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R95 **Russian Economy in 2013. Trends and Outlooks.**
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The review provides a detailed analysis of main trends in Russia's economy in 2013. The paper contains 6 big sections that highlight single aspects of Russia's economic development: the socio-political context; the monetary and credit spheres; financial sphere; the real sector; social sphere; institutional challenges. The paper employs a huge mass of statistical data that forms the basis of original computation and numerous charts.

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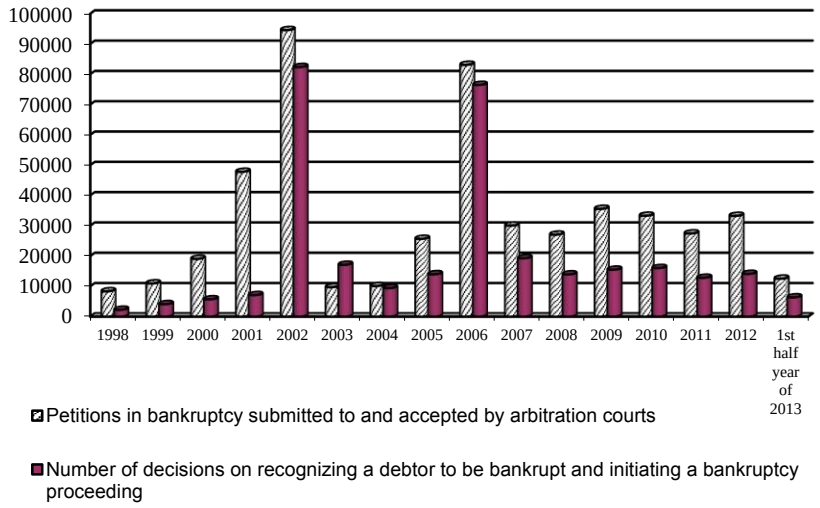
6.3. Bankruptcies in 2012-2013: Growth in the Number of Bankruptcies of Financial Institutions and Individual Entrepreneurs and the Introduction of New Regulations

6.3.1. The Dynamics of Bankruptcies in 2012-2013

The overall situation in the field of bankruptcy over the period under consideration was characterized by a considerable rise, in 2012, in the number of bankruptcies and the number of petitions in bankruptcy submitted to and accepted by arbitration courts. Compared to 2011, the number of submitted petitions in bankruptcy rose by 22.4%, to 40,864. At the same time, the number of petitions in bankruptcy accepted by courts of justice increased by 21.2%, to 33,236. However, in the first half-year of 2013, the number of petitions in bankruptcy submitted to and accepted by courts of justice dropped by 25.4% and 21.1% respectively on the same period of the previous year. A similar trend was observed in the annual number of decisions on recognizing a debtor to be bankrupt and initiating a bankruptcy proceeding: having grown in 2012 by 10% in year-on-year terms, in Q1 2013 their number dropped by 11.1%, compared with the same period of 2012 (*Fig. 1*).



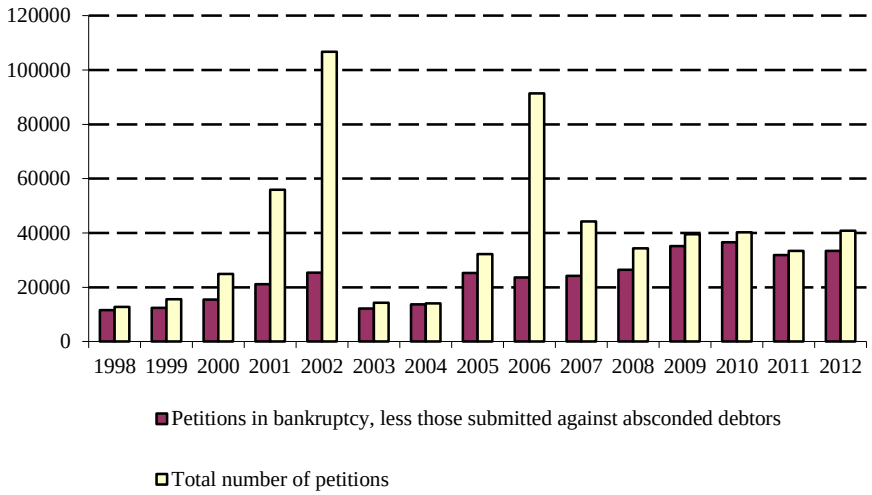
Sources: Statements prepared by the Supreme Arbitration Court of the Russian Federation concerning the consideration, by the arbitration courts of subjects of the Russian Federation, of insolvency (bankruptcy) cases in the period 1998–2013.

