorneys who will personally handle mortgage loan closings. Although this individual reports for administrative purposes to the Chief Executive of the mortgage lending institution, he or she will, as is customary for similar positions in the United States, also report directly to the governing body (board of directors).

a. Two Staff Attorneys. These individuals will each handle all aspects of approximately one mortgage loan closing per week.



3.2 Moderate Volume Assumption

This table of organization contemplates thirty or more mortgage closings per month and a total department of seven attorneys. This table of organization assumes that levels of efficiency have improved and various levels of expertise have developed among the attorneys and among the non-legal staff with whom they interact. Finally, this table of organization assumes that a rapidly growing servicing portfolio has begun to generate increasingly complex servicing problems, and moderate levels of delinquency and potential foreclosure.

1. General Counsel. This individual will personally handle senior level corporate issues and interact with senior management of the lending institution as well as personally supervise the activities of three senior attorneys who will be responsible for three types of legal work. The first two senior attorneys will not have separate legal staff assigned to them, although they may occasionally use the staff attorneys described below who are predominately involved in the day-to-day operation of the mortgage closing department for supplemental assistance. Although this individual reports for administrative purposes to the Chief Executive of the mortgage lending institution, he or she will also report directly to the governing body (board of directors).

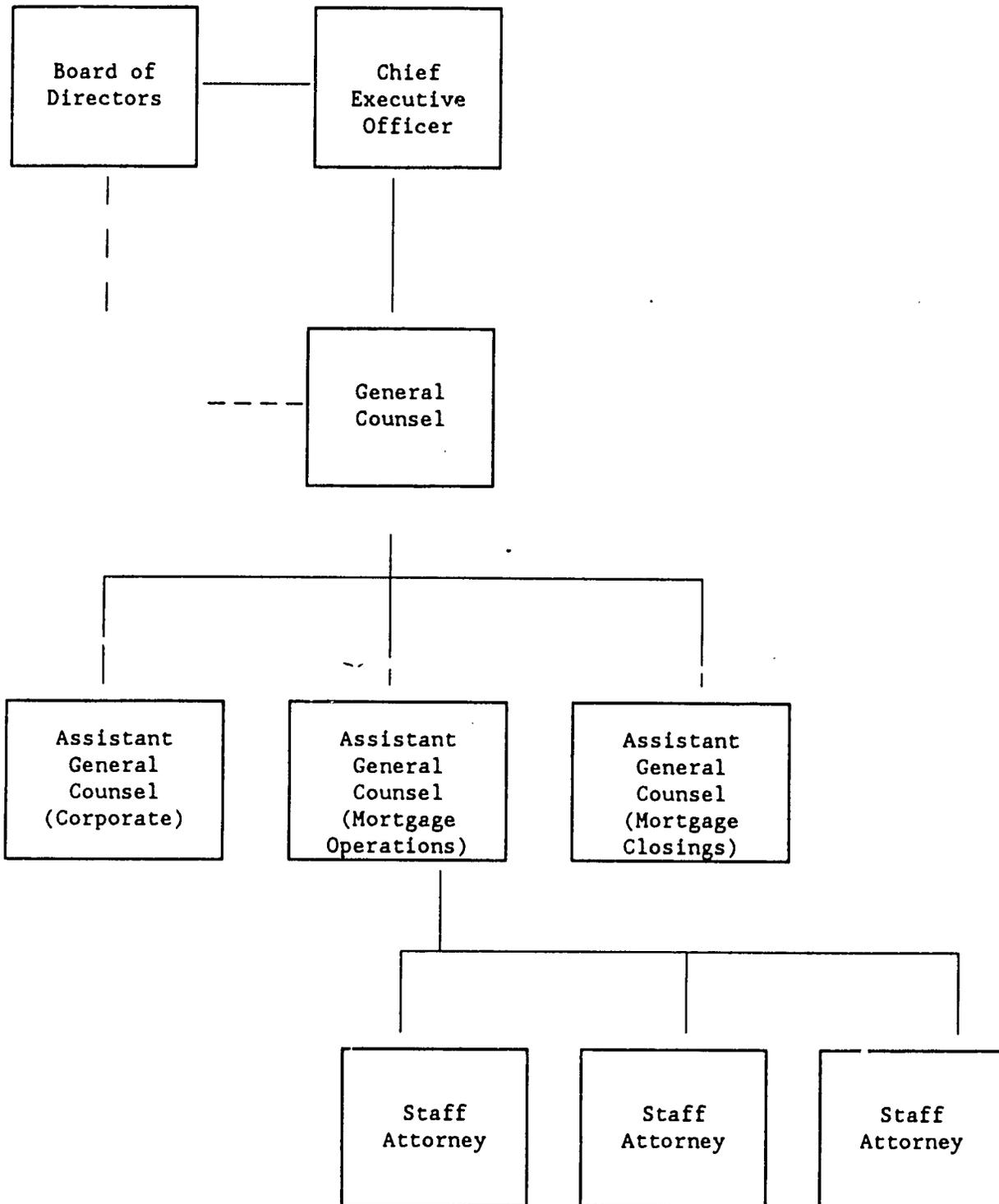
a. Assistant General Counsel (Corporate). Of the three individuals holding the title of Assistant General

Counsel, the first will handle general corporate issues as described above.

b. Assistant General Counsel (Mortgage Operations). The second of the three senior attorneys will handle mortgage loan operations other than mortgage loan closings and will handle all mortgage loan servicing issues.

c. Assistant General Counsel (Mortgage Closings). This senior attorney will supervise three staff attorneys who will handle all aspects of mortgage loan closings. This individual will also personally handle particularly difficult mortgage loan closings and will be responsible for the development of procedures, forms and other issues affecting the mortgage loan closing process. If there is a shortage of qualified attorneys to fill the positions described above, it is in this area that non-attorneys could most easily be trained to take additional responsibilities, under the supervision of the attorneys. Properly trained non-attorneys could augment a smaller complement of attorneys, or could be hired instead of attorneys to perform such functions as gathering title information and preparing loan documents and settlement statements.

(1) Three Staff Attorneys. Each of these attorneys will handle all aspects of at least two mortgage loan closings per week.



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