



WORLD BANK GROUP
Finance, Competitiveness & Innovation

Importance of Legal aspects of NPL Resolution

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Legal aspects of NPL resolution

Three topics:

Importance of both, substantive and procedural debt resolution systems – and their implementation: Particularities of the EU “dual legal system”.

Main **challenges** to efficiently enforce and restructure/liquidate businesses

A few **lessons** learned – what are the key aspects to distinguish what has worked and what hasn't.

Debt resolution and its different approaches (substantive law)

Out-of-Court Enforcement:
contractual agreement
(Debtor can challenge / judicialize for limited reasons)

In-court enforcement

(secured and unsecured)

Out-of-court workouts:
contractual voluntary agreements

Hybrid procedures:
private workouts with the involvement of the judiciary or administration authorities

Judicial reorganizations:
formal reorganizations of viable enterprises under court supervision

Liquidations:
liquidations through the courts with no restructuring

Efficient insolvency and creditors' rights systems are critical for financial stability – among others

The Financial Stability Board (FSB) considers **sound insolvency and creditor/debtor regimes** “**fundamental** to robust and diverse modes of financial intermediation, responsible access to finance, and **financial stability**”.

FSB recognizes the WBG as **standard setter** in the Insolvency and Creditor's Rights space (jointly with UNCITRAL) and recognizes ICR as one of their “Key Standards for Sound Financial Systems”.

Studies show that more developed insolvency systems help increase creditor's **recovery rate** and **reduce non-performing loans (NPLs)**, improve **investment climate**, preserve **jobs**, permit **going concern** if predictably applied.

Modern day financial **crises** have stressed the importance of debt enforcement and insolvency regimes in maintaining financial system stability.

Importance of effective Debt Recovery



- Improves predictability
- Reduces NPLs
- Encourages new business relationships
- Enables rapid asset redeployment
- EUROPEAN PARTICULARITIES:
- Recognition of **ENFORCEMENT** in the EU
- **INSOLVENCY RECAST.**

Some challenges in individual enforcement

Poorly designed enforcement systems: too many hearings, notifications, appeals, outdated execution laws, etc.: Debtor's abuse of inefficient systems that take forever.

Absence or denaturalization of out of court enforcement; secured transactions systems that are widespread.

Malfunctioning institutions, debtor-friendly tribunals – vs. Opposite problem: Too effective, Croatian FINA?

Bailiffs' incentives, attitude, supervision are not aligned with recoveries (fees). Private vs. public.

Problems with Auctions, optimistic valuations, fraud.

If Crisis, unpredictability of recovery actions.

- *Mortgage enforcement actions suspended (UKR / GRC – ARG)*
- *Impossibility / difficulty to “enforce judgements”.*

Some challenges in insolvency systems

- Absence of insolvency cases – unpredictability that hampers OCW (Albania, China)
- Old bankruptcy laws that are geared towards liquidation and not give restructuring room. (Draft nowadays discussing sale of assets in restructuring via auction)
- Laws that have major flaws (absence of DIP financing, or where secured or financial creditors come low in the food chain, or that allow debtor to play with the assets, or lack of voidance actions, etc.)
- Countries with bankruptcy practice but where institutions are known to either lack expertise or to be corrupt (Sales at undervalue, auctions, are major weaknesses). Former bankruptcy judges in jail in some countries. “Whenever I want to punish a judge I give her a bankruptcy case”. (President of Commercial Court)

Which features and context do out of court guidelines need to properly work?

OCW = Multi creditor restructuring agreement (more in depth later in this session)

Light touch London approach / INSOL Principles. Implemented in several countries: standstill - good faith – DIP Financing - plan – agreement.

Institution intensive guidelines: Korea / Istanbul approach. India.

China's Creditor Committees (ongoing).

Intermediate examples: Kiev approach

COMMON PATTERNS: Mandatory (contractually or regulatory), detailed, strong push from regulators, limited time, strong incentives ... And Timely.

What are the key lessons learned from international experience?

- ***Time is the enemy of recovery and insolvency proceeding***

- **Critical success factor: *Identify the bottlenecks.***
- Delays in enforcement actions and insolvency proceedings reduce the available options (value of the asset, sale as a going concern; operational restructuring) due to the loss of key employees and customers of the business, and it hampers the success of those options – or sale to third parties (value)
- Improving the speed of enforcement and insolvency proceedings during a crisis can be mitigated by reassigning additional judges and court staff to handle the increased volume of cases.

