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COVID-19 and NPL Resolution in the ECA region

The enabling environment: insolvency and creditors' rights

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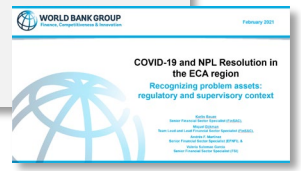
Lessons for the COVID-19 era

- It is critical that **bankers and policymakers respond to the challenges early on**, to contain financial stability risks and enable banks to fulfil their basic intermediary function.
- This requires a decisive policy response in the **following three areas**:

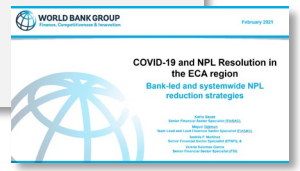
Recognizing problem assets – regulatory and supervisory context:

- **Robust banking regulation and supervision** needed to ensure the proper identification of NPLs and provisioning for credit losses



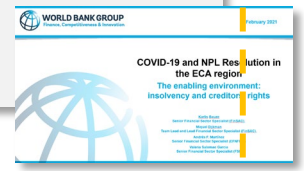
Bank-led and systemwide NPL Resolution strategies:

- **Strengthening of banks' operational readiness** to work out rising volumes of problem assets



The enabling environment – insolvency and creditors' rights:

- **Legal environment** that enables banks to work out bad loans and that avoids steering distressed but viable borrowers towards liquidation



1. **Strong regulatory definitions**
2. **Orderly exit from current borrower relief measures**
3. **Dedicated workout units**
4. **Loan restructuring**
5. **Legal and institutional frameworks**
6. **Bridge gaps between insolvency framework and actual practices**
7. **Coordination between stakeholders**

Agenda

1. **Introduction**
2. The importance of legal systems for NPL resolution
3. Legal and institutional reforms in ECA between the GFC and COVID-19
4. Legal measures in ECA region following the pandemic
5. Policy priorities going forward

Introduction

Pre-GFC legal framework

GFC highlighted the critical importance of well-functioning insolvency frameworks and creditor rights for NPL resolution

- **Weaknesses**:
  - × **Absence of a business rescue culture**.
  - × **Heavy reliance on poorly functioning courts**, with time-consuming judicial processes and unpredictable rulings.
- Consequences:
  - Banks reluctant to take decisive measures early on, allowing the underlying problems to fester.
  - Weaknesses in creditor rights prevented banks from initiating legal enforcement measures vis-à-vis non-viable and uncooperative borrowers, which were often **kept afloat with** extend-and-pretend practices rather than dealt with resolutely.
  - **Weaknesses in creditor rights also hindered the development of secondary markets for NPLs** and **weakened repayment discipline** (willful defaulters).
- Meanwhile, a lack of exit for non-viable borrowers coexisted with **significant missed opportunities in terms of preserving economic activity, jobs, and livelihoods**.
- **Efforts to rehabilitate distressed but potentially viable borrowers often failed** in the **absence of modern out-of-court restructuring** frameworks, while courts (that were often lacking in economic and financial expertise and resources) steered such borrowers towards liquidation if the insolvency system was used at all.

2008 GFC

In the aftermath of GFC many ECA countries embarked on comprehensive legal reforms to modernize their insolvency and creditors' right systems

- Most ECA **countries have reformed**, among others, **their**:
  - ✓ **Enforcement laws**.
  - ✓ **Bailiff systems**.
  - ✓ **Civil procedure codes**.
  - ✓ **Insolvency legislation**.
- Other countries - Albania, Greece, Hungary, Serbia - also strengthened their frameworks for (NPL reduction strategies):
  - ✓ **Loan recovery** and **financial distress**.
  - ✓ **Debt resolution**.
  - ✓ **Insolvency systems**.

These reforms gave a new impetus to countries' NPL resolution drive and have been an important factor behind the lowering of reported NPL ratios in many ECA countries in the years prior to the pandemic.

Introduction

COVID-19 challenges to legal framework

The pressures on asset quality will put countries' overhauled legal systems to the test

- **Rising levels of borrower distress** will inevitably increase the number of **enforcement cases**, **litigation**, and **insolvency**.
- The **increase in caseloads** will likely **strain existing administrative and institutional capacity**.
- **Bottlenecks** may emerge, leading to:
  - × **Time-consuming** judicial **proceedings**.
  - × **Lower recoveries for creditors**.
- And could affect prospects for distressed but potentially viable debtors to rehabilitate

Enabling environment for NPL resolution

1. **Ability of creditors to recover their claims**
2. **Enabling environment for rehabilitating distressed but potentially viable borrowers**
3. **Legal preconditions for facilitating sales of portfolios of NPLs**

Need to work all together seamlessly to successfully manage rising volumes of NPLs and, ultimately, restore economic activity and lending

