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**International Scientific Conference****OUT-OF-COURT PRIVATE BANKRUPTCY IN RUSSIA: FIRST  
EXPERIENCE**

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**Abstract**

The standards on out-of-court private bankruptcy were introduced on 01.09.2020, and they follow-up the rules on citizens' bankruptcy who do not have a self-employed status, which is working in Russia since 01.10.2015. The latter, despite their popularity, have several disadvantages, because it is difficult and rather expensive for citizens. This is the main reason for introducing the institution of out-of-court private bankruptcy applied in administrative proceedings. The article focuses on the foreign experience of applying similar procedures. It is impossible to conclude that Russian legislators have fully received the experience of one country, but it is possible to admit a great similarity with New Zealand legislation. Summarizing the economists' research allows the authors to predict the popularity of out-of-court debt relief, which is caused by deterioration in the financial position of the majority of the Russian population and popularity of many loans. The catalyst was the economic changes caused by COVID-19. The article comments on the conditions of private bankruptcy without recourse to legal proceedings and concludes that the norms of the Russian law on out-of-court private bankruptcy are clearly for a bank loan holder's sake. The study of the legislation reveals positive features and gaps that can complicate legal precedents and require the law readjustment. Based on the data put out in the open, the authors observe the first experience of accepting and considering citizens' applications for initiating out-of-court bankruptcy procedures by Multiuse Centers for providing state and municipal services (MUC) and identify issues affecting creditors' rights.

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*Keywords:* Bankruptcy, out-of-court bankruptcy, citizens, debt relief



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## **1. Introduction**

The introduction of the institution of private bankruptcy in contemporary Russia was very challenging. It took a long time before actualizing these proposals despite the necessity of relevant norms for a discussion by the scientific community even during the introduction and in the first years of the first (1992) and second (1998) bankruptcy laws.

The inclusion in the legislation of provisions on the bankruptcy of private entrepreneurs developed the provisions on the need to free the market, both from bad-faith parties and from occasional bankrupts (*en desastre*). Besides, Russian legislators took the introduction of the rules on the private bankruptcy with no special status (consumer bankruptcy) slow, although an analysis of the practice of applying the rules that commenced in 2015 gave evidence to the state of being relevant.

From 01.01.2020 Russian bankruptcy law experienced major changes. In particular, the rules on out-of-court bankruptcy were introduced (Federal Law of July 31, 2020, No. 289-FZ..., 2020). At the point of the debate, of course, no one could predict what challenges the world and national economies would face. COVID-19 pandemic only exacerbated the financial crisis of certain social categories and the necessity to look for ways to free them from debts.

## **2. Problem Statement**

The mainline of this study is a comprehensive analysis of legislation on the new institution of out-of-court private bankruptcy in Russia, identifying its advantages and anticipated problems of legal enforcement, taking into account the necessity to maintain the balance of convenience of an obligor and creditors.

## **3. Research Questions**

In this study, the review of foreign experience in regulating personal bankruptcy as well as its comparison with the novelties of Russian legislation, analyzed data on out-of-court private bankruptcy for the first month of the new rules of law.

The object of the study is public legal relations related to the recognition of a citizen as a bankrupt out of court.

The research subjects are Russian and foreign legislation, scientific publications on relevant topics, as well as statistical and other contents from open-access property resources.

## **4. Purpose of the Study**

The aim of the study is a comprehensive analysis of the institution of out-of-court bankruptcy as a novelty of Russian law. The designated goal determines the definition of two tasks and their sequential consideration. The first part presents a comparative analysis of the institutions of private bankruptcy in foreign legal systems. The second part contains a retrospective analysis of legal regulation of private bankruptcy in the Russian Federation, as well as a review of novelties of the current Russian legislation and the law enforcement practice that has already begun to take place.

## **5. Research Methods**

The study uses general analysis and synthesis scientific methods, the method of judgment-based sampling, as well as special juridical methods: legalistic, the method of legal comparativistics and its subclasses: temporal comparative studies and comparative legal studies.

## **6. Findings**

### **6.1. Legal regulation of foreign private bankruptcy**

The institution of truncated bankruptcy proceedings is not exclusively a product of native law. Many foreign law enforcement agencies are looking for the best solution to the problem of “Low-Income-Low Asset” (LILA) and “No-Income-No Asset” (NINA) debtors (Ramsay, 2020). They study not only legal and economic issues, but also sociological analysis of debtors (Fisher, 2019). Traditional bankruptcy proceedings and their derivative substitutes are no longer considered the main model of personal bankruptcy. The procedure of truncated bankruptcy proceedings is an urgent need, both for comprehensive creditors and for poor debtors (Smirnykh, 2018). Accordingly, new bankruptcy mechanisms appear, and current ones undergo essential changes.

One of the first countries to apply truncated personal bankruptcy proceedings was New Zealand. Back in the early 2000s, it adopted provisions that reduced the time of the procedure (12 months instead of 3 years) when a debtor meets a number of requirements: debts are not related to business activities, their amount subjects to the prescribed ceilings; there is no or very little probability of improving the debtor’s financial position; he has not resorted to such a procedure before (Telfer, 2003). The key legal effect is debt relief. The experience of New Zealand was received by England and Wales, and then by India, where the number of LILA and NINA is very large.

