International Journal of Recent Technology and Engineering (IJRTE)
ISSN: 2277-3878, Volume-8 Issue-3, September 2019

Features of Regulating Credit Institutions: Mechanisms and Technologies

Inna Leonidovna Burova, Pavel Valerievich Zhesterov, Alla Efratovna Zolotareva

Abstract*: The study was aimed at introducing to the executives of banks and other credit institutions the shared technology and the patterns of bringing the persons controlling the credit institution to subsidiary liability. For achieving these goals, the authors analyzed the cases of bankruptcy of banks in the Russian Federation, in particular, the rules of procedure for taking interim measures if the persons controlling a credit institution are brought to subsidiary liability. In this publication, the judicial practice has been reviewed for the past two years since the entry into force of legislative changes. Practical advice is given, along with routines of the applicants` rights protection in such cases. All of this will not only improve the efficiency of bankruptcy procedures of a bank but will also develop mechanisms of corporate governance in the banking sector toward increased personal responsibility of management decisions makers and those controlling credit institution. The results have been as follows: the authors highlight the shortcomings of the Russian procedural legislation concerning the interim measures taken by courts in banking bankruptcy cases. The identified problems can be solved by amending the national procedural legislation or by adopting special explanations by the Supreme Court of the Russian Federation.

***Keywords*: banking policy, bank insolvency, banking failure, vicarious liability, injunction application, interim measures, freezing order, protection of creditors, arbitration practice, banking bankruptcy cases.**

I. INTRODUCTION

The Russian Federation continues to consolidate its presence in key sectors of the global economy and politics due to objective need and in the name of national interests. The national interests can fully include the restoration and approval of leading positions in the global banking sector. The modern banking sector is a key element of the Russian economy, ensuring its balanced and innovative development. The activities of credit institutions, both money circulation in commercial purposes and banking operations with budgetary funds involve all the processes occurring in the economic life of the society and the state.

Manuscript published on 30 September 2019
* Correspondence Author
Inna Leonidovna Burova*, Russian State Social University (RSSU), Moscow, Russian Federation.
Pavel Valerievich Zhesterov, Russian State Social University (RSSU), Moscow, Russian Federation.
Alla Efratovna Zolotareva, Russian State Social University (RSSU), Moscow, Russian Federation.

The Russian banks are operating in the context of high commercial risks: firstly, the risk of revocation of bank licenses by the Central Bank of the Russian Federation due to the failure to comply with the regularly complicating requirements of this financial regulator; secondly, the risk of bankruptcy due to high contributions to the Contributions Insurance Agency (CIA), or intentional wrongful actions (inaction) of the owners, the manager, and the management bodies of the credit institution.

In the event of a bankruptcy of a credit institution for one of the above reasons, the question arises of satisfying the claims of all creditors in full. Changes in the Russian legislation on bankruptcy made in 2017 explained the procedure and rules for bringing to the subsidiary liability of the persons controlling a credit institution, in case the own funds of the credit institution are insufficient to meet the requirements of all creditors.

II. METHODS

The authors of the article rely on the general scientific system and axiological approaches to study the protection of creditors during banking failure. The research methodology includes a review of scientific literature, open information sources, materials of judicial and arbitration practice, an analytical approach to solving the problem based on the work of domestic scientists on the issue of trial settlement of bankruptcy disputes.

A. Algorithm

Investigation of the mechanisms of bringing to the liability of the persons controlling a credit institution was based on the branching algorithm.

During the study, the authors treated and analyzed civil law rules, jurisprudence, and viewpoints of the authors on the accountability issues in the corporate entity.

The following research stages were identified by the authors:

1. Formulating the research topic.
2. Setting the objectives and tasks of the research.
3. Studying theoretical basis of the research.
4. Analysis and planning of the research.
5. Hypothesizing the research.
6. Selecting the research methods used.
7. Elaborating the unified view of the alleged results of the research.
8. Identification of gaps in legislation.
9. Processing and analysis of research results.
10. Formulating conclusions of the study.