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The importance of legal systems for NPL resolution

Need for a legal environment supporting banks' efforts in resolving NPLs

Addressing high volumes of NPLs requires a robust legal framework

1. Contracts need to be binding and enforceable
2. Collateral should serve its ultimate purpose of guaranteeing transactions and should be easily enforceable upon default
3. The legal and regulatory system should not introduce elements that impede or significantly discourage NPL transactions
4. Tax and banking regulations should not be major impediments to write-offs and out-of-court agreements between firms in financial distress and their main creditors
5. There have to be mechanisms to quickly seize and sell any pledged collateral or (in the case of unsecured loans) enforce against property of the debtor
6. Enforcement and insolvency frameworks are also key for maintaining repayment discipline and for developing markets for portfolios of NPLs

The insolvency system should permit distressed but viable firms to be brought back to commercial viability and promote the swift liquidation of unviable borrowers

Each of these elements should be applied by a cadre of trained, efficient, and transparent institutions that encompass bailiffs, tax authorities, insolvency administrators, and, critically, courts

The importance of legal systems for NPL resolution

Impediments from legal and institutional systems for banks to resolve NPLs

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In practice, most legal systems have shortcomings in one or more areas that affect NPL resolution

Common problems[1]

1. **Difficulties in enforcing debtor's assets in an extra-judicial or judicial process** (either because of weak laws or poor enforcement systems)
2. **Poor collateral legislation or dysfunctional registries** (real estate, pledges, etc.)
3. **Difficulties in restructuring a company** due to impediments in the insolvency system or in the tax legislation
4. **Poorly designed or outdated liquidation regimes**, including possible unclear repayment priorities – e.g., privileged creditors (such as government tax and employee wage claims) may have priority over secured lenders
5. **Environment unconducive to workouts**
6. **Central bank** (or supervisory) regulations that discourage distressed asset sales
7. **Regulatory challenges related to NPL portfolio purchases** (for example, requirements that the purchaser is registered as a local financial entity)
8. **Unfavorable tax treatment of NPL transactions**
9. **Requirements for the ultimate debtor's consent to transfer purchased assets**
10. **Difficulties in restructuring a company** due to the lack of capacity of key local players such as insolvency practitioners or judges
11. **Absence of priority for rescue financing or debtor-in-possession** financing to distressed companies
12. **Moral hazard** (willful defaulters) has been **particularly problematic in ECA countries** where borrowers have had ample opportunity to delay enforcement proceedings by **engaging in delay tactics** (repeated appeals, postponements), or on **account of slow, ineffective, or corrupt courts**

(1) Among many others: see chapter 2, Cerruti et. al., 2019 (link)

The importance of legal systems for NPL resolution

Proper incentives for banks to aim for quality restructurings

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Challenges in post GFC in the proper provision of incentives by the legal and regulatory environment for banks to aim for quality restructurings

- Poorly functioning enforcement and insolvency frameworks **biased banks' decisions vis-a-vis non-viable borrowers towards low-quality restructurings**.
- This locked up the credit stock in **underperforming economic sectors**, contributing to the **rise of zombie borrowers**, **at the expense of more dynamic borrowers**.

- Lack of exit for non-viable borrowers coexisted with **significant missed opportunities in terms of preserving economic activity, jobs, and livelihoods**.
- **Efforts to rehabilitate distressed but potentially viable borrowers often failed** in the **absence of modern out-of-court restructuring** frameworks, while courts (that were often lacking in economic and financial expertise and resources) steered such borrowers towards liquidation if the insolvency system was used at all.

- Loans in **ECA countries are often not syndicated**. **Large borrowers often have loans with various banks**, each of which may have different strategies and collateral positions vis-a-vis the same borrower, which can make it **difficult to achieve a successful workout**.

The importance of legal systems for NPL resolution

Reorganizations in modern insolvency frameworks

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Well-functioning, modern insolvency frameworks enable the rehabilitation of distressed but potentially viable borrowers through financial and operational restructuring

Reorganization

- In **addition to the traditional sale** of the borrower's assets or business and distribution of the proceeds among creditors (liquidation), there needs to be a reorganization possibility.
- Included in **modern insolvency frameworks to restore the commercial and financial viability of distressed borrowers**.
- Reorganizations usually comprise two components:
  - **Financial restructuring**, i.e. the restructuring of the borrowers' liabilities.
  - **Operational restructuring**, i.e. fundamental changes in the company's operations (divestment, discontinuation of non-core activities, reductions in staff, etc.) to restore its commercial viability.

