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**Editorial Board:** *S. Sinelnikov-Murylev (editor-in-chief),  
A. Radygin,  
N. Glavatskaya*

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The review provides a detailed analysis of main trends in Russia's economy in 2011. 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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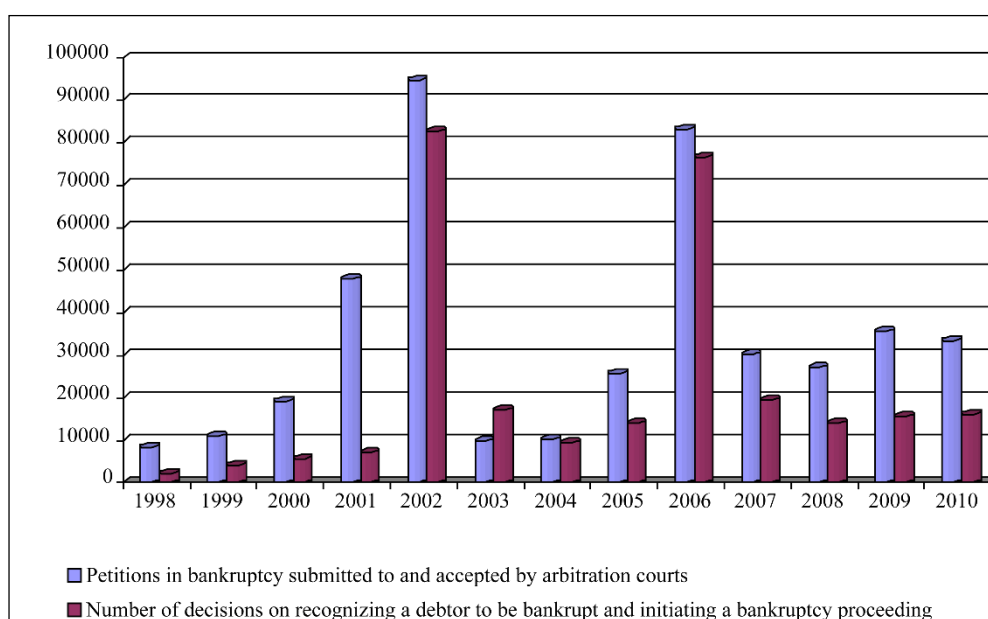
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## 6.4. Bankruptcies in 2009–2011: Post-crisis Dynamics; New Trends; Regulation

### 6.4.1. Dynamics of Bankruptcies (2009–2011)

The overall situation in the field of bankruptcy over the period under consideration was shaped by the following four key trends.

1. First of all, it is necessary to *note the beginning, in first half-year 2011, of a decline in the number of bankruptcies and the number of petitions in bankruptcy submitted to court that followed the period of growth of these indices in 2009–2010*. Thus, over the period of 2009–2010, the number of court decisions concerning the recognition of a debtor to be bankrupt and the initiation of a proceeding in bankruptcy rose by more than 15% (in 2008 – 13.9 thousand; in 2009 – 15.5 thousand; in 2010 – 16 thousand cases<sup>1</sup>). In the first half-year 2011, there occurred a significant drop (by nearly 20%) in the number of petitions in bankruptcy filed with courts of justice (first half-year 2010 – 21,037; first half-year 2011 – 16,853); and a drop by 13.5%, on the same period of 2010, in the number of decisions issued to the effect that a relevant debtor should be deemed to be bankrupt (first half-year 2010 – 8,047; first half-year 2011 – 6,955)<sup>2</sup>. The changes in these indices that occurred over the period of 1998–2010 are shown in *Fig. 12*.



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 of 1998–2010.

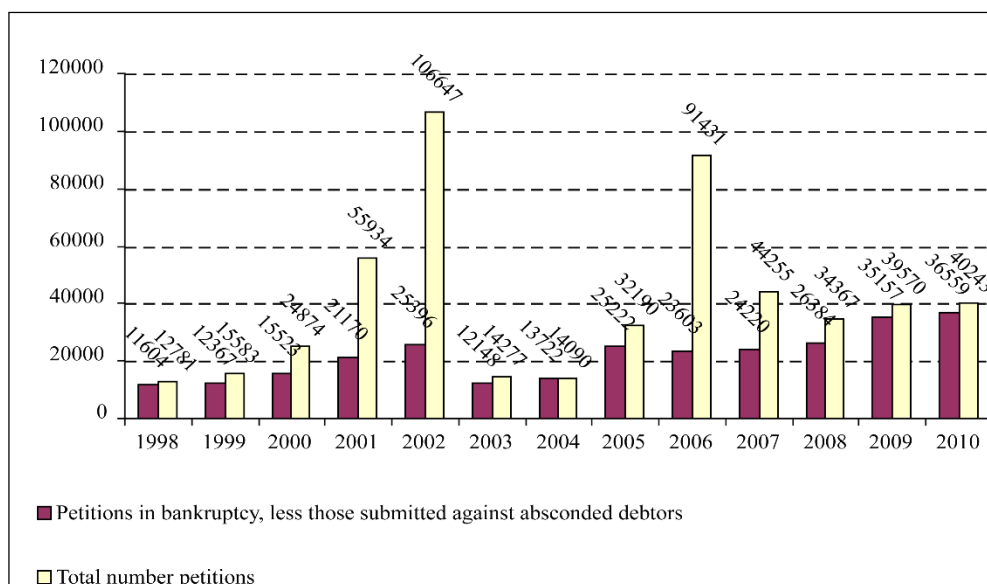
*Fig. 12. Changes in the Number of Decisions on Bankruptcy Petitions over the Period of 1998–2010*

<sup>1</sup> Out of 16,009 decisions on deeming a debtor to be bankrupt and initiating a proceeding in bankruptcy in 2010:  
 – 3.2% (or 508 cases) have to do with state and municipal unitary enterprises;  
 – 13.1% (or 4,882 cases) have to do with individual entrepreneurs;  
 – 5% (or 800 cases) have to do with agricultural producers;  
 – 1.4% (or 224 cases) have to do with financial institutions.

<sup>2</sup> Statement on the consideration, by the arbitration courts of the Russian Federation, of insolvency (bankruptcy) cases in 2008–2010; in the first half-year 2011 – see [www.arbitr.ru](http://www.arbitr.ru)

The surges in the number of bankruptcy cases in 2002 and 2006 and its growth in 1998–2002 (analyzed previously elsewhere)<sup>3</sup> resulted from the government’s activity in connection with the need to ‘clear the field’ of effectively abandoned enterprises through recognizing the absent debtors to be bankrupt and allocating the necessary budget funding to the achievement of that goal.

The years 2009–2010 saw a continuation of the growth (since 2008) of both the overall number of submitted petitions in bankruptcy (2008 – 34.4 thousand; 2009 – 39.6 thousand; 2010 – 40.2 thousand) and the number of petitions submitted with regard to substantive debtors<sup>4</sup> (in 2008 – 26.4 thousand; in 2009 – 35.2 thousand; in 2010 – 36.6 thousand). Thus, over the period of 2009–2010 *the number of petitions in bankruptcy filed against substantive debtors rose by 38.6%*, while the overall growth in the number of petitions in bankruptcy amounted to approximately 17.1%. The peak of growth was observed in 2009. The data on the bankruptcies of ‘substantive’ debtors for 2011 are not yet available, but it can be reasonably assumed that this index is going to decline in accordance with the general downward trend displayed by the number of bankruptcy proceedings. The dynamics of the number of petitions to recognize ‘substantive’ debtors to be insolvent (or bankrupt) over the period between 1998 and 2010, set against that of the overall number of petitions in bankruptcy, can be seen in Fig. 13.



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. 13. The Number of Petitions for Recognizing a Debtor to Be Bankrupt Submitted in 1998–2010

2. A diminishing influence of government policy measures on the dynamics of bankruptcies, including the regulatory activity of tax agencies relating to the recognition of debtors to be bankrupt<sup>5</sup>. Thus, while in 2008 more than 67% of petitions in bankruptcy were submitted by

<sup>3</sup> *Ekonomika perekhodnogo perioda. Ocherki ekonomicheskoi politiki postkommunisticheskoi Rossii 1998–2002*. [The Economy in Transition. Essays on the Economic Policy in Post-Communist Russia of 1998–2002.] M.: IET, 2003, p. 505; *Ekonomika perekhodnogo perioda. Ocherki ekonomicheskoi politiki postkommunisticheskoi Rossii 2000–2007*. [The Economy in Transition. Essays on the Economic Policy in Post-Communist Russia of 2000–2007.] M.: IET, 2008, p. 473.

<sup>4</sup> Substantive debtors are understood to be all the debtors less absconded ones.

<sup>5</sup> On the impact of the activity of government agencies in the sphere of legal entity liquidation on the general trends in the bankruptcy sphere, see Apevalova E. A., Radygin A. D. *Bankrotstva v 2000-e gg.: ot instrumenta reiderov k politike “dvojnogo standarta”*. [Bankruptcies in the 2000s: from Raiders’ Instrument to “Double Standard” Policy] – *Ekonomicheskaiia politika* [Economic Policy], August 2009.

relevant empowered agencies (in the main tax agencies), in 2010 the share of indices belonging to that group dropped to 39.2%.

Against the backdrop of both general growth and the increasing frequency of the application of bankruptcy procedures in some segments, an opposite trend was displayed by the number of bankruptcies of agricultural producers, which declined by more than 5 times between 2006 and 2010 (in 2006 – approximately 4,000 bankruptcies; in 2007 – 2,465; in 2008 – 1,614; in 2009 – 1,036; in 2010 – 800). This was the result of the government's agricultural support measures that involved broader crediting, restructuring of tax liabilities, and allocation of dotations to cover purchases of petrol, oil and lubricants, etc.