III. RESULTS

Table 1. Results of the research

Research result	Result Description
The authors propose to amend the content of paragraph 36 of the Resolution of Plenum of the Supreme Court of the Russian Federation No. 53 dated 21.12.2017, which will allow all of the arbitration courts to uniformly apply the law on interim measures, taking into account the specifics of the cases on bringing to the subsidiary liability of the debtor-controlling persons.	It appears that the above clarifications will increase the efficiency and quality of the administration of justice and the enforcement of judicial acts in cases of bringing to the subsidiary liability of defendants in general, and of the persons controlling credit institutions in particular.

Table 2. Suggestions for improving legislation

Suggestions for improving legislation in the results framework	
The authors consider the following actions necessary:	1. To reflect in the text of paragraph 36 of the Resolution of the Plenum of the Supreme Court of the Russian Federation No. 53 dated 21.12.2017 the following provision: for the application of interim measures it is sufficient to confirm reasonable suspicions of the existence of the grounds provided for in paragraph 2 of Article 90 of the Arbitration Procedure Code of the Russian Federation.
	2. To consider the lack of information on the composition of the property of the person controlling the debtor as not an unconditional basis for refusing to take interim measures. In such a situation the courts have the right to take interim measures, setting the total value of the property subject to seizure. The bailiff may further determine the specific composition of property subject to seizure.
	3. When deciding on interim measures in cases of subsidiary liability of the debtor-controlling persons, to take into account the presumption of the defendant's guilt in the bankruptcy of the debtor and the impossibility of fully repaying the claims of creditors established by paragraph 2 of Article 61.1 of the Bankruptcy Law. At the same time, the refutation of the evidentiary presumption of the reckless conduct of the alleged violators of the debtor's rights lies with the controlling persons themselves, who for this purpose have the right to use all means of evidence provided for by the Arbitration Procedure Code of the Russian Federation.

IV. DISCUSSION

Banking crises inevitably (though not necessarily always appropriately) bring forth demands for more and different regulation of banks, and the recent global crisis is no exception [1]. A bank's insolvency triggers extraordinary intervention – either judicial or administrative. As practice shows, the bankruptcy of banks and other credit institutions occurs due to the inability to fulfil the requirements of the financial regulator (the Central Bank of the Russian Federation), which are becoming more complicated every year. The bankruptcy of a credit institution may also be caused by unlawful actions (inaction) of its owners and members of governing bodies.

According to the BankInformService news agency, during 2018, the Central Bank of the Russian Federation revoked the licenses of 57 banks, which accounted for 11 % of the total number of credit institutions registered on the territory of the country. This figure is higher than in 2017, when licenses were revoked from 47 credit institutions, but lesser than five years ago when the Bank of Russia had started the "recovery" of the banking sector.

In the event of bankruptcy of a credit institution, the complete satisfaction of the claims of all creditors whose funds have been placed in the credit institution at the time of the revocation of its license becomes urgent.

To protect the rights of the creditors in the event of bank bankruptcy, it is possible to bring the persons controlling the credit institution to subsidiary liability. The effective protection of the creditors depends on timely interim measures taken in respect of the property of the persons controlling the credit institution. An application for interim measures shall be filed as part of a separate dispute in a bankruptcy case.

In December 2018, there were significant changes in the procedure for taking interim measures when the court resolved the issue of bringing of the persons controlling the credit institution to subsidiary liability.

As a general rule, in economic turnover, legal entities bear independent property liability for their obligations to creditors (clause 2 of Article 56 of the Civil Code of the Russian Federation). This rule fully applies to the activities of banks and other credit institutions.

The subsidiary liability for the obligations of a credit institution constitutes a derogation from this general rule [2, 3]. Despite several special works dealing with subsidiary liability [4, 5, 6, 7], the institute of law has not been fully investigated so far.

Therefore, based on the analysis of the existing legal practice, the authors will examine the legal framework for the protection of the rights of creditors in case of bankruptcy of a bank and will give practical advice to lawyers to ensure their faster and more successful work.

Most of the research on the bankruptcy of credit institutions in our country has been focused on issues of legal regulation [8]. However, very little is known about procedural problems during court proceedings. Federal law constitutes the legal basis for considering the case of bringing to subsidiary liability of the officials controlling a credit institution, as follows: Federal Law No. 127-FZ dated 26.10.2002 "On Insolvency (Bankruptcy)" (Bankruptcy Law), Arbitration Procedure Code of the Russian Federation (APC RF), Code of Administrative Offenses of the Russian Federation (CAO RF), and Civil Code of the Russian Federation (CC RF).