In the Republic of Korea, the Credit Counseling and Recovery Service (Soogeun, 2006) was established in 2002 to rescheduling of loans to financial institutions (in other cases, the legal action is applied). The due date is up to 20 years. This is similar to the Russian restructuring, but out of court and under official management.

In several countries, truncated proceedings for consumer bankruptcy is carried out as citizens’ online appeals (for example, New Zealand, Ireland) (Ramsay, 2020).

Although, there are still national legal systems that have not to adopt a new reality. For example, the laws of Germany (Ramsay, 2020) and Indonesia do not provide for a debt write-off, which researchers criticize (Toha & Retnaningsih, 2020).

Thus, among the general global trends are the use of administrative procedures, the use of checklists, the smallest involvement of judicial authorities, and the transition to the regular bankruptcy procedure only in case of disputes (Smirnykh, 2018).

### **6.2. Legal regulation of private bankruptcy in the Russian Federation**

Since 01.10.2015, the Russian legal system has received a conceptually new legal institution, which differs from the institution of corporate bankruptcy, both in terms of goals and means aimed at achieving

them. In addition to the traditional goal of ensuring pro rata settlements of creditors' claims, the rules on private bankruptcy give a debtor the right to put off payment of debts by restructuration and re-establish payment behavior; to be out of debts if there is no such an opportunity. Of course, this mechanism was based on foreign experience (Vinogradova et al., 2018). Since 2015, almost 150,000 Russian citizens have used this mechanism. The debtors themselves initiated the procedure.

In addition to the obvious benefits, this institution has disadvantages, in particular, a complex and expensive mechanism of judicial bankruptcy, obligatory participation of an insolvency practitioner in it. In practice, the amount of compensation to the insolvency practitioner reaches up to 150, 000 – 200, 000 rubles (vs 10,000, and then 25,000 rubles). This makes the procedure impossible for debtors who are cash-strapped and short of funds.

Meanwhile, the total number of Russians who have a bank loan or that from a microlender (hereinafter referred to as MOs) is steadily growing, often a borrower has several loans (as of 01.04.2020, they account for 54% of the debt on bank loans). The vast majority of MOs borrowers (73%) have one working loan, but only 15% of them were able to bring an account current loan in six months (Analysis of the dynamics of the debt load., 2020).

COVID-2019 pandemic has had an extremely negative impact on both the Russian and global economy (Debts of Russian credit card., 2020) and catalyzed introducing a new bankruptcy mechanism into the Russian legislation – out-of-court one.

Originally, its support was proposed to be assigned to the insolvency practitioner, and the legal affects were comparable to debt restructuring. A period of time it is a year. The affects are the following: if a debtor's property status improves, it allows for quashing the proceedings, if it mismatches the bankruptcy criteria, then a creditor or a debtor initiates a judicial procedure. If the financial situation of a citizen remains unchanged after a year, he is adjudged a bankrupt (Draft Federal Law No. 792949-7., 2020). Many outlines of the bill faced just criticism, in particular, financing of the officer's work, in fact, at his own expense, which made these regulations inactive.

In the version of the bill as follows, which was constituted, these shortcomings managed to avoid. Out-of-court bankruptcy is possible under a complex of terms: a) the amount of outstanding obligations, including the unmatured obligations, is from 50,000 to 500,000 rubles, without regard for financial penalties (time will tell how much optimal the amounts owed are); b) enforcement proceedings have ended due to the lack of property to be sold after settlements with creditors as of the date of filing the bankruptcy application regarding a debtor (Federal Law of October 02, 2007, No. 229-FL., 2007).

The responsibility for carrying out the procedure is taken by MO. Its functions have been expanded. Such a decision is difficult to recognize as successful because previously the MO duties included only obtaining of documents, handing them to various departments according to the competence of each for making a decision. Later, they were to issue the finished documents to the applicant. In this case, MO, in fact, is charged with the responsibility of conducting the bankruptcy procedure. It is possible to explain MO allocation of functions that go beyond their competence only by MO breadth and their availability on the territory of Russia.

A debtor can send in an application, both at the place of his residence and his location, supplied with a list of all known creditors attached in the same form as if the court bankruptcy procedure (Order of the Ministry of Economic Development of the Russian Federation No. 530., 2015 of August 05, 2015).

A sample of information reviewed from the Unified Federal Register of Bankruptcy Information showed the following: 1,456 applications were sent in during the first month of the new rules in MOs around Russia. Regarding 456 debtors, an institution of extrajudicial bankruptcy proceedings is reported on (the results of reviewing 456 extrajudicial bankruptcy proceedings) and presented in Tables 1-4). Respectively 1,000 applications of citizens were taken back (the reason in most cases is the lack of information on the return of writs of execution to the execution creditor on grounds set by part 1 of article 46, № 229-FL) (Unified federal registry...)