At the same time, bankruptcy indices were increasing elsewhere: thus, for example, the number of bankruptcies of individual entrepreneurs more than doubled over the period of 2007–2009 *by comparison with the previous years*: in 2004–2006 there were 200–700 bankruptcies per annum; in 2007 – 2,478; in 2008 – 4,751; and in 2009 – 5,423). In 2010 there occurred a certain decline to a total of 4,882 bankruptcy cases (by 10% on 2009).

3. *A more noticeable activity of creditors, from the year 2009 onward, in the sphere of protection of their interests in the framework of bankruptcy procedures, and in 2010 – also in the initiation of bankruptcy proceedings.*

Thus, over the period of 2009–2010, the number of applications, disputes, complaints and petitions files in the framework of *bankruptcy* procedures effectively *doubled*: from 111,521 in 2008 to 232,845 in 2010; the rate of growth of opened and considered bankruptcy cases was noticeably lower. The main reason for that growth was the considerably increased number of petitions filed with courts in connection with failures to comply with and violation of contractual obligations; the general economic situation; as well as changes in bankruptcy legislation in the part of granting some new rights to the participants in bankruptcy proceedings. In particular, this had to do with the right to dispute the transactions carried out by a debtor; the right to bring the persons and entities controlling a debtor to subsidiary responsibility; the right to submit a petition concerning the intention to redeem claims relating to mandatory payments, etc.<sup>6</sup> In the first half-year 2011, this index became somewhat adjusted by dropping by 10.9% on 2010.

Besides, the year 2010 saw a rise of 31.7% on 2009 in the number of petitions submitted on behalf of creditors in bankruptcy, which in 2010 amounted to 39.1% of the total number of petitions. The share of petitions filed by debtors shrank from 23.1% in 2009 (9,145 petitions) to 21.7% in 2010 (8,727 petitions)<sup>7</sup>.

4. *In the period of 2010–2011 there emerged an upward trend in the number of concluded amicable agreements, financial recoveries of enterprises and external management procedures.*

Thus, while the level of solvency recovery of enterprises as a result of the imposition of external management was traditionally low, the number of external management procedures actually effectuated in the first half-year 2011 rose by 30.9% on 2010 (839 in the first half-year 2011

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<sup>6</sup> Out of 232.8 thousand of applications, disputes, complaints and petitions, 165 thousand (or 70.1%) is constituted by documents concerning the determining the amount of creditor claims. That index also significantly rose on 2008 (by 2.4 times: in 2008 – 67.6 thousand), while the number of petitions concerning the dismissal of an arbitration commissioner was no longer declining, and in 2010 it even slightly increased – to 13,416 (or to 5.8% of the total number of applications, disputes, complaints and petitions).

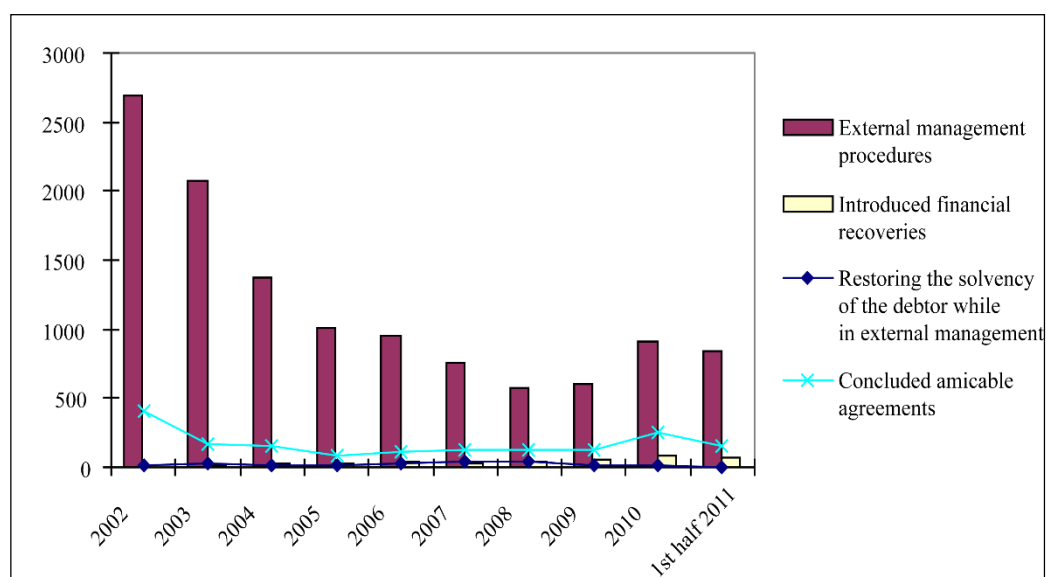
As follows from statistical data, the number of creditor complains concerning the violation of their rights and lawful interests considered in 2010 rose on 2009 by 73.5%. The number of petitions concerning the determining of the amount of creditor claims increased by 33.2%; and the number of petitions concerning prolongation of a bankruptcy proceeding increased by 27.5%.

The bulk (62.4% of the total number) of petitions, applications and complaints were considered by courts in the phase of a bankruptcy proceeding. In the phase of supervision, 33.4% of the petitions were considered. The number of petitions considered during external management procedures nearly tripled, increasing from 2,158 to 5,749.

<sup>7</sup> Here and throughout the text bankruptcy statistics are taken from *Analiticheskaya zapiska k statisticheskomu otchetu o rabote arbitrazhnykh sudov Rossiiskoi Federatsii v 2010* [Analytical Note to the Statistical Report on the Operation of the Arbitration Courts of the Russian Federation in 2010], pp.16–19.

against 641 over the same period of 2010). The period of 2002–2008 had been characterized by a 5-fold drop in the number of external management procedures.

The dynamics of the number of external management procedures, financial recoveries and amicable agreements in 2002 and the first half-year 2011 is shown in *Fig. 14*.



*Source:* Statement on the consideration, by the arbitration courts of subjects of the Russian Federation, of insolvency (bankruptcy) cases in 2006–2010 and the first half-year 2011.

*Fig. 14.* The Dynamics of the Number of External Management Procedures, Financial Recoveries and Amicable Agreements over the Period of 2002 – First Half-year 2011

By all indications, the year 2011 saw a historic high of the number of concluded amicable agreements for the entire period of 2002–2011, which amounted to approximately 300. That year would have also seen a peak in the number of cases when financial recovery procedures were applied. In the first half-year 2011, 76 such cases were already registered, which is by 13.4% higher than the previous historic high of 67 cases achieved in the same period of 2010.

The ongoing (for two years in a row) growth in the number of concluded amicable agreements and actually introduced financial recovery and external management procedures was triggered, for the most part, by the tax innovations introduced in 2010; by the increased opportunities for applying installment plans and delays in redeeming the accumulated arrears of mandatory payments, and for writing off uncollectable payables; as well as by the innovations designed to prevent bankruptcies of financial institutions (including insurance organizations) and to regulate the special bankruptcy procedures established for independent (non-state) pension funds, professional participants of the securities market, and asset managers of investment funds and mutual investment funds.

#### 6.4.2. Bankruptcy Legislation in 2009–2011

The global economic crisis acted as an external stimulus for the implementation of some long-due alterations and the abandonment of the formerly inertia-based policy of the Russian government in the field of bankruptcy. Another reasons for an upsurge in the lawmaking activity in that direction were the mounting payables owed by some of Russia's biggest banks, loans issued to some big companies against their assets and the deterioration of the financial indices of many of those companies, and the anticipated growth in the number of bankruptcies of enterprises in 2009–2010.

In order to correctly estimate the latest innovations introduced in the bankruptcy field with regard to certain specific sectors of the economy, it is important to understand the status of and the situation faced by the relevant objects of regulation.

According to a study undertaken by the All-Russian Public Opinion Research Center (*VTsIOM*) and the Deposit Insurance Agency, in 2010, 40% of Russians, or about 40 m persons, had a deposit or account with one or other bank. For more than 57% of citizens, the most important criterion when selecting a bank was whether or not it was state-owned<sup>8</sup>. In 2009 and 2010, the number of banks was falling due to the imposition, by the RF Central Bank, of more rigorous standards for credit institutions. As a result, in 2009, 44 banks had their licenses recalled, and in 2010, 28 more credit institutions were liquidated<sup>9</sup>. More than 50% of the banking system is directly or indirectly controlled by the State. Thus, on the one hand, the State has clearly embarked on a process of creating a fully-fledged banking system, while on the other hand, it is taking measures designed to protect depositors' interests.

In the last few years, the number of insurance organizations was decreasing by approximately 10 to 12% per year (as of the end of 2010, Russia had 618 insurance organizations registered in the *Unified State Register of Insurance Entities*; as of the end of 2009, their number was 702; and as of the end of 2008, it was 779)<sup>10</sup>. The introduction, in 2010, of more stringent equity capital requirements for insurance organizations, and the intensification of competition will be conducive to consolidation of the insurance market. According to some forecasts, between 200 and 250 insurance companies will be liquidated. Over the next five years, the share of Russia's top twenty companies in total premium volume will increase from 69 to 80-85%, while that of the top ten companies – from 55 to 65-70%<sup>11</sup>. At the same time, the compulsory motor-vehicle liability insurance *OSAGO* and the voluntary motor-vehicle insurance *KASKO* still represent the largest segments of the insurance market.