The location of the rules on subsidiary liability in different sources inevitably leads to legal conflicts, raises many questions of both theoretical and practical nature. Besides, the application of general rules without taking into account the specifics of banking leads to a decrease in the quality of justice in this category of cases. For example, the absence of special legal norms has led to the fact that when considering this category of economic disputes, the courts most often refuse bankruptcy trustees to satisfy their applications for the seizure of money and other property of the defendants. There are no explanations of the highest court on the procedure for adopting interim measures in cases of bringing to the subsidiary liability of the persons controlling a credit institution (Table 1, Table 2). The Ruling of the Supreme Court of the Russian Federation No. 305-ES17-4004 dated December 27, 2018 is the only act of judicial interpretation of the procedure in question. This article seeks to fill gaps in procedural legislation on interim measures, using access to documents of the recent disputes.

A. National practice for examining applications for interim measures in cases of holding subsidiary liable the persons controlling credit institutions

According to the CIA, as of May 28, 2019, Russia completed bankruptcy proceedings against 317 banks, and 363 banks were in liquidation [9]. Such activity of the Central Bank of the Russian Federation in revoking licenses from credit institutions is due to the need to improve the national economy and ensure the financial security of bank customers. As the scientific literature notes, the reduction in the number of credit institutions is associated with the "improvement of the banking system and the closure of credit institutions conducting illegal activities" [10].

It should be noted that bank depositors remain the main victims in the revocation of licenses. To date, a state deposit insurance system has been created to protect their property interests. To pay compensations to depositors, the CIA uses the insurance fund, which under the circumstances tends to exhaustion.

If during the verification of the bank bankruptcy circumstances, the bankruptcy trustee (whose functions are performed by the CIA) concludes that there are signs of fictitious or intentional bankruptcy, he/she shall appeal to the arbitration court with the view of bringing to subsidiary liability the persons controlling the credit institutions. Other persons listed in Section 61.14 of the Bankruptcy Law are also entitled to file such an application.

The arbitration court should consider a separate dispute on bringing to subsidiary liability the persons controlling the credit institution in the framework of the general banking bankruptcy case. Based on the results of the hearings, the arbitration court shall issue a ruling on satisfying (in whole or part) the applicant's claims or refusing to satisfy them.

As practice shows, in the overwhelming majority of cases, the actual execution of a court decision to satisfy the claims for bringing to subsidiary liability is impossible. The reason for this is the concealment by the persons controlling the bank of their money and other property that may be levied from the judicial authorities and bailiffs, including abroad. This state of affairs is also favored by long periods of consideration of claims for bringing to the subsidiary liability of the persons controlling the credit institution; multisubject composition of the participants of arbitration proceedings; and statutory requirement for the provision of a large amount of evidence.

Thus, the judicial act, the prospect of execution of which is obviously small, essentially represents only a fiction of judicial protection. Therefore, a trial during which a dishonest defendant has the opportunity to hide his/her property and avoid foreclosure on it, and when the plaintiff has no real legal means of counteracting such behavior of the defendant, does not meet the goals of justice. Judicial effectiveness is manifested to the maximum extent only with the actual restoration of the violated rights of creditors, which in this case is expressed in the return to them of the money invested in the bank on which they reasonably rely.

For this purpose, national courts have an effective procedural mechanism in the form of the interim measures institution, whose timely and prudent application removes obstacles to the enforcement of a court decision in the future. According to Article 90 of the APC RF, interim measures are allowed at any stage of arbitration proceedings if failure to take such measures can complicate or make impossible execution of the judicial act, and also prevent causing significant damage to the applicant.

It should be borne in mind that the court has the right to dismiss the applicant's claim for interim measures. The applicant's application is dismissed in the following cases: firstly, if the applicant has not provided sufficient reasons for making such a claim with the indication of specific circumstances confirming the need for interim measures; secondly, if the applicant has not submitted evidence confirming his/her arguments (paragraph 13 of the Resolution of the Plenum of the Supreme Arbitration Court of the Russian Federation No. 11 dated 09.12.2002 "On Certain Issues Relating to the Implementation of the APC of the Russian Federation").