Fig. 1. Changes in the Number of Decisions on Bankruptcy Petitions over the Period 1998–2013

Similar opposite changes were observed in:

– the number of completed insolvency (bankruptcy) proceedings: in 2012, it rose by 15.4% on 2011; in the first half-year of 2013, it dropped by 21.2% on the same period of the previous year;

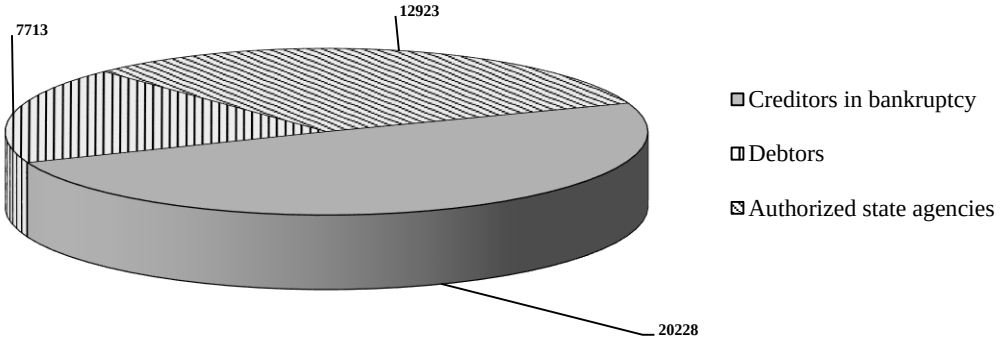
– the number of applications, disputes, complaints and petitions considered by courts of justice: in 2012 it rose by 17% on 2011; in the first half-year of 2013 it dropped by 11.2% on the same period of the previous year (*Fig. 2*).



Sources: Statements concerning the consideration, by the arbitration courts of subjects of the Russian Federation, of insolvency (bankruptcy) cases over relevant periods; analytical notes to the statistical reports on the operation of the arbitration courts of the Russian Federation over relevant periods, prepared by the Supreme Arbitration Court of the Russian Federation.

Fig. 2. The Number of Petitions for Recognizing a Debtor to Be Bankrupt Submitted in 1998–2012

The structure of petitions in bankruptcy filed with courts of justice in 2012 is shown in *Fig. 3*.



Source: Analytical Note for 2012 prepared by the Supreme Arbitration Court of the Russian Federation.

Fig. 3. The Structure of Petitions in Insolvency (bankruptcy) Filed with Courts of Justice

It can be seen that, in 2012, almost one half of petitions that a debtor should be recognized to be bankrupt were submitted to courts of justice by creditors in bankruptcy (49% or 20,228 petitions).

The proportion of petitions in insolvency (bankruptcy) submitted by debtors dropped from 22% in 2011 (7,273 petitions) to 19% in 2012 (7,713 petitions). In 2012, the share of petitions that a debtor should be recognized to be bankrupt, submitted by authorized state agencies (mainly tax agencies) amounted to 32% (12,923 petitions vs. 10, 477 petitions in 2011).

In 2012, the number of petitions in bankruptcy submitted with regard to financial and credit institutions increased almost twofold (2011 – 58 petitions; 2012 – 109 petitions). The number of petitions in bankruptcy submitted with regard to agricultural producers went up by 11%, most likely due to the slackening of state support in the corresponding market segments.

In 2012, the number of petitions in bankruptcy submitted with regard to individual entrepreneurs rose by one third (+31%) (2011 – 4,761 petitions; 2012 – 6,248 petitions). It seems that the main factor behind this growth in the number of petitions in bankruptcy was Resolution of the Plenary Session of the Supreme Arbitration Court of the Russian Federation, of 30 June 2011, No 51, 'On Judicial Practices in Bankruptcy Cases of Individual Entrepreneurs'. This Resolution has unambiguously established that a petition to recognize a debtor individual entrepreneur to be bankrupt should be accepted for consideration by a court of justice if the amount claimed against him is no less than Rb 10,000. Previously, there was a split of opinion over that issue, because the RF Civil Code stipulated that 'the rules of the present Code which regulate the activity of juridical persons that are commercial organizations shall apply respectively to the entrepreneurial activity of citizens effectuated without the formation of a juridical person […]', which meant that the amount claimed against a debtor individual entrepreneur should be no less than Rb 100,000. However, the Civil Code has a reservation in this respect: '[…] unless it arises otherwise from a law, other legal acts, or the essence of a legal relation' (Article 23.3 of the RF Civil Code). It was precisely this reservation that was used by the Supreme Arbitration Court to substantiate its position over that issue.