Russia's non-state pension funds (hereinafter NSPF) have rather successfully survived the acute phase of the crisis. Their 2010 results had more than compensated for their losses in 2008. However, according to the Expert RA rating agency, the gap between the yield on the placement of pension reserves and inflation, accumulated over the past 5 years, remains no less than 10 to 15 p.p. This means that the issue of assets' depreciation in real terms remains high on the agenda. The resolution of that issue can be brought about through upgrading the pension funds' investment policy<sup>12</sup>.

In 2009, the NSPFs managed to occupy the central niche in the trust management market, where they now accounted for up to 40% of operations carried out by asset management companies (AMC). It should be said that the market did not suffer even a single major bankruptcy, while the State totally refrained from giving any assistance to the system. Nevertheless, the NSPFs still have to deal with such issues as the wide-spread dishonesty of their agents, and the necessity to increase people's trust in the system, to create compensatory mechanisms, to establish a single concept of market development, etc.<sup>13</sup>

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<sup>8</sup> Ye. Kukul. *Stavki katiatsia vniz*. [The Rates are Tumbling Down] // *Rossiskaia Gazeta* – Stolichnyi Vypusk [The Russian Gazette – Moscow Issue]. No 5166, 23 April 2010.

<sup>9</sup> On the liquidation of credit institutions (as of 1 January 2011) – [www.cbr.ru](http://www.cbr.ru)

<sup>10</sup> *Igroki strakhovogo rynka i ikh kapitaly*. [Players of the Insurance Market and Their Finances] – [www.allinsurance.ru](http://www.allinsurance.ru), 14 February 2011.

<sup>11</sup> The Marillion company's forecast of the insurance market's development. [www.allinsurance.ru](http://www.allinsurance.ru), 20 December 2010.

<sup>12</sup> In Q4 2010, the NSPF's assets increased by a staggering \$ 30-35bn. The key factor of that surge in assets was the considerable rise in the stock market (thus, in the course of the afore-said period the MICEX Index grew by 18%). According to the Expert RA rating agency, the volume of pension reserves and pension savings rose to Rb 790-800bn. By the end of 2011, the NSPF's aggregate assets are likely to rise to Rb 1.5-1.2 trillion, depending on the market situation. See *Itogi 2010 na rynke NPF: v poikakh effektivnosti* [2010 NSPF market results: a quest for efficiency] – [www.raexpert.ru](http://www.raexpert.ru)

<sup>13</sup> *Krizis proshol – riski ostalis*. [The Crisis Is Over – The Risks Are Still There.] An Overview by the Expert RA Rating Agency of the NSPF Market Based on the Results of the Year 2009. – see [www.raexpert.ru](http://www.raexpert.ru)

In the next three years a stable growth and consolidation of the market can be expected: 69% of participants in the opinion poll conducted by Expert RA Rating Agency are anticipating that, towards the end of 2012, the volume of the NSPF market will exceed Rb 1.5 trillion (which means that it will have more than doubled over 3 years). At the same time, 72% of the respondents believe that more than 90 funds will remain on the market (and 39% think that their number will be no more than 70). However, this does not mean that the potential for NSPF growth will be exhausted – 68% of participants in the survey expect that no more than 7m insured persons are going to transfer their pension savings into these funds<sup>14</sup>.

Over the past decade, the securities market has been experiencing a rapid growth of quotations coupled with an increasing interest in that market displayed by private investors. As of 1 September 2006, 1,402 organizations were operating as professional securities market participants under broker licenses; 1,410 organizations held licenses of professional securities market participants authorized to operate as dealers; 1,048 organizations held licenses of professional securities market participants for the conduct of trust management; 9 organizations held licenses for the conduct of clearing activities on the securities market; 748 organizations operated under professional securities market participant licenses for depositary operations; 77 organizations operated under licenses to run registers; 5 organizations held licenses for organizing trade in the securities market; and 6 organizations held licenses to operate a stock exchange<sup>15</sup>.

The number of companies – professional participants of the securities market and the collective investments market in recent years has been displaying a gradual downward trend, which is going to continue. First of all, the number of professional securities market participants will be declining in response to the coming in force, from 1 July 2010, of alterations introduced in the specifications of sufficiency of own funds for professional participants in the securities market and the asset managers of mutual investment funds and independent pension funds<sup>16</sup>. The tougher requirements established by the regulator will result in either these companies being ousted from the market and then liquidated, or in their merger with some other structures.

The years 2003–2007 saw a robust development of mutual investment funds (hereinafter MIF) against the backdrop of the then favorable macroeconomic situation. Thus, the volume of aggregate net assets over that period increased more than 35 times (Rb 11.7bn as of 1 January 2003, and up to Rb 420.5bn as of 1 January 2007). According to the National League of Management Companies, as of 29 August 2008 the number of functioning MIFs was 1,058; the number of MIFs being created was 19; the number of asset managers (AM) was 287; net asset

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<sup>14</sup> *Solidarnost' v detaliakh i voprosy po sushchestvu. Resul'taty oprosa regulatorov finansovogo rynka, top-menedzherov negosudarstvennykh pensionnykh fondov i upravliaiushchikh upravliaiushchikh kompanii na konferentsii 'Budushchee pensionnogo marketa'* [Solidarity in Details and Some Essential Issues. Results of Surveys of Financial Market Regulators, Top Managers of Non-State Pension Funds and CEOs of Asset Managers at the Conference *The Future of Russia's Pension Market*]. See [www.raexpert.ru](http://www.raexpert.ru)

<sup>15</sup> *Sovershenstvovanie nadzora na finansovom rynke Rossii* [Improving Russia's financial market supervision] – see [www.raexpert.ru](http://www.raexpert.ru)

<sup>16</sup> Thus, from 1 July 2010 onwards, the professional participants in the securities market engaged in dealer and (or) broker operations, as well as securities management, must possess a charter capital in the amount of no less than Rb 35m, and from 1 July 2011 onwards – Rb 50m.

The companies operated under a license to provide depositary services unrelated to security settlements effectuated through organizers of trading in the securities market or through entities authorized to execute depositary operations on behalf of investment funds (MIFs and NSPFs) – Rb 60m, and from 1 July 2011 onwards – Rb 80m.

For market participants engaged in clearing activities and trading in the securities market – Rb 80m, and by 1 July 2011 – Rb 100m. The size of the charter capital of companies providing services of running registers of securities holders – Rb 100m, and from 1 July 2011 – Rb 150m; of stock exchanges – Rb 150m, and from 1 July 2011 – Rb 200m. The specifications of sufficiency of own funds for asset managers of investment funds, mutual investment funds and non-state pension funds established from 1 July 2010 envisage the floor of Rb 60m, and from 1 July 2011 – Rb 80m. – *Chislo professional'nykh uchastnikov rynka tsennykh bumag okruga snizhaetsia, I eta tendentsiia sokhranitsia*. [The Number of the District's Professional Securities Market Participants is Declining, and This Trend is Bound to Persist]. – <http://www.verbacapital.ru>, 21 September 2010.



value (NAV) of all Russian MIFs amounted to approximately Rb 507bn, of which that of close-end funds amounted to Rb 365bn; that of open-end funds amounted to Rb 104bn; and that of interval unit investment funds amounted to Rb 38bn. As for the situation in 2008–2010, we may describe it as follows:

- a stable decline in the net asset value of MIFs and asset managers from May 2008 through December 2009 by nearly 44.4% (from Rb 552.81bn to Rb 307.4bn respectively);
- growth in the number of MIFs, from 1 January 2009 through 1 January 2010, by more than 19% (from 1,050 to 1,252 respectively);
- considerable growth in the number of asset managers, from 1 January 2009 through 1 January 2010, by more than 4.8 times (from 68 to 328).

According to a survey of 2,000 developers carried out by the Association of Russian Builders in 2009, two-thirds of Russia's building companies were either on the verge of bankruptcy or had already gone bankrupt. This circumstance was fraught with serious danger not only for one of Russia's most important industries, but also for the social and economic right of investors (individuals and organizations alike).

Thus, the State's innovations in the field of prevention and introduction of a special bankruptcy procedure clearly represent, on the one hand, instruments for regulating consolidation and liquidation processes in the corresponding markets, and a means for preventing the negative social consequences of these developments.

The further course of bankruptcy legislation development, centered on the idea of *creating favorable conditions for satisfaction of the creditors' interests and for improvement of their rights' protection*, was determined by two factors. The first factor was the State's decision to provide assistance to the banking sector, and to take measures designed to preserve the stability of that sector, including by creating conditions for keeping banks' bad loan levels low. The second factor was large-scale irregularities in repayments under loan agreements. The idea itself can be deemed to be both an anti-crisis decision (because 40% of Russian citizens have bank deposits) and a decision that satisfies the interests of the currently strong financial lobby. Most likely, some combination of all these aspects was taken into account by the authorities before making the afore-said decision.

Within the framework of implementation of that idea, Russia adopted Federal Law, of 30 December 2008, No. 296-FZ, '*On the Introduction of Alterations in the Federal Law 'On Insolvency (Bankruptcy)'*' and Federal Law, of 28 April 2009, No. 73-FZ '*On the Introduction of Alterations in Some Legislative Acts of the Russian Federation*'. Those alterations were designed to *increase the transparency of bankruptcy proceedings*, mainly by changing the rules regulating the activities of arbitration commissioners and their self-regulatory organizations (SROs); *by increasing their responsibility*; and by introducing a number of other innovations.

### ***1. Arbitration Commissioners***

Firstly, the new laws *have raised the level of responsibility* of arbitration commissioners. The non-performance or improper performance by an arbitration commissioner of his or her duties, including those envisaged by federal standards, now constitutes a ground for his or her being removed from the process of management, which is to be carried out by one or other arbitration court on demand of the persons taking part in the bankruptcy case. Also, the procedure for implementing the decision on an arbitration commissioner's disqualification is now specified in detail<sup>17</sup>.

