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Russia's Bankruptcy Law: Hit or Miss?

By Kristen Blyth

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It's been nearly two months since Russia first allowed people to declare bankruptcy, and so far it's going as swimmingly as declarations of overwhelming debt possibly can. Earlier apocalyptic predictions of arbitration courts drowning under a tsunami of citizens rushing to settle their financial troubles have not come to fruition. The program's got off to a healthy start, with a reported 2,000 personal bankruptcy applications filed in the law's first 30 days.

The option for indebted Russians to wipe their financial slate clean has been a long time coming, and marks how far the country's understanding of insolvency has evolved in recent years. The concept of bankruptcy has suffered a public image problem in Russia partly as a hangover from the 1990s, where the process was applied arbitrarily and abused to redistribute assets in committing credit fraud.

Since then, great strides have been made in the regulation and transparency of indebtedness. Nine federal laws were passed in 2013 alone making significant changes to Russia's law on bankruptcy, including big improvements to information available in the state's bankruptcy database.

But until now, the government only provided companies a formal mechanism for declaring bankruptcy, leaving individuals with few options for debt restructuring and rendering consumer lending a risky practice. As Russian bankruptcy legislation marks an important milestone, how does the law measure up as a practical and reasonable tool for debt relief?

Aside from closing a significant legal gap, the measure allows banks more opportunities for recourse to recover money from the owners of bankrupt companies who have avoided paying back their debts — which seems to include quite a number of multi-millionaires.

Among those being pursued by Russian banks is Telman Ismailov, a Russian-Turkish businessman and former owner of the sprawling Cherkizovsky market in Moscow. Banks have also filed bankruptcy applications against Mikhail Balakin, a construction tycoon estimated by Forbes to be worth $1.7 billion; Ralif Safin, a former senator and ex-vice president of LUKoil; and Vladimir Kekhman, Russia's former 'banana king' who reportedly owes almost $68 million.

The law doesn't go easy on individuals deemed by the courts to be bankrupt — banning them from holding executive positions at companies for three years, requiring them to notify banks when applying for fresh loans of their bankrupt status for five, and punishing those found to be declaring 'false bankruptcy' with up to six years in prison.

These conditions don't make declaring bankruptcy desirable or easy — nor should it be. The 'tough love' approach serves as a deterrent from taking bankruptcy declaration lightly or abusing the law for fraudulent purposes. In that respect, the insolvency amendment may do some great work in helping clean up and further regulate the Russian business sphere.

At the same time, the vast majority of bankrupt people are decidedly not wealthy. One of the major drawbacks of Russia's bankruptcy law is that the process of declaring that you have no money is expensive.

In countries like Germany, the federal budget covers this expense and in countries like the U.S. and Britain, debtors are obliged to pay a flat fee, but Russia places a burden on debtors to cover court costs for the duration of their application process, which will likely take months and could cost up to hundreds of thousands of rubles. Leaving open the possibility that the cost of declaring bankruptcy will total more than the debt itself may be a significant deterrent to Russians who could benefit from the option. Likewise, the law leaves open the chance that debtors will be restricted from traveling outside the country — an unnecessarily harsh, and another likely off-putting, measure.

As it's written, the law protects creditors more than debtors — and in a time of economic decline, when the average Russian is less and less able to make ends meet, that can be dangerous. Still, the personal bankruptcy option has formalized a new opportunity for debt relief that didn't exist before. Russia's insolvency legislation is becoming more sophisticated, and Russians in debt have more choices for financial relief than they did before. Despite the law's shortcomings, that's never a bad thing.

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