**Table 1.** Age of debtors, on whose application the procedure of out-of-court bankruptcy was initiated, the number of proceedings \*\*

| 18-30 years old | 31-54 years old | 55-70 years old | 71 years old and older |
|-----------------|-----------------|-----------------|------------------------|
| 67              | 290             | 85              | 7                      |

\*\* There is no information about the age of 7 debtors in the Unified Federal Register of Bankruptcy Information cards

However, there is a lack of uniformity in the Unified Federal Register of Bankruptcy Information data. So, in many cases, it is indicated that there is no data on creditors or the number of accounts payable, for example, the principal amount of debt is 59,000 rubles, and the amount of debt is 0. In some cases, the amount of debt is several times more than the amount of the initial loan amount. More likely this is referred towards MO creditors. Taking into account the lack of information on the number of financial sanctions, it can be assumed that in some cases it is combined with the principal debt, which is a direct infringement of Federal Law No. 127 since to determine the terms of bankruptcy, only the amount of the principal debt is taken into account (Federal Law of October 26, 2002, No. 127-FZ., 2002). In some cases, information about the debtor's creditors is not indicated at all in the notification of the introduction of out-of-court bankruptcy. In some cases, MO employees, on the contrary, give detailed information about the lender, the reasons for incurring of debt, for example, Content: Loan and Interest Debt. Foundation: No. 39410735319 of 25.01

The lack of unified normative requirements to the procedure of entering information on the Federal Recourse site and their content interferes with a right of the creditor, deprived of opportunities to assess the prospects for change in a legal position of the debtor and to exercise the right of transforming extrajudicial bankruptcy into a court one may if: a) he is not specified in the list of creditors, b) the debt to him is not given not to the fullest extent and this greatly affects a citizen's correspondence to the criteria for out-of-court bankruptcy. Whereas, a creditor charges the original cost for judicial bankruptcy (with an unclear prospect of their collection from the debtor).

Since the out-of-court bankruptcy procedure is completed six months after the publication of the notice of its initiation, it will be possible to analyze the statistics of the grounds for its completion only after 01.03.2021.

**Table 2.** Amount of debt in initiated proceedings, number of proceedings \*\*\*

| 50000 –<br>100000<br>rubles. | 101000 –<br>200000<br>rubles. | 201000 –<br>300000<br>rubles. | 301000 –<br>400000<br>rubles. | 401000 –<br>500000<br>rubles. | Меньше<br>50000<br>rubles. | Больше<br>500000<br>rubles. |
|------------------------------|-------------------------------|-------------------------------|-------------------------------|-------------------------------|----------------------------|-----------------------------|
| 40                           | 120                           | 98                            | 96                            | 89                            | 5                          | 1                           |

\*\*\* There is no information on the amount of debt owed by 7 debtors in the Unified Federal Register of Bankruptcy Information cards

**Table 3.** Types of creditors \*\*\*\*

| Physical person | Banking companies | Micro lenders | Collection teams / agencies | Federal Tax Service of the Russian Federation | Resource-supplying organizations | Other corporate bodies | Multiple lenders of different types |
|-----------------|-------------------|---------------|-----------------------------|---|----------------------------------|------------------------|-------------------------------------|
| 6               | 286               | 112           | 5                           | 15  | 14                               | 18                     | 86                                  |

\*\*\*\* Data on different types of creditors are taken into account in the corresponding column 1-7, as well as in column 8.

**Table 4.** Number of impositions of a debtor for whom the out-of-court bankruptcy procedure has been initiated \*\*\*\*\*

| One | Two – five | Six-ten | More than ten |
|-----|------------|---------|---------------|
| 67  | 290        | 85      | 7             |

\*\*\*\*\* There is no information on the number of impositions of 7 debtors in the Unified Federal Register of Bankruptcy Information cards.

## 7. Conclusion

Based on foreign experience, the Russian legislators introduced an administrative procedure for private bankruptcy, which is free for a debtor, has a low barrier entry. The analysis of the data of the Unified Federal Register of Bankruptcy Information in September 2020 allows the authors to conclude that the majority of debtors are in the age group from 31 to 54 years old (Table 1). They have debts for 100,000 to 200,000 rubles (Table 2). Creditors, as a rule, are the banks (83.8%) or MOs (25.8 %). 20.1% of debtors have debts to creditors of various types (Table 2.3). The number of debtors with one or two to five impositions to creditors is almost equally distributed (Table 4).

After the end of the out-of-court bankruptcy, the citizen is excused from further performance of the creditors' claims specified by him in the application for adjudication of his bankruptcy. This rule does not apply in case of inequitable conduct of the debtor (for example, in case of a court verdict available that bankruptcy fraud or fraud during bankruptcy is set out). The obligations to pay current payments, by commitments that are inseparably attached to the debtor identity and in several other cases remain unchanged (Federal Law of October 26, 2002, No. 127-FL., 2002). The end of an out-of-court private bankruptcy entails the same effects as in case of a regular bankruptcy.

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