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<sup>17</sup> Later on, in December 2010, it was established, by Federal Law No. 429-FZ, of 28 December 2010, '*On the Introduction of Alterations in the Federal Law 'On Insolvency (Bankruptcy) and on the Invalidation of Parts 18, 19 and 21, Article 4 of the Federal Law 'On the Introduction of Alterations in the Federal Law 'On Insolvency (Bankruptcy)'*', that requirements to the property liability of arbitration commissioners for the non-performance or improper performance of their duties could be extended by the inclusion of federal standards professional activity standards and regulations. Data from the Register of Disqualified Arbitration Commissioners should be entered in the Unified Federal Register of Bankruptcy Information.

Secondly, the introduced alterations have changed the system of commission-fee payments to an arbitration commissioner and the persons invited thereby to render their services in the course of the bankruptcy process. The newly introduced mechanism of commission-fee payments is designed to stimulate an arbitration commissioner's activity on behalf of the creditors. It envisages that the commission fee of an arbitration commissioner should be fixed at 15 to 45 thousand rubles per month<sup>18</sup>, depending on which stage of bankruptcy process management is conducted, and that an additional payment can be made to an arbitration commissioner on the creditors' initiative<sup>19</sup>.

The amount of money that may be spent by an arbitration commissioner on the services of specialists invited by him or her is also subject to detailed regulation, and depending on the size of the balance sheet value of the debtor's assets it may be equal to 10% of the value of assets from Rb 200,000 to Rb 2,995,000; and to 0.01% of sums in excess of Rb 1bn, if asset value is above Rb 1bn<sup>20</sup>. Also, the size of payments for such services, as it is determined by the law, and the payments themselves can be recognized as unjustified on the basis of a petition filed by the persons taking part in the bankruptcy case, if such services are not related to the aims of the ongoing bankruptcy proceedings or to the duties imposed on the persons invited by the commissioner in bankruptcy, or if the size of payments for such services is '*clearly not proportionate to the expected result*'.

Thirdly, the new legislation has extended the duties of arbitration commissioners in the part of provision of information to participants in bankruptcy proceedings: to the creditors – with regard to the transactions and actions that will entail or can entail the civil liability of third parties, and with regard to the revealed indications of fraudulent bankruptcy; and to the corresponding government agencies – with regard to the revealed administrative violations and crimes.

Fourthly, the new laws *have introduced rigid requirements to the compulsory liability insurance contracts concluded by arbitration commissioners*. The law has defined the objects of compulsory insurance, the insurance event and the insurance risks under liability insurance contracts, and has defined the procedure for the effectuation of payments due under such contracts. In July 2009<sup>21</sup>, the amounts of insurance payments to be due under the contracts concluded by arbitration commissioners were slightly reduced.

## ***2. Self-Regulatory Organizations (SROs) of Arbitration Commissioners***

Firstly, the new laws *have extended the powers and increased the responsibility of self-regulatory organizations (SROs) of arbitration commissioners*. Thus, starting in 2009, these SROs have been granted the right to issue accreditation to the insurance organizations, valuers, and professional securities market participants that are involved in the maintenance of a register, as well as to other persons invited by arbitration commissioners within the framework of implementation of their duties in the course of one or other bankruptcy case. Also, the SROs in question are obliged to develop standards and rules for arbitration commissioners' activities and to supervise their implementation, as well as to make sure that commissioners in bankruptcy duly observe all the requirements concerning compulsory liability insurance.

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<sup>18</sup> This amount can be increased by a court decision on the petition filed by participants in a bankruptcy case.

<sup>19</sup> For more details, see Items 10-14, Article 20.6 of the Federal Law '*On Insolvency (Bankruptcy)*'.

<sup>20</sup> In July and December 2009, the size of interest payments due to arbitration commissioners and the size of payments for the services rendered by the persons invited by an arbitration commissioner were slightly changed. For more details, see Items 10 and 11, Article 20.6 and Item 3, Article 20.7 of the Federal Law '*On Insolvency (Bankruptcy)*' as amended by Federal Law of 17 December 2009, No. 323-FZ, '*On the Introduction of Alterations in Articles 20.6 and 20.7 of the Federal Law 'On Insolvency Bankruptcy'*' and Article 4 of the Federal Law '*On the Introduction of Alterations in the Federal Law on Insolvency (Bankruptcy)*'.

<sup>21</sup> For more details, see Item 2, Article 241 of the Federal Law '*On Insolvency (Bankruptcy)*' as amended by Federal Law of 19 July 2009, No. 195-FZ.

In December 2010<sup>22</sup>, SROs of arbitration commissioners were also authorized to issue accreditation to electronic trading floor operators who organize bidding for the sale of debtors' property.

Secondly, the new legislation has established that *self-regulatory organizations of arbitration commissioners should be obliged to disclose data on their activities*, including the data concerning their compensation funds; asset managers; and all the instances of disciplinary measures being applied against arbitration commissioners.

Thirdly, *the new legislation has established the procedure for the use, by SROs of arbitration commissioners, of their compensation funds, from where payments to debtors are made*: the procedure for presenting claims with regard to compensatory payments; the timelines for making compensatory payments; the conditions for the placements of monies held in a compensation fund; the asset manager's responsibilities; the procedure for transfer of the monies held in a compensation fund to the national association of arbitration commissioners when the information on a self-regulatory organization is struck off the register.

Fourthly, *the government's control over the activity of SROs of arbitration commissioners has been toughened*. The control functions delegated to the Federal Service of State Registration, Cadastre and Cartography (*Rosreestr*, formerly *Rosregistration*) were strengthened through giving the Service some additional powers:

- the right to initiate proceedings against an arbitration commissioner, a self-regulatory organization of arbitration commissioners and (or) that organization's official in an event of their having committed an administrative violation, and to consider that case or to refer it for consideration to an arbitration court;
- the right to enter information on not-for-profit organizations in the Unified State Register of Self-Regulatory Organizations of Arbitration Commissioners and to take part in its maintenance;
- the right to establish the status of the association of self-regulatory organizations of arbitration commissioners as a national one;
- and some other powers.

In an event of a failure of a SRO of arbitration commissioners to comply with the instructions issued by the controlling (or supervisory) agencies with regard to correcting relevant violations committed in the process of elaborating standards and operative rules, or dealing with complaints submitted with regard to certain actions committed by that organization's members, representatives of the government agency are obliged to apply to an arbitration court with a petition that the relevant organization be struck off the *Unified State Register*.

### **3. Other Measures**

1. The desire to achieve the maximum degree of satisfaction of creditors' claims was the reason for *the introduction of a number of mechanisms for disputing transactions aimed at withdrawal of a debtor's assets* – 'suspicious transactions' and 'deals that result in preference being given to one creditor at the expense of another'. In fact, that was the first time in five years when the State adopted some legislative measures designed to narrow the 'grey field' in the field of bankruptcy regulation.
2. Then, *responsibility of the debtor's owners is established*. For the first time, alongside the aforesaid persons, real owners – 'the persons controlling a debtor', understood to be those persons that have possessed, during a period of less than two years prior to the petition in bankruptcy being submitted against the relevant debtor to an arbitration court, the right to issue

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<sup>22</sup> By Federal Law of 28 December 2010, No. 429-FZ 'On the Introduction of Alterations in the Federal Law "On Insolvency (Bankruptcy)" and Recognizing as Null and Void Parts 18, 19 and 21 of Article 4 of the Federal Law "On the Introduction of Alterations in the Federal Law "On Insolvency (Bankruptcy)"'.

to that debtor instructions that had to be complied with, or in any other way determine the debtor's actions, – can be brought to subsidiary responsibility<sup>23</sup>.

The possibility to actually bring such persons to responsibility is doubtful – given the fact that very often the real owners and beneficiaries of valuable Russian assets cannot be identified even in the course of criminal investigation.

The responsibilities of the directors and owners of credit institutions arising in an event of the situation of imminent bankruptcy are determined, as well as some new sanctions to be applied against them, including a 10-year ban forbidding such persons to acquire shares in credit institutions in an amount of more than 5%, and a three-year ban forbidding them to occupy the post of director of a credit institution.

3. *The possibility for a closed sale of debtor assets has been narrowed.* Elaborate legislative regulations have been introduced with regard to the procedure for the sale of an enterprise, these rules being also extended to the sale of a debtor's property or part of that property (Articles 110, 111 and 139 of the Federal Law 'On Insolvency (Bankruptcy)'). While the possibility of a closed sale of assets has been preserved, that sale now being termed 'bidding with sealed price proposals', numerous necessary technical innovations are introduced (the definition of the procedure for submitting an application for the participation in bidding and the requirements for such an application; the requirements to the conclusion of the contract of purchase and sale of an enterprise; the scope of open information concerning the process of sale of an enterprise has been increased, etc.).

The procedure for a formally open bidding has been proclaimed, but the practice of selling debtor's assets to 'VIP' buyers (even under a somewhat limited scenario) will continue, especially if one takes in consideration the increasing pressure exerted by the State on arbitration commissioners whose role, in fact, is to actually organize the bidding or to attract a third organization specifically to perform that function.

In addition to those procedures, a bankrupt enterprise may now be sold at an auction or through a tender – in those cases when the buyer must comply, in regard of a given enterprise, with the conditions set by a creditor committee or a creditor meeting.