The most noteworthy trends observed in recent years were as follows: firstly, there was a rise in the number of court-approved amicable agreements and the resulting growth in the number of terminations of bankruptcy proceedings. Over the course of the period 2008-2012, the number of such cases increased by 4.4 times (from 126 in 2008 to 563 in 2012). It should be said that, in 2012, the number of amicable agreements hit an eleven-year high, thus proving the effectiveness of changes introduced to the corresponding part of bankruptcy regulation. One of the major factors behind the growth in the number of concluded amicable agreements was the introduction, in 2010, of a number of amendments to tax legislation, which increased the possibilities of paying the tax arrears in installments, of getting tax deferrals, and of writing off hopeless payables.

Secondly, there was a drop in the number of bankruptcies of state unitary enterprises. Over the period 2008-2012, it fell by more than 2.3 times (from 176 to 76).

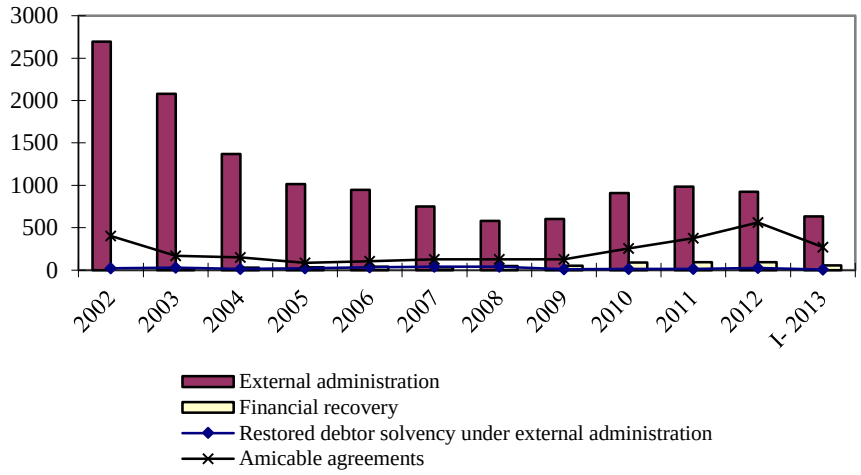
Thirdly, the period 2011-2013 saw a continuation of the upward trend displayed by the number of statements disputing the transactions carried out by a debtor (which grew from 5,090 in 2011 to 8,406 in 2012). In the first half-year of 2013, the number of such statements increased by 30% compared with the same period of 2012. The persistence of this upward trend proves, among other things, the effectiveness of the mechanism, introduced in April 2009, for challenging suspicious transactions, 'transactions which result in preferential satisfaction of claims of one creditor over other creditors' claims', etc. (Articles 61.1-61.9 of the Federal Law 'On Insolvency (Bankruptcy')[1].

Over the course of that period, the number of claims for cost recovery in bankruptcy cases also continued to grow.

Fourthly, there was a continuation of the drop in the number of cases where external administration was effected. In 2012, the number of such cases went down by 6.5% on the

[1] For more details, see Apevalova E.A. *Bankruptcies in 2009-2011: Their Dynamics and Trends*. MIEP. 'The Economic and Political Situation in Russia', October 2011.

previous year, while in the first half-year of 2013 it dropped by 16.8% compared with the same period of 2012 (*Fig. 4*).



Source: Statements concerning the consideration, by the arbitration courts of subjects of the Russian Federation, of insolvency (bankruptcy) cases over the periods 2006 – 2010, 2008– 2011, 2009–2012, and first half year of 2013.

Fig. 4. Changes in the Number of Cases of Effected External Administration, Financial Recoveries, Restoration of Debtor Solvency, and Concluded Amicable Agreements over the Period 2002 – First Half Year 2013

Cases when a company under external administration restores its solvency or when it repays its debts in the course of financial recovery are few and far between, and their number continues to decline.