Expedited reorganization proceedings ("pre-packs")

- Allow the **debtor and creditors to negotiate out-of-court**, circumventing time-consuming judicial processes.
- As per a specific process, typically prescribed by the insolvency law, these **agreements are brought to the court for approval**.
- Once the legal requirements are met and court approval has been obtained, these agreements **bind dissenting and non-participating creditors**.
- One of the key objectives is to achieve out-of-court the **necessary majorities amongst each class of creditors for the approval of a reorganization plan**, comprising financial and operational restructuring, which is ultimately validated by the court (and that is what gives validity against third parties).

The importance of legal systems for NPL resolution

Tax regimes and restructuring

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Legal frameworks need to enable debt reduction and should be supported by tax regimes that do not unduly disincentivize restructuring

Challenges faced

- A workout or a **reorganization that is considered "taxable", may discourage the parties from closing a deal**.
- **Establishing a similar treatment of workout restructurings and formal reorganizations** to avoid incentivizing the parties to file a judicial process if the tax treatment is preferential.
- The **legal difficulties for tax authorities** and **state-owned banks to grant debt reductions in out-of-court workouts** (and, sometimes, also in in-court reorganizations)

- While a few countries have adopted legislation expressly permitting tax authorities to grant "market-based" **debt reductions or concessions in the context of a reorganization, these have not been widely used**

The reluctance to grant concessions seems to be due to fears that tax authorities and state-owned banks could face political retaliation and charges of destroying state property

The importance of legal systems for NPL resolution

Preconditions for applicability of write-offs

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There are often legal requirements that banks first exhaust all possible measures before write-offs are allowed and tax deductibility is granted

Challenges faced

- In practice, **write-offs and the granting of tax deductibility do often require banks to first exhaust all other options**
- This **entails a final court ruling which can be difficult and time-consuming to obtain**.

- Although most jurisdictions now allow deductions for tax purposes for provisions and write-offs, **the conditions that need to be met for the deductions to be allowed can sometimes introduce added complexities** for banks when booking provisions or writing-off loans.

The importance of legal systems for NPL resolution

Preconditions for the sales of portfolios of NPLs

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Several legal and regulatory preconditions need to be met to allow for the sales of portfolios of NPLs

1. **The sale of NPLs requires that the legal system allows the transmission of claims on the borrowers to the investor in such assets without requiring the debtor's consent**
2. **Other potential legal obstacles for NPL sales can include:**
   - a. Bank secrecy and data protection laws
   - b. Requirements on the registration of security interests transferred with the NPLs
   - c. Notification to debtors and the position of guarantors of NPLs
   - d. Preemption rights of borrowers

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Legal and institutional reforms in ECA between the GFC and COVID-19

Overview of post-GFC reforms

Temporary enforcement moratoria in the early stages of the GFC

- Imposing **temporary stays on creditor enforcement against debtors**, aimed at avoiding a premature liquidation of firms. Previous experience in Greece and Ukraine illustrates the difficulties in exiting from these enforcement moratoria, particularly for households.
- With **banks** and other creditors **experiencing serious liquidity pressures** at the time, the concern was that **creditors' scramble for liquidity would increase the risk of pushing distressed but viable firms into liquidation**.
- **Suspension of creditor enforcement**: legal obligation for banks(applied to a broad range of borrowers), with **no role for banks in assessing the borrower's long-term viability, willingness to pay, and whether the financial difficulties could be credibly** attributed to the crisis. Many of those borrowers failed to keep up with repayment obligations once the measures were withdrawn.

Followed by reforms to address weaknesses in debt resolution, insolvency, and creditor rights

- In the **decade following the GFC**, many countries:
  - ✓ **Reformed their enforcement laws**, **bailiff systems**, **civil procedure codes**, and **insolvency legislation**.
  - ✓ Undertook **measures to allow for faster enforcements**, including by introducing **out-of-court mechanisms for enforcement**.
  - ✓ **Implemented institutional changes to strengthen the judiciary and capacity of the main actors** (judges, bailiffs, insolvency administrators etc.), with reforms often still ongoing at the start of the pandemic.

Reforms addressed a broad range of areas

i. **Modernization of insolvency laws**, including through the introduction of proper reorganization systems;
ii. Introduction of the **possibility of financing viable companies in financial distress while undergoing a reorganization**.
iii. "**Best interest of creditors test**" that determines that no creditor should have a plan imposed that offers a pay-off lower than the liquidation of the company.
iv. Accelerated reorganization proceedings.
v. Expedited treatment for no-asset cases.
vi. Electronic auctions.
vii. Possibility to sell the business as a going concern, even during liquidation, etc.