As an improvement on the existing procedure one may regard the introduction of *an online bidding procedure with regard to a bankrupt enterprise*. By Order of the RF Ministry of Economic Development of 15 February 2010, No. 54 the following procedures and requirements are approved:

- the procedure for an online open bidding for a debtor's estate (or an enterprise) to be sold in the framework of a bankruptcy proceeding;
- the requirements to the online auction floors and operators of online auction floors relating to open online bidding for a debtor's estate (or an enterprise) to be sold in the framework of a bankruptcy proceeding;
- the procedure for confirming the compliance of online auction floors and operators of online auction floors with the established requirements.

Besides, the *Unified Federal Register of Bankruptcy Information* has been created that contains and makes public a broader spectrum of issues relating to the conduct of procedures applied in bankruptcy cases (concerning the initiation of each proceeding in bankruptcy; the conduct of bidding on the sale of property of debtors and the results of biddings; the suspension or dismissal of arbitration commissioners, etc.).

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<sup>23</sup> A debtor's actions may be determined by a controlling person, including by means of coercing the director or members of the board of directors of a debtor organization, or by exerting a leading influence on the said director or members of the board of directors in another way (in particular, the persons that control a debtor may be the members of a liquidation commission; or a person authorized on the basis of a power of attorney, a normative legal act, or special authorization to conclude transactions on behalf of the debtor, or a person empowered to dispose of 50% or more of voting shares in a joint-stock company, or more than half of the charter capital of a limited liability company). Federal Law of 28 April 2009, No. 73-FZ 'On the Introduction of Alterations in Some Legislative Acts of the Russian Federation'.

In December 2010, the Federal Law regulating the procedure for the creation and functioning of the Register was signed<sup>24</sup>. Thus, in particular, the creation and functioning of the Unified Federal Register of Bankruptcy Information is to be effectuated by the operator of the Unified Federal Register of Bankruptcy Information, that operator being a legal entity registered in the territory of the Russian Federation and in possession of appropriate technical appliances enabling the said operator to ensure the creation and keeping of the said Register in an electronic form, and also an entity selected specifically for the performance of the said functions by the regulatory agency.

The procedure for selecting the operator of the Unified Federal Register of Bankruptcy Information is to be confirmed by the regulatory agency and must ensure the possibility of participating in the selection procedure of all the entities that comply with the criteria established by the regulatory agency. Alongside the information that will have to be published under the Federal Law, the Unified Federal Register of Bankruptcy Information should also incorporate certain other types of information, the list of which is to be established by the regulatory agency.

The reliability of the information on a given debtor as of the moment of it being entered in the Unified Federal Register of Bankruptcy Information is to be checked by an operator of the Unified Federal Register of Bankruptcy Information by means of comparing it with the information contained in the Unified State Register of Legal Entities and/or the Unified State Register of Individual Entrepreneurs.

The information to be published under the bankruptcy law is to be entered in the Unified Federal Register of Bankruptcy Information from 1 April 2011<sup>25</sup>.

In July 2009<sup>26</sup>, the status of creditors in the framework of proceedings in bankruptcy was further strengthened.

Firstly, *the distribution of responsibility and the powers with regard to the sale of enterprises were defined more precisely*: from now on, it has been consolidated in legislation that the functions of the organizer of bidding are to be performed by an external manager; the procedure and conditions for the conduct of bidding are not to be determined in advance by a creditors' committee, as it happened earlier, but are to be approved on the basis of an application submitted by an external manager. In this connection, the terms for the sale of a debtor's estate have been expanded and further specified, and in addition these terms have to be coordinated with the arbitration commissioner, or a creditor committee, or a creditor meeting. Among these terms are, for example, the composition of the estate; the form of bidding (an auction or a tender); the terms of the tender, the form of presenting the proposal of price (close or open); and the starting price of the estate; the mass media organs where the announcements of the bidding are to be published (Item 1 of Article 139 of the Federal Law '*On Insolvency (Bankruptcy)*').

Thereby, the level of debtor-creditor asset sale transparency was increased, while opportunities for abuse on the part of arbitration commissioners, including by restricting access to auctions by pooling (when assets are grouped into large auction lots); and by publishing upcoming auction announcements in small-circulation newspapers and magazines and then buying out all the copies, etc.

Secondly, a number of *innovations relating to the satisfaction of creditor claims secured by a pledge* were adopted. This enables an arbitration court to determine both the process and conditions of sale of the subject of pledge, should any differences arise between the commissioner in bankruptcy and a creditor in bankruptcy with regard to the liabilities secured by the pledge. And this means that, in the event of a repeat auction being declared as having failed, such creditor is now endowed with the right to retain the subject of pledge, valuing it in an amount which must be

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<sup>24</sup> Federal Law of 28 December 2010, No. 429-FZ '*On the Introduction of Alterations in Federal Law "On Insolvency (Bankruptcy)" and Recognizing as Null and Void Parts 18, 19 and 21 of Article of the Federal Law "On the Introduction of Alterations in the Federal Law "On Insolvency (Bankruptcy)"*'.

<sup>25</sup> Item 2 of Article 4 of Federal Law of 28 December 2010, No. 429-FZ.

<sup>26</sup> Federal Law of 19 July 2009, No. 195-FZ '*On the Introduction of Alterations in Some Legislative Acts of the Russian Federation*'.

10% lower than its initial selling price at the repeat auction. Moreover, this means that the creditor is not to take advantage of the right to retain the subject of pledge, and the latter can be sold by way of public sale (Items 4, 4.1 of Article 138 of the Federal Law ‘On Insolvency (Bankruptcy)’).

The adopted legal norms represent a natural continuation of the previous innovations introduced in the field of civil law that made it possible for ownership of the subject of pledge to be transferred to the pledgeholder without resorting to judicial proceedings<sup>27</sup>. These innovations make it possible for pledgeholders, of which banks with high degree of state control constitute the majority, to provide solutions to that problem by applying lawful methods.

Thirdly, the *extension of tax norms to the regulation of relations pertaining to settlements with regard to mandatory payments* (paragraph 2 of Item 3 of Article 84; paragraph 2 of Item 2 of Article 194 (in regard of strategic enterprises) of the Federal Law ‘On Insolvency (Bankruptcy)’ ) was abolished. The abolition of that norm is conducive to a more frequent application of the instruments of amicable agreements and financial recovery of enterprises.

In April 2010,<sup>28</sup> *large-scale innovations were introduced that were designed to prevent bankruptcies of financial institutions (including insurance companies), as well as to regulate the special procedure for the conduct of bankruptcy proceedings against non-state pension funds, professional securities market participants and the asset managers of investment and mutual investment funds.*

On the whole, these innovations were based on the model of financial recovery and interim management regulation initially stipulated in Federal Law of 25 February 1999, No. 40-FZ ‘On the Insolvency (Bankruptcy) of Credit Institutions’, which was now substantially expanded to encompass a broader range of issues to be regulated and the categories of persons to which these new legal norms were to be applied.

The range of persons that were to be subject to the new special bankruptcy norms was expanded to include asset managers of investment funds, mutual investment funds, and non-state pension funds, which under the new law were placed in the category of financial institutions.

The range of issues to be regulated encompasses measures designed to prevent bankruptcies of financial institutions similar to the measures for financial recovery of credit institutions<sup>29</sup>: the provision of financial aid to an organization by its founders; alterations introduced in the organization’s structure of assets and liabilities; reorganization and other measures that are not forbidden by legislation (Article 183.1 of the Federal Law ‘On Insolvency (Bankruptcy)’).

In an event when proper grounds arise for applying the measures designed to prevent bankruptcy of a financial institution, the said institution is obliged to approve and submit to the controlling agency – the RF Central Bank – a plan for restoring its solvency, including an analysis of its financial situation, a list of measures to be implemented in order to prevent its bankruptcy, and the timelines for their implementation that should not exceed a period of 6 months.

The grounds for implementing the measures designed to prevent bankruptcy of a financial institution are as follows (Article 183.2 of the Federal Law ‘On Insolvency (Bankruptcy)’):

- 1) multiple refusals, within the period of one month, to satisfy the claims of creditors in regard of financial liabilities;
- 2) failure to fulfill obligations in regard of mandatory payments within the period of more than 10 working days from the date established for the execution of those payments;
- 3) insufficiency of available cash for timely fulfillment of financial liabilities and (or) obligations in regard of mandatory payments, if the fulfillment of such liabilities and (or) responsibility is already due.

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<sup>27</sup> Federal Law of 30 December 2008, No. 306-FZ ‘On the Introduction of Alterations in Some Legislative Acts of the Russian Federation in Connection with Improving the Procedure for Levying Execution on Pledged Property’.

<sup>28</sup> Federal Law of 22 April 2010, No. 65-FZ ‘On the Introduction of Alterations in the Law of the Russian Federation ‘On the Organization of Insurance Business in the Russian Federation’ and Some Legislative Acts of the Russian Federation’.

<sup>29</sup> Article 7 of Federal Law of 25 February 1999, No. 40-FZ ‘On the Insolvency (Bankruptcy) of Credit Institutions’.

In each of the aforesaid cases the financial institution is obliged to submit to the controlling agency, within 15 days, a notification with an attached plan for restoring its solvency (if any indicia of bankruptcy in this connection are absent).

Within 30 working days, the controlling agency must make the relevant decision concerning the introduction of interim management of the financial institution, or lack of feasibility of introducing interim management.

Interim management is introduced in the following instances:

- 1) the controlling agency reveals the instance of multiple refusals, within the period of one month, to satisfy creditors' claims in regard of financial liabilities; or failure to fulfill obligations in regard of mandatory payments within the period of more than 10 working days from the established date for their execution, if in each of these instances the financial institution failed to notify the controlling agency of the presence of those circumstances;
- 2) the controlling agency made the decision that interim management should be introduced on the basis of the results of its on-site audit or its analysis of the submitted plan for restoring the financial institution's solvency;
- 3) the financial institution fails to fulfill or improperly fulfills the plan for restoring its solvency (Item 1 of Article 183.5 of the Federal Law 'On Insolvency (Bankruptcy)').

