



## BANKRUPTCY OF INDIVIDUALS AS A NEW FACTOR FOR CREDITS TO BE ISSUED

*For the attention of heads of legal departments in lending institutions and other financial organisations*

**Pepeliaev Group advises that on 1 July 2015 the amendments to the Bankruptcy Law<sup>1</sup> will be enacted in connection with rehabilitation procedures being implemented for debtors who are individuals. Lending institutions should consider the implications of these new provisions being enacted when granting loans to individuals.**

Relationships between financial institutions and borrowers who are individuals may be significantly affected by the changes resulting from the adoption of Federal Law No. 476-FZ "On amending Federal Law 'On insolvency (bankruptcy)' and individual legislative acts of the Russian Federation with regard to regulating rehabilitation procedures implemented in relation to debtors who are individuals".

Below we examine the most important changes in relation to the bankruptcy of clients who are individuals.

### **Particular aspects of initiating a lawsuit for the bankruptcy of an individual further to a creditor filing an application**

An individual himself/herself may file for bankruptcy, or a creditor, or an authorised body may petition for him/her to be declared bankrupt.

Further to a creditor's application, a lawsuit concerning the bankruptcy of an individual may be initiated if the following three conditions are met at the same time:

- the claimed amount is no less than **RUB 500,000** and it has been in arrears for three months;
- as a general rule, a claim must be supported by a judicial decision, unless such claim (i) is based on loan agreements or notarised transactions, (ii) is confirmed by a notary's writ, or (iii) the individual acknowledges such claim but does not repay the relevant amount;
- the creditor has deposited with the court an amount to be paid as a consideration to the financial manager (RUB 10,000).

The relevant application is filed either with a commercial ('arbitration') court if the individual's obligation involves business activities (including having his/her official status as an individual entrepreneur terminated), or with a general jurisdiction court (in all other instances) at the location where the individual resides.

For a bankruptcy petition to be recognised and a **procedure initiated for an individual's debt to be restructured**, it must be proved that such individual is insolvent, i.e. that the individual is unable a) to meet creditors' requirements in relation to monetary obligations in full and/or b) to fulfil its obligation to make mandatory payments.

The Law establishes certain presumptions; should any of them be true, an individual is deemed insolvent (article 213.6(3) of the Law).

### **Procedure for a creditor to raise claims in a lawsuit involving an individual's bankruptcy**

For the claims of the debtor's creditors to be included in the list of creditors' claims and in order to participate in the first meeting of creditors, the creditors' claims may be raised during the debt restructuring procedure as set out by article 71 of the Law **within two months of the information being published in the Unified Federal Register of Bankruptcy Information<sup>2</sup>** (the "UFRBI") that the petition to have an individual declared bankrupt is valid. For the first time the rule has been introduced that a court may extend the above period if there was a good reason for no claims to be raised during that period.

If the court approves the plan to restructure the debt, creditors' claims which are not included in the plan may be raised within the period for which the plan to restructure the individual's debt has been approved.

### **PG's comment:**

*If there is a corresponding record in the UFRBI and if the creditor does not receive on a timely basis information that the procedures had been put in place to be implemented in a bankruptcy case in relation to a debtor, this is not a good reason for failing to raise claims within the prescribed period. We recommend following at least the information entered into the UFRBI which concerns individuals who have borrowed large amounts.*

### **Implications of the procedure for restructuring an individual's debt: particular aspects with regard to credit institutions**

It is mandatory to introduce the procedure for restructuring an individual's debt if a court recognises the application for declaring an individual bankrupt as justified.

Apart from the implications of the above procedure (article 213.11 of the Law), starting from the date when the procedure for restructuring an individual's debt is implemented, a moratorium is imposed on satisfying creditors' monetary claims (except for current payments), and the individual's debt to **the creditor lending institution is declared to be unrecoverable**.

### **PG's comment:**

*This provision has the corresponding legal consequences provided for in Regulation No. 254-P of the Bank of Russia "On the procedure for lending institutions to form reserves for bad debt, debt under loans and equivalent debt" dated 26 March 2004, as well as article 292 of the Russian Tax Code.*

<sup>1</sup> Federal Law No. 127-FZ "On insolvency (bankruptcy)" dated 26 October 2002 (the "Law").

The following may be asserted only in individual bankruptcy cases: creditors' claims in relation to monetary obligations as well as claims for transactions to be invalidated and claims to have the consequences implemented of a transaction being invalid.

Penalties (fines or late payment interest) and other financial sanctions, as well as interest on all the liabilities of the relevant individual, cease to be charged (except for current payments).

The enforcement of writs of execution to collect a monetary penalty from individuals is suspended (except for some cases involving liabilities secured by a mortgage).

In its capacity as a creditor, the lending institution may offer a plan for restructuring the individual's debt as required by articles 213.14 and 213.15 of the Law. The plan is subsequently to be approved by the meeting of creditors and the court.

### **Declaring a debtor bankrupt and disposing of an individual's property**

The court imposes the procedure for disposing of an individual's property if such an individual has been declared bankrupt (for example, if the plan for restructuring the individual's debt was not submitted within the established period or if it was not approved by the creditors' meeting). This procedure is imposed for a maximum period of six months. The court may also temporarily restrict the right of the bankrupt individual to exit the Russian Federation.

The claims raised by the creditors of the individual who has been declared bankrupt are satisfied out of the debtor's entire property, including the debtor's share in common property, **except for property** on which execution cannot be levied in accordance with civil procedure legislation (article 446 of the Russian Civil Procedure Code).