In 2012, arbitration courts considered a total of 1,724 petitions containing requests that a commissioner in bankruptcy should be dismissed, which represented a rise on 2011 by more than 7% (in 2011 – 1,552 petitions). Arbitration courts explain the growth in the number of filed petitions by the recommendations issued by the Presidium of the Supreme Arbitration Court of the Russian Federation (RF SAC) in the form of an information letter as of 22 May 2012, No 150 'An Overview of the Practices of Arbitration Courts in Dealing with Disputes Involving Dismissals of Commissioners in Bankruptcy'. In that letter, the RF SAC's Presidium has pointed out, in particular, that 'the absence of proof in confirmation of the precise amount of incurred losses, as well as the actual absence of losses shall not be an impediment for dismissing a commissioner in bankruptcy, if the possibility of incurring such losses as a result of violations committed by him has been established'; 'A commissioner in bankruptcy may be dismissed for having incurred unjustified expenses …', etc.

As a result of the introduction of special norms concerning bankruptcy of construction companies, arbitration courts in 2012 considered a total of 31,625 such petitions, their share in the overall number of considered applications, complaints and petitions amounting to 13.2%. The year 2012 also saw a rise in the number of petitions to the effect that the parties exercising control over a debtor should be brought to subsidiary responsibility (from 1,032 in 2011 to 1,177 in 2012).

Besides, there is also growth in the number of petitions belonging to another category - concerning the redemption of claims presented to a debtor. Thus, in 2011, arbitration courts

considered a total of 739 petitions stating an intention to redeem claims presented in respect of mandatory payments, and in 2012 – a total of 1,032 such petitions, of which 793 (or 77%) were resolved to petitioners' satisfaction.

By way of summing up the results of the period of 2012–2013, we may point to the following relatively significant trends in bankruptcy procedures:

- absence of any marked trends in the movement of the number of bankruptcies;
- decline of the number of bankruptcies of state unitary enterprises;
- rising numbers of bankruptcies of financial and credit institutions, as well as individual entrepreneurs;
- existence of efficient mechanisms for disputing the transactions concluded by a debtor and for concluding amicable agreements;
- persisting inefficiency of external management and financial recovery procedures;
- preservation of a pro-creditor bankruptcy procedure model in this country.

6.3.2. Bankruptcy Legislation in 2012 – 2013: Special Norms for Special Societies

December 2013 saw a continuation of the **trend**, which had emerged in 2007, **towards making the bankruptcy procedures established for certain categories of entities so complicated as to render their bankruptcy virtually impossible** (Federal Law No 379-FZ, of 21 December 2013 'On the Introduction of Alterations to Some Legislative Acts of the Russian Federation'). This time, specialized societies and housing mortgage agents were added to this particular category. Specialized societies may be set up in the form of a financial society or a society created for the purpose of project financing. The creation of these new legal forms is envisaged in Article 15.1 of the Federal Law of 22 April 1996, No 39-FZ 'On the Securities Market'. The goals of a specialized financial society and its core activity consist essentially in the acquisition of monetary claims and the right to present claims to debtors in respect of their monies owned against credit contracts, loan agreements, and other liabilities[1].

The goals and core activity of a specialized society created for the purpose of project financing is to provide funding for a long-term investment project (launched for a period of no less than three years) by means of acquiring the monetary claims that will arise in connection with the realization of property created as a result of that project's implementation; by means of rendering services, producing goods and (or) carrying out work by way of using the property created as a result of that project's implementation; by means of acquiring other property necessary for that project's implementation or related to its implementation; and by means of issuing bonds secured by pledging monetary claims and other property (Item 2 of Article 15.1 of the Federal Law 'On the Securities Market').

Specialized societies are vested with a number of powers, including the right to issue bonds secured by a pledge. The only plenipotentiary representative of such societies can be their asset managers. The functions of the asset manager of a specialized society may be performed by a manager, the asset manager of an investment fund, mutual fund, private pension fund or other organization established as an economic society, on condition that the said organization in

[1] Including, among other things, the rights that may arise in the future in connection with the already existing liabilities or future liabilities, as a result of acquisition of other property related to the monetary claims being acquired, including the rights arising under lease contracts and tenancy contracts, and the issuance of bonds secured by a pledge of monetary claims.

entered by the Bank of Russia in the register of organizations empowered to act as asset managers of specialized societies.

A petition in bankruptcy against a specialized society may be filed only by a representative of the holders of its bonds in accordance with the law on securities and on the basis of the decision of a general bondholder meeting. In this connection, the specialized society's creditor may not petition a court to the effect that the said society should be recognized to be bankrupt, if the realization of such a right has been restricted by the relevant contract. Similar restrictions are applied to the right of a specialized society's director to file a petition in bankruptcy.