The controlling agency's decision to introduce interim management must be published and posted on the website of the controlling agency. The purpose of interim management introduction is to restore the solvency of a financial institution and/or to guarantee the safety of property.

The aims of interim managers are as follows:

- to adopt measures designed to prevent bankruptcies and/or to control the application of such measures;
- to eliminate the existing grounds for suspension or limitation of the license of a financial institution.

The composition of an interim management team, as well as the procedure and the grounds for changing its composition, should be approved by the controlling agency. The person appointed head of an interim management team should be an arbitration commissioner who has passed an additional examination which is to entitle him or her to exercise relevant managerial functions in the afore-listed institutions. The head and members of an interim management team should be selected by the controlling agency in the procedure established by the regulatory agency. On his or her appointment, the head of the interim management team should conclude a liability insurance contract.

The controlling agency has the right to send its representatives to a financial institution for the purpose of exercising control over the activities of that financial institution and its interim managers.

The Law sufficiently thoroughly regulates the functions of interim managers, the consequences of their appointment, their duties, and the consequences of limitation and suspension of the powers of the executive bodies of a financial institution (Articles 183.7–183.11 of the Federal Law 'On Insolvency (Bankruptcy)').

The term in office of interim managers is between three and six months, with the possibility of an extension of up to three months.

Interim managers should carry out an analysis of the financial situation of the financial institution in their charge, and no later than 45 days after the date of their appointment should submit, to the controlling agency, a conclusion on the financial situation of that financial institution. In the event the conclusion suggests the possibility of restoring the solvency of the financial institution, the interim managers should submit, to the controlling agency, a plan for solvency restoration. In the event of the impossibility thereof, the interim managers should recommend that a petition for bankruptcy be filed.

On conclusion of their term in office, interim managers should submit a report on the results of their activities.

The new law has introduced *a new definition of the indicators of bankruptcy of a financial institution*. While previously a petition for bankruptcy of a credit institution was primarily associated with a license recall and a court ruling confirming the existence of monetary obligations, the new procedure envisages the following indicators of bankruptcy:

- 1) the amount of claims against a debtor, constituting its monetary obligations and/or mandatory payments, is no less than 100 thousand rubles, and the debtor has failed to satisfy those claims over the course of 14 days;
- 2) a debtor has failed to implement, within 14 days from the entry into force of the court decisions on the recovery of the debt; in such cases, the debtor should be deemed as bankrupt irrespective of the amount of claims against it;
- 3) the value of a debtor's property is insufficient to cover its money obligations to the creditors and its mandatory payment liabilities;
- 4) the solvency of a financial institution has not been restored in the period of its interim management team's activity.

It should be emphasized that a financial institution should be deemed to be incapable of meeting the demands of its creditors and/or fulfilling obligations in regard of mandatory payments even in the presence of only one of the above-listed indicators of bankruptcy.

As far as the peculiarities of insurance organization bankruptcy prevention are concerned, special attention should be paid to the additional grounds for the application of bankruptcy prevention measures to an insurance organization. These grounds are as follows:

- multiple violations, within one year after the discovery of the first violation, of the standard ratio between the amount of the entity's own financial resources as established by the existing norms, and the amount of its assumed liabilities or the requirements to the composition and structure of its assets necessary for covering its insurance reserves and own funds;
- recall or suspension of the license for effectuating the established types of compulsory insurance, as well as limitation of that license.

In these cases, interim management should be appointed by the Federal Insurance Supervision Service (Rosstrakhnadzor). The right to file with an arbitration court a petition in bankruptcy, in addition to some other entities, is granted to a professional association which is recognized to be endowed with the right to present claims to a debtor – insurance organization – within the limits equal to the amount of entrance fees, membership fees, special-purpose contributions and other payments transferred to the professional association, as well as compensatory payments and other related expenses.

*Legal regulation was introduced with regard to the transfer (or sale) of the insurance portfolio* during the implementation of the measures designed to prevent bankruptcy, as well as in the course of a proceeding in bankruptcy. The sale of the insurance portfolio may be effectuated upon its coordination with the Federal Insurance Supervision Service's agencies. The transfer of the insurance portfolio (Article 184.9 of the Federal Law 'On Insolvency (Bankruptcy)') implies its transfer to another insurance organization(s) or to its management company.

In this connection, the insurance portfolio being transferred must include:

- a) outstanding liabilities under insurance policies as of the date of the decision concerning the transfer of the insurance portfolio (or insurance reserve);
- b) assets received in order to cover the insurance reserves created by the insurer.

The procedure for the transfer of the insurance portfolio, including the procedure for fulfilling the obligations assumed under insurance policies, and the procedure for fulfilling the obligations of the management company are established by the Federal Insurance Supervision Service. In an event of insufficiency or lack of assets at the disposal of that insurance organization, the outstanding liabilities under insurance policies may be covered by the professional association with the monies earmarked for covering compensatory payment.

The notification concerning the transfer of an insurance portfolio must be published. Within the period of one month from the date of its publication, insurers and insurance policy holders have



the right to present to the insurance organization a request that the insurance policy the rights and liabilities under which are to be transferred should be annulled.

Besides, *the order of priority with regard to claims of third-priority creditors has been altered* (Article 184.10 of the Federal Law 'On Insolvency (Bankruptcy)').

Highest priority will now go to claims under compulsory insurance policies. Previously this category included only compulsory individual insurance, while all the other types of compulsory insurance were given second priority. In addition, the Federal Law's articles have been augmented by those regulating the claims concerning refunds of compensatory payments and insurers' claims.

Second priority will go to the claims under life insurance policies and other types of personal insurance. The range of claimants has also been expanded by including therein insurers.

Third priority, instead of claims under individual insurance policies, will now be granted to claims under civil responsibility insurance policies presented for causing damage (harm) to the life or health.

Fourth priority, instead of 'claims of other creditors', will go to claims presented under civil responsibility insurance policies for causing damage property of third parties and under property insurance policies.

Fifth priority will be granted to claims presented by other creditors.

The specific feature of an amicable agreement concluded with an insurance organization is the necessity to redeem the outstanding claims of first- and second-priority creditors, the claims of insured persons, beneficiaries, insurers under compulsory insurance policies, as well as the claims pertaining to refunds of compensatory payments and related expenses.

It should be noted, among the specific features of bankruptcy of professional securities market participants<sup>30</sup>, asset managers of mutual investment funds, investment funds and non-state pension funds, that the primary goal of the interim management team after its appointment is to ensure safety of the monies and securities owned by their clients. Besides, interim managers must establish the sufficiency of monies and securities owned by the clients and kept on a special broker account, depo account, or a separate bank account for the satisfaction, in full, of the clients' claims with regard to restitution in regard of their monies and securities (Article 185.2 of the Federal Law 'On Insolvency (Bankruptcy)').

On the whole, the relations arising in connection with bankruptcy of the aforesaid organizations are to be regulated by the same norms as the bankruptcies of financial institutions (which has been discussed earlier), with a few specific variations.

Thus, in order to satisfy the clients' claims in the course of supervision or a proceeding in bankruptcy, the arbitration commissioner or register keeper keeps a register of the clients of a relevant professional securities market participant or asset manager. The participation of the register keeper is mandatory if the number of clients exceeds 100. The contract with the register keeper may be concluded only in an event of the latter having insurance liability coverage with regard to inflicting losses on the clients.

The claims of the clients of a professional securities market participant or asset manager are satisfied in full if the amount of the clients' funds kept on their accounts is sufficient for satisfying their claims. If the amount of the clients' funds pooled in one account is insufficient to satisfy their claims in full, these funds should be transferred to the clients in amounts proportional to their claims. The unsatisfied claims of the clients are to be entered in the creditor register and given a third order of priority.

Besides, there exist a number of specific features of the actual conduct of the procedures of supervision and a proceeding in bankruptcy. Thus, for example, the clients' funds are not included in the bankrupt estate of a professional securities market participant, asset manager or clearing institution, if these are kept on a special broker account, depository account, transit account, depo

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<sup>30</sup> In accordance with Federal Law of 22 April 1996, No. 39-FZ 'On the Securities Market', professional securities market participants are to be understood as persons carrying on broker, dealer, depository activity, management of securities, keeping of securities registers, organization of trade on the securities market. From 1 January 2013, clearing will also be recognized as a type of professional activity on the securities market.

account, individual account of a securities holder, or a separate bank account opened for carrying on settlements against transactions relating to trust management. This also applies to the funds transferred for trust management to an asset manager or credited as investment units.

The securities owned by a professional securities market participant or asset manager and circulating on an organized market must be sold through an organizer of trading on the securities market. The securities that cannot be traded in that way must be sold in the procedure determined in Article 111 of the Federal Law ‘On Insolvency (Bankruptcy)’.

Some specific bankruptcy features are also consolidated with regard to non-state pension funds.

