

Persons controlling Russian financial institutions at greater risk of liability

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Under [amendments](#)* that came into force on 1 July 2021, it is now considerably easier to hold controlling persons liable for the obligations of financial institutions. The law expands the definition of a controlling person, imposes new obligations on financial institutions and gives the Bank of Russia the right to independently determine controlling persons not only in cases of insolvency of financial institutions, but also in the course of their normal economic activities.

The amendments also allow the Bank of Russia to impose subsidiary liability claims against controlling persons and demand seizure of their assets if banks, insurers and non-state pension funds encounter significant financial difficulties.

The contents of the amendments are described in more detail below.

New obligations of financial institutions

The amendments apply to the following financial institutions and their controlling persons:

- credit institutions;
- insurance organisations; and
- non-state pension funds.

These organisations are required on an ongoing basis to identify their controlling persons in accordance with the criteria established by Russian legislation on bankruptcy, update information on these persons and send it to the Bank of Russia. The Bank of Russia has established the form, procedure and timing of such notifications (please see [here](#)* and [here](#)*).

Distinguishing features of a controlling person

A person is deemed to be a controlling person in relation to a financial institution in accordance with the provisions of insolvency legislation, including [Article 61.10](#)* of the Bankruptcy Law.

A controlling person is an individual or a legal entity that has had the right, not more than three years prior to the emergence of bankruptcy signs, to give binding instructions to a financial institution or the ability to otherwise determine its actions (e.g. effecting transactions and determining their terms).

Before these amendments were passed, the status of controlling persons was established by a court in the case of an institution's bankruptcy when deciding whether to bring subsidiary liability against former management and beneficiaries for the debts of the bankrupt entity. The list of controlling persons will now be predetermined through the ordinary economic activity of a financial institution to make it easier to establish the responsible persons in a bankruptcy.

The amendments expand the range of those who can potentially be recognised as controlling by adding to it those who exercised or are exercising control over the financial institution determined in accordance with International Financial Reporting Standards (IFRS), which are recognised in Russia.

In particular, according to IFRS 10, control is understood as the existence of an investor's right to receive income from the investee, the risk of changes in such income and the possibility to influence the income from the investee due to the investor's powers.

In addition, the Bankruptcy Law is supplemented with a new presumption according to which a controlling person is a person included by the Bank of Russia in the list of controlling persons of the relevant financial institution, until it is proved otherwise.

The person included in the list of controlling persons has the right to challenge this inclusion with the Bank of Russia and, in case of refusal, in court.

New powers of the Bank of Russia

The amendments give the Bank of Russia the following new functions.

Maintenance of lists of controlling persons

In relation to each financial institution, the Bank of Russia will maintain a list of controlling persons and post this information on its official [website*](#).

The list will include controlling persons whose information was received from the financial institution itself. The Bank of Russia may also independently recognise a person as a controlling person and include it in the list. Information on controlling persons will be provided to Rosfinmonitoring, the financial sector supervisory authority in Russia. The Russian government is given the right to determine cases when the Bank of Russia is entitled not to post information on the inclusion of a person in the list of controlling persons.

Adoption of decisions on declaring a person as controlling

The Bank of Russia has the right to declare a person as being in control of a financial institution. The decision must contain a justification, including information on the circumstances on which it is based.

Financial institutions must inform the persons concerned that they have been declared controlling persons no later than one business day following the day on which they receive the relevant information from the Bank of Russia.

Right of the Bank of Russia to apply for subsidiary liability and provisional measures

The amendments provide for the right of the Bank of Russia to apply to bring controlling persons to subsidiary liability and liability in the form of compensation for losses in accordance with the Bankruptcy Law.

The amendments also give the Bank of Russia the right to apply to the court for the seizure of assets of the controlling person before the filing of the above applications with the court (preliminary interim measures).

Thus, if a financial institution's equity capital is negative, the Bank of Russia is entitled to apply for the arrest of the assets of the controlling persons in the amount necessary to replenish the financial institution's equity capital and bring it to the statutory amount. The Bank of Russia does not need to provide collateral in this case.

Challenging the inclusion of a person in the list of controlling persons will also not prevent a commercial court from accepting the Bank of Russia's application for the imposition of preliminary interim measures.

A person whose property was affected by provisional security measures may claim from the Bank of Russia, at its discretion, compensation for losses or payment of compensation in the following cases:

- if the Bank of Russia fails to file a claim within one month in connection with an imposed arrest (i.e. to bring to subsidiary liability or liability in the form of compensation for losses in accordance with the Law on Bankruptcy); or
- if the court rejects the Bank of Russia's claim.

The court will determine the amount of compensation depending on the nature of the violation and other circumstances of the case in the range from RUB 1,000 (EUR 12) to RUB 1m (EUR 11,560).

Comments

The amendments create substantial risks for persons participating both in the capital and management of financial institutions. They should therefore monitor the listing of controlling persons on a regular basis and, if there are grounds for doing so, challenge inclusions in a timely manner.

The new provisions of the law simplify the seizure of personal property of a controlling person in case of a significant deterioration in the situation of a financial institution (i.e. when the value of its capital becomes negative). The possible compensation in the event of establishing the unlawfulness of such a seizure can be as much as RUB 1m (EUR 11,560), which can hardly be considered proportionate.

It is obvious that the new norms are aimed at combatting bad-faith practices on the financial market. However, the risk of top managers, board members and shareholders of financial institutions facing subsidiary liability has increased exponentially. Potential and current controlling persons should be extremely careful and prudent when conducting the business of a financial institution. It is recommended that top managers protect their interests when they take office (e.g. by concluding an insurance contract covering the liability of managers and executives).

Importantly, in current court practice, there is a tendency to expand the scope of the Law on Bankruptcy. For example, when some banks were rehabilitated, their former owners and management became defendants in exorbitant claims for losses based on insolvency regulations, even though the bank had been successfully rehabilitated and remained in operation. The amendments unfortunately do not limit this trend in any way.

For further information, please email the authors or your usual contact at CMS Russia.

* In Russian

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