In other words, what one can observe here is the *restriction of the right of creditors in bankruptcy, challenging of the existing competition norms, and an attempt to provide an administrative solution to the problem posed by the inefficient performance of certain state-owned legal entities.*

In an event of bankruptcy of a specialized society, the introduction of an observation procedure, financial recovery and external management are not allowed. The information concerning the recognition of a specialized society to be bankrupt and the initiation of proceedings in bankruptcy is entered into the Single State Register of Bankruptcies, but *without being published in an official information source*.

Competition mechanisms are not relied upon in connection with the sale of property used as a pledge to secure bonds, either. The procedure and conditions for the bidding, as well as the starting selling price of property used as a pledge to secure bonds are to be established by a representative of the bondholders, and only in absence of such a representative or absence of a relevant bondholder decision – by the commissioner in bankruptcy. Besides, it is envisaged that property may be transferred by one specialized society to another specialized society, the latter assuming all the liabilities of the issuer of bonds.

The issues relating to bankruptcy of a housing mortgage agent are dealt with in a similar manner. It seems that the main goal is to protect the rights of some of the investors - the issuers of bonds. In this connection, the actual sources of funding - judging by the recent amendments to the RF Civil Code whereby a new type of bank account (a nominal account) was introduced - may remain unknown. The introduction of a new form of a legal entity endowed with special rights closely resembles the practice of creating public corporations, resorted to a few years ago.

Also in December 2013, new Federal Law No 410-FZ, of 28 December 2013 'On the Introduction of Alterations to the Federal Law "On Private Pension Funds"' was adopted, whereby a special bankruptcy procedure was introduced for these funds as well. The following specific features were established:

1. Additional grounds for applying measures designed to prevent bankruptcy of pension funds participating in mandatory pension insurance plans. Among these, for example, is failure to fulfill the obligation to repay the amount of pension reserves and (or) pension savings to those insured persons who are entitled to special pension payments; insufficiency of mandatory pension insurance reserves and property needed for ensuring proper functioning of a pension fund in accordance with its charter, etc.[1]

[1] For further details, see Subitems 1-3, Item 1 of Article 187.2 of the Federal Law ‘On Insolvency (Bankruptcy’), as amended by Federal Law of 28 December 2013, No 410 'On the Introduction of Alterations to the Federal Law "On Private Pension Funds" and Some Legislative Acts of the Russian Federation'.

If such grounds arise, the pension fund should be obliged to duly notify of their emergence the controlling body, and submit to the controlling body a plan for recovering its solvency, on condition that there are no indicia of bankruptcy.

2. Specific procedures for the appointment and operation of the provisional administration of a private pension fund participating in mandatory pension insurance plans.

3. The composition of current payments executed by a private pension fund.

4. Specific features of bankruptcy procedures are established with regard to private pension funds participating in mandatory pension insurance plans.

Thus, for example, the bankruptcy procedures applied to a private pension fund participating in mandatory pension insurance plans do not include the mechanisms of observation, financial recovery, external management and amicable agreements.

5. Specific features of proceedings in bankruptcy. These should last for a period of one year, and may be extended beyond that period on request of a participant in the proceedings in bankruptcy.

6. Specific procedures for bringing to responsibility the persons exercising control over a private pension fund participating in mandatory pension insurance plans.

The innovations introduced in respect of special protection of pension savings appear to be justified and are distinctly oriented to social protection measures. However, any conclusions as to their effectiveness may be drawn only after a time lapse sufficient for an adequate evaluation of their practical implementation.

In the field of general norms regulating insolvency issues the trend that had emerged in 2009 - **the toughening and more detailed elaboration of the procedure for bringing to responsibility the persons exercising control over a debtor** - has continued. While 2009 the definition of persons exercising control over a debtor was introduced, their procedural rights in bankruptcy proceedings determined, and the procedure for considering the petitions for bringing to responsibility the persons exercising control over a debtor established, in June 2013 (by Federal Law No 134-FZ, of 28 June 2013 'On the Introduction of Alterations to Some Legislative Acts of the Russian Federation in the Part of Prevention of Unlawful Financial Operations') the presumption of a debtor's bankruptcy as a result of an act of failure to act on the part of the persons exercising control over the debtor was established in the following cases:

- damage caused to the property rights of creditors as a result of a transaction concluded by the person exercising control over the relevant debtor, or concluded for the benefit of that person, or approved by that person;
- if the relevant accounting documents do not contain the necessary information on the objects entered into the records, or if that information is distorted, as a result of which the effectuation of proceedings in bankruptcy becomes more complicated. In such a case, the person responsible for the organization of accounting record-keeping should be brought to responsibility.