1. Apart from the general grounds, the new legislation has established the following additional grounds for the imposition of bankruptcy prevention measures:
  - the standard size of pension reserves for fixed-parameter pension schemes has dropped, by the end of a relevant quarter, below the level envisaged by the controlling agency;
  - the actuarial deficit, as reflected in the latest annual actuarial assessment of a non-state pension fund, has increased on the previous year.
2. Liabilities under contracts on non-governmental pension provision and the composition of the list of creditors whose claims are due to be satisfied at the expense of pension reserves and pension savings, as well as the amount of payables, should be determined and entered in the register of creditors’ claims by the interim manager.
3. Within 6 months from the date of an arbitration court’s ruling that a non-state fund should be deemed to be bankrupt and bankruptcy proceedings should be initiated, the commissioner in bankruptcy should ensure:
  - the transfer of pension savings to the RF Pension Fund and the conclusion of proper settlements with the creditors of the pension investment fund;
  - the payment or transfer to other funds of the redemption sums or their transfer as an insurance premium payment under the pension insurance contracts concluded with insurance organizations;
  - the transfer of the fund’s duty with regard to the payment of non-governmental lifetime pensions, and its pension reserves to another non-state pension fund.
4. A bankrupt pension fund’s pension savings and pension reserves should not become part of the bankrupt’s assets, and are to be used only for the afore-said purposes. The procedure for satisfying the creditors’ claims at the expense of pension reserves and pension savings is being regulated by Article 186.7, 186.8 of the Federal Law ‘On Insolvency (Bankruptcy)’.
5. When bankruptcy-prevention measures are being applied or bankruptcy proceedings are being implemented, the duties with regard to payment of non-governmental lifetime pensions and pension reserves can be transferred, with the concurrence of the controlling agency, to another non-state pension fund.
6. All transactions for the sale of non-state pension funds’ properties in which pension reserves and pension savings are invested should be registered by a specialized depository. The procedure for such accounting operations should be set by the controlling agency.
7. The sale of the enterprise and the replacement of any assets of a non-state pension fund are not permitted.

Thus, the State increases the levels of protection of the various types of pension savings, insurance contributions, share deposits and investments. On the macroeconomic and political levels, the positive social effect of such innovations is clear and evident. On the negative side, the implementation of these legal norms might end up with the State regulating the number of monetary asset management funds and companies and their mergers and takeovers, as well as redistribution of the corresponding markets in favor of influential big players with good political connections.

In February 2011<sup>31</sup>, the bankruptcy law was extended to include the specific features of bankruptcy of clearing institutions, concerning, among other things, the determination of the size of the monetary obligations arising from financial contracts. Monetary obligations arising as a result of contracts concluded under a general agreement (or a joint contract) which corresponds to the model contractual terms (envisaged by Article 51.5 of the Federal Law ‘On the Securities Market’), and (or) the rules of the staged auction, and (or) clearing rules and regulations, should be terminated in the procedure envisaged by the afore-said general agreement (or joint contract), and (or) the rules of the staged auction, and (or) clearing rules and regulations. The afore-said termination inevitably results in a monetary obligation, whose size should be determined in the procedure envisaged by the general agreement, and (or) the rules of the staged auction, and (or) clearing rules and regulations.

An interim manager has the right to refuse to implement only those financial contracts concluded between the creditor and the debtor that belong to the afore-said contract types. Creditors whose claims relate to net obligations are deemed to be third-priority creditors.

The afore-said legal innovations have been in force since 11 August 2011.

Since 11 February 2011, ‘transactions handled at public auctions on the basis of even a single bid addressed to an unlimited range of auction participants, as well as actions aimed at implementing the obligations and duties arising from such transactions, cannot legally be challenged’ as suspicious and resulting in preference being given to one creditor at the expense of another.

The most important innovations of that period are as follows:

- 1) the abolition of judges’ *exclusive* right to determine whether or not supervision should be introduced, to consider petitions, applications and complaints in bankruptcy cases; disputes concerning the amount of the creditors’ claims; the creditors’ claims whose validity has been contested; the creditors’ claims in the bankruptcy cases of failed financial institutions and absentee debtors;
- 2) the extension of grounds for recognizing a transaction as null and void in the event of an ‘interrelated contract’ that should be understood as ‘a contract concluded with the central contracting party on the basis of an offer, including the bid, submitted at an auction, on whose basis the now invalid contract with the central contracting party was concluded’ (Item 5, Article 61.6 of the Federal Law ‘On Insolvency (Bankruptcy)’). Interrelated contracts that entail losses eligible for recovery can be concluded in the course of suspicious transactions or the debtor’s transactions resulting in preference being given to one creditor at the expense of another.

In July 2011, Russia adopted a new bankruptcy regulation<sup>32</sup> specifically targeting developers<sup>33</sup>. Item 6, Article 201.1 of the Federal Law, of 12 July 2011, No. 210-FZ contains an extensive list of grounds for deeming a person to be a creditor of a developer, reflecting the various forms of consolidation of legal relationships introduced into practice in the field of construction.

As of the date of introduction of supervision upon an indebted developer, the debtor has the right to conclude contracts envisaging transfer of residential property and agreements altering or dissolving those contracts only after having been granted an express written permission of the

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<sup>31</sup> Federal Law of 7 February 2011, No. 8-FZ ‘On the Introduction of Alterations in Some Legislative Acts of the Russian Federation in Connection with the Adoption of the Federal Law ‘On Clearing and Clearing Activities’.

<sup>32</sup> Federal Law of 12 July 2011, No. 210-FZ, ‘On the Introduction of Alterations in the Federal Law ‘On Insolvency (Bankruptcy) and Articles 17 and 223 of the Code of Arbitration Procedure of the Russian Federation with Regard to the Determination of the Particulars of the Bankruptcy of Developers Having Attracted Monetary Resources of Participants of Construction’.

<sup>33</sup> Developer is a legal entity irrespective of its organizational-and-legal form, including a housing construction cooperative society or an individual entrepreneur, to which claims are presented for the transfer of residential property, or monetary claims. The special bankruptcy rules should be applied irrespective of whether or not the developer has any ownership, rental or sublease rights to the land plot, and also irrespective of whether or not the developer has ownership rights or any other property rights to the construction object.

interim manager. The same holds true for any other real estate transactions, including transactions in land.

The court decision on the imposition of supervision upon a developer should be forwarded by the arbitration court to the agencies carrying out the state registration of real property rights and real estate transactions, at the place of location of the developer's land plots.

The decision of the creditors' meeting that an amicable agreement should be concluded in a debtor's bankruptcy case, should be taken by a majority vote of all creditors in bankruptcy and the authorized state agencies, in accordance with the register of the creditors' claims. This decision will be deemed to be adopted if it has been voted for by all the creditors whose claims related to the debtor's obligations are secured by pledge, and by no less than three-quarters of participants a given construction project.

Unlike in all the other categories of bankruptcy cases, the bankruptcy case of a developer is participated in by the participants in a construction project who have claims for residential property transfer, and the authorized executive agency of a RF subject, exercising control and supervision over the participatory share construction of blocks of flats and (or) other real estate objects in the area where the said construction project is being implemented.

In response to a petition filed by the applicant or some other person-participant in the bankruptcy case of a developer, the application court has the right to take measures designed to satisfy the creditors' claims and the debtor's interests (measures ensuring the performance of obligations) in the form of *a ban on the lessor concluding a contract on the lease of the land plot with any other person but the developer*, and *a ban on the lessor disposing of that plot in any other way*.

As of the date of introduction, by the arbitration court, of supervision upon an indebted developer, any claims against the developer for the transfer of residential properties and (or) any monetary claims except those regarding current payments should be filed against the developer only within the framework of the developer's bankruptcy case throughout the whole period of supervision and the duration of all the subsequent procedures applied in the developer's bankruptcy case, in accordance with the established procedure for filing a claim against a developer.

As of the date of introduction of supervision upon an indebted developer, the implementation of the documents of execution concerning the claims filed by participants in a construction project, should be suspended for the whole period of supervision and all subsequent procedures applied in the developer's bankruptcy case. As of the date of opening of bankruptcy proceedings, the implementation of the said documents of execution should be discontinued.

Within 5 days from the date of confirmation of supervision and bankruptcy proceedings, the interim manager and the commissioner in bankruptcy should inform all the participants in the construction project known to them, of the introduction of supervision or the opening of bankruptcy proceedings. They should also inform these participants in the construction project that they are now eligible to file claims for the transfer of residential properties and (or) monetary claims, and that a participant in the construction project is now eligible to unilaterally refuse to implement a contract envisaging the transfer of a residential property.

The opening of bankruptcy proceedings against a developer constitute a ground for a participant in the relevant construction project to unilaterally refuse to implement a contract envisaging the transfer of a residential property. This refusal can be stated, within the framework of the developer's bankruptcy case, in the process of determining the amount of the monetary claim of that participant in the construction project.

When determining the amount of the monetary claim of a participant in a construction project, the court should take into account the amount of his or her losses in the form of the actual damage caused by violation of the developer's obligations relating to the transfer of the residential property. The amount of that damage represents the difference between the cost of the residential property (determined as of the date of dissolution of the contract envisaging the transfer of the residential property) that should be transferred to the participant in the relevant construction

project, and the amount of the monetary resources paid prior to the dissolution of that contract, and (or) the cost of the property (determined by the contract envisaging the transfer of the residential property) transferred to the developer.

When the validity of claims for the transfer of residential properties is being considered by the arbitration court, it is required that evidence confirming the fact that a participant in the relevant construction project has indeed made a full or part partial payment in pursuance of his or her duties towards the developer should be submitted thereto.

The claim for the transfer of a residential property, declared to be valid by an arbitration court should be entered in the register of claims for the transfer of residential properties.

The rules for maintaining a register of claims for the transfer of residential properties, including the content of information required to be entered in that register and the procedure for release of information from the register of claims for the transfer of residential properties should be in conformity with the established federal standards.