#### **PG's comment:**

*Please be advised that exceptions do not include residential premises which are mortgaged.*

The initial sale price of a pledged item as well as the procedure and conditions of the bid are determined by the bankruptcy creditor whose claims are secured by a pledge on the property being sold.

### **Procedure for satisfying the bankruptcy creditors' claims**

No execution may be levied on pledged property, including under an out-of-court procedure, from the date when the court has issued its ruling upholding as justified the petition to declare an individual bankrupt and up to the date when the plan for restructuring the individual's debt has been approved, or the date when the court has decided to declare the individual bankrupt.

However, the debtor may dispose of the pledged property, lease it out or transfer it free of charge to any other person or otherwise dispose of it, or encumber the pledged item with rights and claims of third parties only subject to the creditor's approval, if such creditor's claims are secured by the above pledged property, unless otherwise a federal law or a pledge agreement provides otherwise and unless such condition follows from the nature of the pledge.

While the plan for restructuring an individual's debt is implemented, the funds generated from the sale of the pledged item are transferred to the bankruptcy creditor (the pledgee) **in full**; however, the amount of such funds may not exceed the principal amount of the debt on the obligation secured by a pledge and the payment for using these funds.

While the individual's property is being disposed of, **eighty percent** of the amount generated from the sale of the pledged item is used to satisfy the creditor's claims in relation to the obligations secured by the debtor's property.

### **Consequences of settlements between a debtor (who is an individual) and creditors being completed**

After settlements with creditors have been completed, the bankrupt individual is released from any obligation to satisfy any further claims of creditors, including those not asserted when procedures were introduced to restructure the individual's debts or to sell the individual's property.

***An individual may not be released from his/her obligations*** in a number of instances provided for by article 213.28(4) of the Law, e.g. if it has been proved that the individual acted unlawfully when the obligation arose or was performed on which the creditor based its claim. Such unlawful acts include, without limitation, committing a fraud or actions aimed at ***fraudulently evading the settlement of amounts the individual owes to creditors, or concealing or intentionally destroying property.***

If it is found that an individual has concealed property or unlawfully transferred property to third parties, the bankruptcy creditors whose claims were not satisfied when the individual's debts were restructured or his/her property was sold, are entitled to raise a claim with the debtor for execution to be levied on that property.

### **Implications of recovery procedures being implemented in relation to an individual debtor in the light of legal relationships with financial institutions**

- While the plan for the restructuring of an individual's debts is being implemented and within five years after this plan has been implemented, ***an individual may not conceal*** applying for a loan, the fact that he or she implemented that plan.
- Within five years after an individual is declared bankrupt, he or she ***may not assume any obligations*** in relation to facility and/or loan agreements without indicating that he or she was bankrupt.
- **The individual's credit history must include**, among other things, information about any procedures implemented in bankruptcy proceedings involving the individual, about lessee borrower being released from the obligation to comply further with creditors' claims, or information that the rule has not been applied which releases the borrower from his/her obligation further to comply with the creditors' claims as a result of the bankruptcy procedure involving an individual being resumed, if a court (a commercial ('arbitration') court) has resolved to declare the above individual bankrupt.
- A bankrupt individual ***may not***, for three years after the date when he/she is declared bankrupt, ***hold positions*** in the management bodies of a legal entity or take part in managing a legal entity in any other way.

## Recommendations

The new legal regulations concerning the bankruptcy of an individual do not exclude abuses on the part of bad-faith individual debtors who wish to be released from their obligations. To this end, we recommend analysing and comparing both the additional information provided by the debtor and the information identified independently. This should be done at the initial stages of a bankruptcy case being considered (i.e. before a plan for restructuring debt has been approved), to prevent the relevant individual from being groundlessly released from its obligations.

## Help from your adviser

Pepeliaev Group's experts have extensive experience of providing support to credit institutions, representing clients in bankruptcy cases and safeguarding the interests of banks in disputes with individuals, including those heard by general jurisdiction courts.

We will readily provide comprehensive legal support not only in respect of the bankruptcy of individual debtors (who are individuals) or transactions which are challenged with a view to satisfying creditors' claims in full, but also in relation to issues that require the internal documents of financial institutions to be improved, as well as other aspects of financial institutions' activities.

## Contact details



**Igor Marmalidi**  
Partner  
«Pepeliaev Group»  
Tel.: +7 (495) 967 00 07  
E-mail: [i.marmalidi@pgplaw.ru](mailto:i.marmalidi@pgplaw.ru)



**Lidia Gorshkova**  
Group Head of Banking and Financial Practice  
«Pepeliaev Group»  
Tel.: +7 (495) 967 00 07  
E-mail: [l.gorshkova@pgplaw.ru](mailto:l.gorshkova@pgplaw.ru)



**Sergey Spasenov**  
Partner (St Petersburg)  
Pepeliaev Group  
Tel.: +7 (812) 640-60-10  
E-mail: [s.spasenov@pgplaw.ru](mailto:s.spasenov@pgplaw.ru)



**Yulia Litovtseva**  
Head of Bankruptcy and Anti-crisis Protection of Business Practice  
«Pepeliaev Group»  
Tel.: +7 (495) 967 00 07  
E-mail: [y.litovtseva@pgplaw.ru](mailto:y.litovtseva@pgplaw.ru)



**Egor Lysenko**  
Head of Siberian office "Pepeliaev Group" in Krasnoyarsk  
Phone: +7 (391) 277-73-00  
E-mail: [e.lysenko@pgplaw.ru](mailto:e.lysenko@pgplaw.ru)



**Vladislav Korablin**  
Associate  
«Pepeliaev Group»  
Tel.: +7 (495) 967 00 07  
E-mail: [v.korablin@pgplaw.ru](mailto:v.korablin@pgplaw.ru)