- ***Think outside the (court) box.***

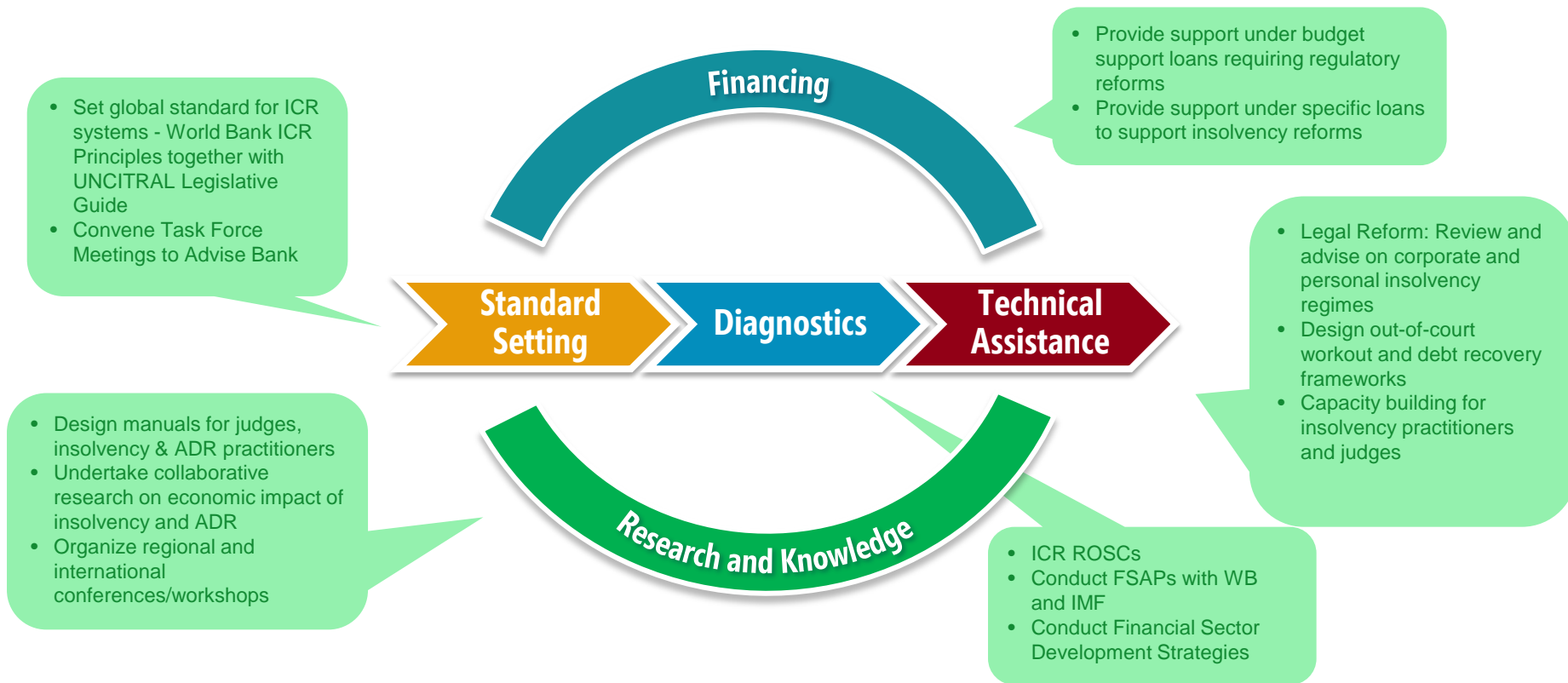
- **Critical success factor: *Catalyze out-of-court enforcements and workouts.***
- In countries where it is constitutional, provide expedited enforcement avenues outside of the court. Also, stigmas prevent debtors from going into formal insolvency proceedings (which are public) until it is too late to save the company. Informal rules for negotiated workouts can provide an incentive for debtors—often the first to notice signs of trouble in the business—to seek solutions with creditors early enough to save the company.

What are the key lessons learned from international experience?

• ***Implementation, implementation, implementation!***

- Critical success factor: *Invest time implementing reforms after laws are enacted.*
- Insolvency administrators need to be well regulated under discipline codes, well remunerated, incentivizing appropriate behavior – supervision must be strict.
- Judges, IP's and other stakeholders need specialized training, including basic business and accounting training.
- Bailiffs regulation must be in place and work well.

Insolvency & Debt Resolution Work Streams



Thank you!

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