As of the date of introduction, by an arbitration court, of supervision over an indebted developer, the following claims against the developer on the part of other persons or against other persons on the part of the developer should be submitted and considered throughout the whole period of supervision and all subsequent procedures applied in the developer's bankruptcy case only within the framework of the developer's bankruptcy case:

- 1) claims for the recognition of the existence or non-existence of a property right or any other right or encumbrance with regard to real estate, including uncompleted construction objects;
- 2) claims for the recovery of real estate, including uncompleted construction objects, from the unlawful possession of another person;
- 3) claims for the demolition of an unauthorized structure;
- 4) claims for the declaration of a real estate transaction to be invalid or non-concluded, and for the application of the consequences of the invalidity of that void transaction;
- 5) claims for the transfer of real estate for the purposes of performing an obligation by a debtor to transfer that real estate in ownership, economic jurisdiction or operative management, or to transfer that real estate for use to the claimant;
- 6) claims for the State registration of the transfer of title to real estate (Article 201.8 of the Federal Law 'On Insolvency (Bankruptcy)').

In the course of bankruptcy proceedings against a developer, the creditors' claims, except the creditors' claims relating to current payments, should be satisfied in the following order of priority:

- 1) first priority should be given to the claims for the compensation for damage (harm) caused by the debtor to the life or health of citizens; their settlement involves the capitalization of the corresponding time payments and the payment of compensation for the inflicted moral damage;
- 2) second priority should be given to the claims for severance benefits, for the payment of labor of persons working or having worked under labor contracts, and for the remuneration payable to the authors of intellectual activity results;
- 3) third priority should be given to the monetary claims of citizens-participants of construction;
- 4) fourth priority should be given to the claims filed by other creditors.

In the process of financial recovery, external management and bankruptcy proceedings, in the event that a debtor developer has an uncompleted construction object, the arbitration commissioner should put forward for consideration at a meeting of participants of construction, no earlier than 1 month and no later than 2 months after the date of his or her appointment, the issue of addressing the arbitration court with an appeal that the claims filed against the developer by participants of construction be settled by way of transferring the developer's rights to the uncompleted construction object and the land plot to a housing cooperative or to a specialized consumer cooperative of another type.

The transfer of an uncompleted construction object to participants in the relevant construction project may be carried out if the following conditions are simultaneously met:

- 1) the value of the debtor's rights to the uncompleted construction object and the land plot does not exceed by more than 5% the aggregate amount of the participants of construction's claims

entered in the register of the creditors' claims and the register of claims for the transfer of residential properties; or the decision that the uncompleted construction object should be transferred to participants of construction has been approved by the affirmative vote of three-quarters of the forth-priority participants of construction; or the necessary amount of money has been paid into the deposit account of the arbitration court in accordance with Item 4, Article 201.10 of the Federal Law 'On Insolvency (Bankruptcy)';

2) the value of the property remaining in possession of the debtor after the transfer of the uncompleted construction object is sufficient for covering the current payments and for settling the claims filed by the first-priority and second-priority creditors; or the necessary amount of money has been paid into the deposit account of the arbitration court in accordance with Item 5, Article 201.10 of the Federal Law 'On Insolvency (Bankruptcy)';

3) the register of the creditors' claims does not contain any claims filed by the creditors who are not participants in the relevant construction project with regard to the obligations secured by a pledge of the developer's rights to the uncompleted construction object and the land plot; or the afore-said creditors have given their assent to the transfer of the uncompleted construction object; or the necessary amount of money has been paid into the deposit account of the arbitration court in accordance with Item 6, Article 201.10 of the Federal Law 'On Insolvency (Bankruptcy)';

4) on completion of construction of the uncompleted construction object, it contains a number of residential properties sufficient to satisfy the claims filed by all participants in the construction project with regard to that particular construction object, entered in the register of the creditors' claims and the register of claims for the transfer of residential properties, in accordance with the terms of the contracts envisaging the transfer of residential properties (and there are no instances when one and the same residential property in the block of flats is simultaneously claimed by two or more participants in the construction project, except for the instances envisaged by Item 7, Article 201.10 of the Federal Law 'On Insolvency (Bankruptcy)'). With the consent of a participant in the construction project, he or she may be allotted a residential property whose layout design, floor space and location will differ from those stipulated in his or her contract envisaging the transfer of residential property;

5) the uncompleted construction object belongs to the developer by right of ownership;

6) the land plot where the uncompleted construction object is situated belongs to the developer by right of ownership or any other property right;

7) participants in the relevant construction project have adopted a decision that a housing cooperative or a specialized consumer cooperative of another type, corresponding to the provisions of Item 8, Article 201.10 of the Federal Law 'On Insolvency (Bankruptcy)', should be established.

In the event that a debtor developer has a block of flats whose construction has been completed, the arbitration commissioner should put forward for consideration at a meeting of participants in the construction project, no earlier than 1 month and no later than 2 months after his or her appointment (if the object's construction is completed within the period of bankruptcy proceedings, no later than 2 months after the date of its completion), the issue of addressing the arbitration court with an appeal that the claims filed against the developer by participants in the construction project should be settled by transferring ownership of residential properties in that block of flats to participants in the construction project.

The transfer of residential properties to participants in a construction project may be carried out if the following conditions are simultaneously met:

1) a completed block of flats has been issued an official completion certificate authorizing its commissioning;

2) the developer and participants in a construction project have not signed the deeds of real estate or any other documents concerning the transfer of residential properties to participants in the construction project;

3) the value of the residential properties to be transferred does not exceed by more than 5% the aggregate amount of the claims filed by participants in the construction project, entered in the register of the creditors' claims and the register of claims for the transfer of residential properties;

or the decision that residential properties be transferred to participants in the construction project has been approved by the affirmative vote of three-quarters of the forth-priority participants in the construction project, with the exception of the juridical persons-participants in the construction project; or the necessary amount of money has been paid into the deposit account of the arbitration court in accordance with Item 4, Article 201.10 of the Federal Law ‘On Insolvency (Bankruptcy)’;

4) the value of the property remaining in possession of the debtor after the transfer of residential properties to participants in a construction project is sufficient for covering the current payments and for settling the claims filed by the first-priority and second-priority creditors; or the necessary amount of money has been paid into the deposit account of the arbitration court in accordance with Item 5, Article 201.10 of the Federal Law ‘On Insolvency (Bankruptcy)’;

5) the register of the creditors’ claims does not contain any claims filed by the creditors who are not participants in construction with regard to the obligations secured by a pledge of the developer’s rights to the completed block of flats, the land plot and the residential properties to be transferred; or the afore-said creditors have given their assent to the transfer of residential properties to participants in the construction project; or the necessary amount of money has been paid into the deposit account of the arbitration court in accordance with Item 6, Article 201.10 of the Federal Law ‘On Insolvency (Bankruptcy)’;

6) all participants in a construction project are allotted residential properties in accordance with the provisions of their contracts envisioning the transfer of residential property, and the number and the size of the residential properties being transferred is sufficient to satisfy the claims filed by all participants in the construction project with regard to that particular construction object, entered in the register of the creditors’ claims and the register of claims for the transfer of residential properties, in accordance with the terms of the contracts envisaging the transfer of residential properties (and there are no instances when one and the same residential property in the block of flats is simultaneously claimed by two or more participants in the construction project, except for the instances envisaged by Item 7, Article 201.10 of the Federal Law ‘On Insolvency (Bankruptcy)’). With the consent of a participant in the construction project, he or she can be allotted a residential property whose layout design, floor space and location will differ from those stipulated in his or her contract envisaging the transfer of residential property.

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On the whole, as far as the situation in the field of bankruptcy in 2009-2011 is concerned, it was the first time since 2004 that we saw a systemic development of Russia’s bankruptcy legislation. The impetus for those changes came from outside the legislative domain – it was provided by the crisis phenomena in the global and Russian economy that resulted in a more than 15% rise in Russia over the period of 2009-2010.

The fact that the State made use of the key ideas for exiting the crisis – supported the banking sector and protected financial institutions in their role of creditors by reducing the level of bad debts – determined the adoption of a number of urgently needed legislative measures primarily designed to strengthen the creditor’s position and to improve the overall transparency of the bankruptcy process.

However, the motives behind the recent legislative initiatives have inevitably narrowed the State’s focus and thus have left a number of most important issues on the waiting list. Some of those issues are as follows:

- the issue of participation of the tax agencies in bankruptcy procedures (for the purpose of eliminating the conflict of interests between their major task of collecting taxes and the necessity of liquidation of potentially lucrative enterprises, and for the purposes of preventing the Federal Tax Service’s bodies from hampering the application of financial recovery mechanisms and the conclusion of amicable agreements);
- issues relating to the development of bankruptcy prevention mechanisms (bankruptcy hindrance mechanism, mechanism for the conclusion of amicable agreements, financial

- recovery mechanism), and to the restoration of the solvency of enterprises and their preservation (especially those whose output is export-oriented and competitive) in the instances when this approach is economically and/or socially feasible;
- the issue of supervision over the activities of SROs of commissioners in bankruptcy and SROs of valuers still failing to efficiently perform their functions and to provide high levels of service;
  - the issue of monitoring and analyzing the practical implementation of legislation, of detecting problems in the areas of application of the new legal norms (adopted over the period December 2008 through January 2011) concerning the activities of commissioners in bankruptcy and their SROs (including the legal norms on the application of liability measures, by a SRO, to arbitration commissioners, and by the controlling agencies – to a SRO and the legal norms regulating the accreditation, by a SRO, of organizations of valuers and organizations maintaining registers of securities); the issue of the practical effectiveness of the legal norms establishing the liability of person exercising control over companies, and the issue of the practical effectiveness of the legal norms for contesting ‘suspicious transactions’ and ‘transactions resulting in preference being given to one creditor at the expense of another’.