Besides, it is determined that the limits of subsidiary responsibility of the persons exercising control over a debtor are extended to:

- claims entered into the register of creditors;
- claims presented after the register has been closed;
- claims in respect of current payments that remained unredeemed due to insufficiency of debtor estate.

However, the scope of responsibility should be diminished if it can be proved that the damage inflicted on creditors due to any failures on the part of the person exercising control is less than the amount of claims presented to that person, which will have to be satisfied.

Another noteworthy trend is **the lower level of independence granted to a commissioner in bankruptcy.** Thus, for example, a commissioner in bankruptcy is now obliged to valuate relevant property for the purpose of selling the bankrupt company in response to a petition filed by creditors or tax agencies.

In addition, **proceedings in bankruptcy have become more open** because, from July 2012 onwards, the report on property valuation and inventory results must be entered into the Single State Register of Bankruptcies.

In December 2012[1] and July 2013[2], **more detailed regulation was introduced in the field of bankruptcy procedures applied to construction companies**. In particular, the new amendments establish the order in which the claims presented by the bank that has issued a surety should be satisfied; the timelines for the implementation of some measures envisaged in the framework of bankruptcy procedures applied to a construction company are changed, and so on. Thus, for example, the period for a commissioner in bankruptcy to file a petition that the claims of the participants in a construction project should be satisfied by means of transferring to them the construction company's rights to the unfinished building has been extended to 6 months (previously - 2 months). Besides, the mandatory amount to be paid by the participants in a construction project in an event of transfer of the unfinished building to them has been reduced by half – from 20 to 10% (Item 5 of Article 201.10 of the Federal Law 'On Insolvency (Bankruptcy'), if the construction company lacks the resources to make the necessary current payments and to satisfy the claims presented by first and second priority creditors.

In July 2013 it was determined that the control functions over the bankruptcy procedures applied to financial institutions - the category which also includes insurance companies, private pension fund, etc.[3] should be exercised by the Bank of Russia. The Deposit Insurance Agency exercises the powers of a liquidator of financial institutions, and also acts as a commissioner in bankruptcy in cases when such functions are envisages by the law on public corporations. The Bank of Russia approves the list of persons to be included in the provisional administration, appoints the head of the provisional administration, etc.

In July 2013, the RF Government submitted to the State Duma draft law No 316848-6, whereby it is envisaged that proceedings in bankruptcy may be initiated by a company's employees, or even by its former employees. The necessary precondition for the initiation of initiated on these grounds is the presence of wages in arrears over a period of more than 3 months. If arrears of wages arise due to financial problems, the employer himself is obliged to file a petition in bankruptcy.

Besides, the new amendments have altered the procedure for satisfying the claims relating to wages in arrears in an event of bankruptcy. These are second priority claims, and are to be satisfied consecutively, one by one, in accordance with a calendar-based schedule. So, if the bankrupt debtor's estate is insufficient, the claims of some employees, although of the same priority as those due to be satisfied at an earlier date, may remain unsatisfied. In order to

[1] Federal Law No 294-FZ, of 30 December 2012 'On the Introduction of Alterations to Some Legislative Acts of the Russian Federation'.
[2] Federal Law No 189-FZ, of 2 July 2013, 'On the Introduction of Alterations to the Federal Law 'On Insolvency (Bankruptcy').
[3] For more details, see Article 180 of the Federal Law 'On Insolvency (Bankruptcy').

eliminate the possibility of such situations, the claims of all the employees will at first be satisfied in amounts up to Rb 30,000. The amount of wages in arrears in excess of Rb 30,000 will then be paid in accordance with a calendar-based schedule – first those due to be paid at an earlier date, and then those due to be paid at a later date[1]. The daft law was passed in the first reading in the autumn of 2013.

On the whole, it can be concluded that the pro-creditor orientation of bankruptcy procedures has become stronger, and that special measures have been introduced to prevent some entities - specialized societies, private pension funds, etc. (as defined by the State) from going bankrupt.

[1] List of important documents at the stage of their approval. - *Glavnaia kniga* [General Ledger], 2013, No 16.- www.consultant.ru