When deciding on taking interim measures, the court should make sure that if the requirement is satisfied, failure to take this particular measure will make it difficult or impossible to enforce the judicial act.

The intricate nature of the execution of a judicial act or the impossibility of execution thereof may be due to the lack of property of the defendant and his/her active actions aimed at reducing the volume of his/her property.

As practice shows, the clarifications of the highest court described above have become unachievable for the applicant, who usually does not have the opportunity to present indisputable evidence to the court, confirming with certainty the illegal actions of the bank owners or members of the management bodies aimed at concealing their property. However, there are prerequisites for changing the situation. An excellent example is the IpoTekBank bankruptcy case, in which, when considering a cassation appeal by the bankruptcy trustee, the higher court supported the CIA's position on the unreasonable refusal of the lower courts to take interim measures.

B. The issue of proving the facts underlying the application for interim measures

Based on the provisions of Part 2 of Article 90 of the APC of the Russian Federation, the following can serve as grounds for taking interim measures in cases of bringing the persons controlling a credit institution to subsidiary liability: a significant amount of subsidiary liability; possibility of interested parties to take measures to reduce their property; or likelihood of causing significant damage to the bank and its creditors.

Moreover, court interim measures are, by their nature, an expedited and preliminary remedy. In this regard, the rules of proving the grounds for taking interim measures should not be similar to those that apply when proving circumstances on the merits of a judicial dispute, when a party is required to provide clear and convincing evidence of the circumstances of the case or evidence prevailing over the evidence of the adversary.

It appears that to apply interim measures, it is sufficient to confirm reasonable suspicions of the existence of the grounds provided for in subsection 90 (2) of the APC of the Russian Federation. In its ruling dated December 27, 2018, No. 305-ES17-4004 in case No. A40-80460/2015, the highest court drew attention to this circumstance. The bankruptcy trustee may obtain evidence of reasonable suspicions of the intention of the controlling persons to hide their property (to avoid meeting the requirements of creditors). Under paragraph 1 of Article 20.3 of the Bankruptcy Law, he/she has the right to send requests to:

- The Federal Service for State Registration, Cadastre and Cartography with a request for an extract on the rights of a person to his/her (existing) real estate items;

– The Federal Tax Service with a request for information on open (closed) accounts with credit institutions; and

– Credit institutions with a request to provide statements of settlement accounts opened in the name of the defendant.

It is advisable to request the specified information starting from the date when a significant deterioration in the financial condition of the bank occurred and until the date of preparation of the claim for interim measures.

At the same time, if the bankruptcy trustee does not have information on the defendant’s property, then this circumstance, in the author's opinion, cannot serve as an unconditional basis for refusing to take interim measures. In such a situation the applicant may ask the court to take interim measures, setting the total value of the property subject to seizure. The specific composition of the property subject to seizure may be further determined by the bailiff as per the requirements of Federal Law No. 229-FZ dated 02.10.2007 "On Enforcement Proceedings in the Russian Federation".

It is also suggested that when considering cases of bringing the persons controlling a credit institution to subsidiary liability, the courts should take into account the usually prevailing practice of concealment by dishonest managers of their property when bringing them to subsidiary liability for bankrupt bank obligations.

Therefore, the statements of the bankruptcy trustee on the measures taken by the defendants to conceal their property cannot be ignored by the court when making a procedural decision on interim measures, because according to part 2 of Article 4 of the APC of the Russian Federation, the explanations of the persons involved in the case relate to evidence in the arbitration process. In this regard, the court, when making a procedural decision, must properly assess them and state the reasons why the bankruptcy trustee's claims were rejected if deciding to refuse to take interim measures.

It should be noted that the promptness of resolving the issue of application of interim measures with a low standard of proof of the relevant circumstances does not violate the rights of the subsidiary debtor, since in addition to the requirement to judicially verify the validity and proportionality of these measures, the legislation also has established the other guarantees of compliance with its interests. Thus, in particular, at the request of the defendant, the interim measure can be replaced by another measure (Article 95 of the APC RF) or cancelled in the short term by the same court (Article 97 of the APC RF). Besides, the defendants are not limited in their right to use the property in respect of which the interim measures have been taken, unless the bankruptcy trustee in his/her application asks for the opposite. Since the persons brought to subsidiary liability are not business entities and their property is not used in the entrepreneurial activity, the restrictions imposed by the court cannot cause property damage to them.

Moreover, when deciding on interim measures in cases of subsidiary liability of the persons controlling a credit institution, it is necessary to take into account the presumption of the controlling persons' guilt in the bankruptcy of the debtor and the impossibility of fully repaying the claims of creditors established by paragraph 2 of Article 61.1 of the Bankruptcy Law. In this regard, interim measures are an adequate and proportionate means of protecting the property interests of the credit institution and its creditors. At the same time, the refutation of the evidentiary presumption of the reckless conduct of the alleged violators of the rights of the credit institution and creditors thereof lies with the defendants themselves, who for this purpose have the right to use all procedural means of evidence provided for by the Arbitration Procedure Code of the Russian Federation.

V. CONCLUSION

The research on the cases of bank failure has focused on the Russian Federation. The authors examine the procedural rules for the adoption of interim measures if the persons controlling a credit institution are brought to subsidiary liability. Practical advice is given, along with routines of the applicants` rights protection in such cases. All of this will not only improve the efficiency of bankruptcy procedures of banks but also develop mechanisms of corporate governance in the banking sector toward increased personal responsibility of management decisions makers and those controlling credit institutions.

The conducted research develops the theory of banking failure and clarifies the legal regulation of vicarious liability.

The shortcomings of the Russian procedural legislation concerning the interim measures taken by courts in banking bankruptcy cases are highlighted. The identified problems can be solved by amending the national procedural legislation or by adopting special explanations by the Supreme Court of the Russian Federation.

The authors recognize the uncertainty of procedural law in determining the extent and degree of reliability of the evidence to be presented by the bankruptcy trustee handling statement on the adoption of interim measures. In this regard, it is believed that the court has enough powers to adopt interim measures by setting the total value of the property subject to seizure. The specific composition of the "locked-in" property, its availability, and cost can be specified in the enforcement procedure.

REFERENCES

1. D. T. Llewellyn, “Handbook of Safeguarding Global Financial Stability”, 2013, pp. 451-464. Available: https://doi.org/10.1016/B978-0-12-397875-2.00027-1
2. I.L. Shilovskaya, S. J. Starodumova, M. A. Volkova, P. V. Zhesterov, “The judicial practice of the European Court in the sphere of non-material reputational harm”, Man in India, vol. 96(12), 2016, pp. 5635-5645.
3. E. A. Sukhanov, “The responsibility of the corporation members for its debts in modern corporate law”, Problems of modern civil law, Moscow, 2013, pp. 103.
4. I.L. Burova, P. V. Zhesterov, “Application of the legislation of the Russian Federation on the vicarious liability of the persons controlling a credit institution”, Economic and social development. Book of Proceedings, 2018, pp. 685-690.
5. T. B. Shibanova, A. S. Vasilyeva, “Subsidiary responsibility of the controlling entity as an additional risk factor in the activities of agricultural organizations”, Proceedings of the International Academy of agrarian education, vol. 39, 2018, pp. 175-177.
6. O. V. Gutnikov, “Subsidiary responsibility in the legislation on legal entities: issues of legal regulation and legal nature”, Law: Journal of Higher School of Economics, vol. 1, 2018, pp. 45-77.
7. D. O. Yarovoi, “Subsidiary responsibility as an instrument for improving corporate governance”, Management Sciences in the Modern World, vol. 1(1), 2018, pp. 513-317.
8. I.F. Subareva, “The tendency to reduce credit institutions: protection of depositors' rights, legal problems of banking supervision and legal responsibility of the Bank of Russia”, Banking law, vol. 5, 2017, pp. 46-52.
9. Deposit Insurance Agency: Banks` liquidation. Retrieved 28.05.2019 from https://www.asv.org.ru/liquidation/
10. E. A. Isaeva, Yu. A. Sharamok, “The development of innovative methods to prevent bankruptcy of credit institutions in Russia”, Internet-journal «Science», vol. 8(5), 2016. Retrieved 28.08.2018 from: http://naukovedenie.ru/PDF/100EVN516.pdf