These reforms, together with changes in the strengthening of enforcement proceedings considerably strengthened the legal framework of many countries in ECA

Legal and institutional reforms in ECA between the GFC and COVID-19

Effects of EU developments in ECA countries

Recent developments in the EU may give these legal reforms a new impulse

Directive on Restructuring and Insolvency (2019/1023)

- Aimed to **harmonize some aspects of pre-insolvency proceedings.**
- **Addressed preventive restructuring frameworks**, discharge of debt and disqualifications, and measures to increase the efficiency of procedures concerning restructuring, insolvency, and discharge of debt.
- **Obliges all EU Member States to incorporate pre-insolvency proceedings**. Once fully implemented, it will lay a framework that enables the early restructuring of firms that are facing imminent financial distress.
- **Objective**: **debtors file earlier for pre-insolvency proceedings**, as it is often the case debtors only file for reorganization at a late stage when there is little left to save and recovery prospects are poor.
- Already passed before the pandemic, in March 2019. **Pandemic will help to accelerate its implementation**.

An EU Directive to strengthen collateral enforcement has been proposed

- The proposal promotes the introduction of **accelerated, extrajudicial collateral enforcement**.
- This **would help to:**
  - ✓ Avoid the unnecessary erosion of collateral values due to time-consuming enforcement procedures.
  - ✓ Strengthen recovery rates.
  - ✓ Reduce credit losses for originating banks.
  - ✓ Increase the attractiveness of bad loans.

Once in place, the expectation is that banks and other credit institutions would seek to allow for accelerated, extrajudicial collateral enforcement on newly originated loans

Legal and institutional reforms in ECA between the GFC and COVID-19

Boundaries for effectiveness of EU developments in ECA countries

Despite ECA region's many legal reforms over the past decade, institutional capacity to put these enhanced legal frameworks to effective use is often weak

- **Borrowers** still view the **insolvency system as a stigma.**
- **Banks** seek to **avoid insolvency system** due to **past problematic experiences** and concern over handing control to a judiciary that is perceived to be inefficient.
- **Judges** often **lack training and specialization** in commercial cases **and** have **limited resources** to perform their duties.
- **Insolvency administrators** are often **poorly remunerated**, **not properly supervised**, and **lack the proper qualifications**.
- The introduction of **private bailiffs** - to attract younger, more dynamic, and transparent professionals - has not always lived up to expectations as former public bailiffs have often been rehired as private ones.

Despite commendable progress in modernizing enforcement and insolvency laws, **weaknesses in the supporting institutions**, including skills gaps in courts, untrained and minimally supervised insolvency administrators, and a lack of familiarity among creditor and debtor advisors with newly introduced restructuring tools, **may prevent them from reaping the full benefits of past reforms**

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Legal measures in ECA region following the pandemic

Measures and innovations across countries

Innovations in court systems, that can improve access to justice and reduce delays and costs

- Several countries have forged ahead with **digitization by strengthening their electronic court systems**.
- Some ECA countries have **introduced or enhanced the infrastructure for electronic filing for insolvency and remote creditor meetings**, among other improvements.
- Ensuring access to judgments online also **increases the transparency of justice systems** and can contribute to enhanced consistency in case-law.
- **Latvia** and **Scotland** are examples.

Short-term legal measures, including enforcement moratoria, to flatten the so-called bankruptcy curve

- Some countries have introduced or raised threshold requirements for creditors commencing insolvency processes:
  - ✓ Poland: adopted the Anti-Crisis Shield 4.0, **which suspended the 30-day deadline for filing a petition for bankruptcy.**
  - ✓ Belgium, the Czech Republic, Italy, Russia, and Spain introduced **short-term restrictions for creditors to petition bankruptcy proceedings**.
- **Several common law countries** have for a limited time **suspended the legal requirement of directors to put companies into insolvency** and the associated personal liability.
- Several countries **suspended or extended procedural terms**:
  - ✓ **Bulgaria**: general **stay on procedural terms and suspension of court hearings**, effective for the period of the emergency (all procedural terms on administrative, litigation, arbitration, and enforcement proceedings).
  - ✓ **Croatia**: **suspended all sales of assets and enforcement proceedings**, including electronic public auctions, as well as enforcement procedures, while the default interest rate has been temporarily abolished.
  - ✓ **Italy**: **temporarily suspended hearings** and **procedural terms** and eliminated the duty to recapitalize in order to avoid liquidation.

Legal measures in ECA region following the pandemic

Potential unintended side effects

Although the policy objective to preserve economic activity is highly relevant under the current extraordinary circumstances, these short-term legal measures can have unintended side effects if they remain in place for too long

Context…

- **Many insolvency systems**, in their standard form, **already provide for a suspension in creditors' enforcements**, giving debtors breathing space to reorganize.
- In countries where reorganization proceedings work properly, **the stay in creditor enforcement is used to design a restructuring plan**. This is, however, not always the case.
- The **additional time** granted by enf**orcement moratoria may add to delays in proceedings**.
- While these short-term measures played a useful role at the beginning of the crisis…

… and their unintended side effects

- …their **impact needs to be monitored closely** as their prolongation can inadvertently block or **delay the exit for zombie borrowers**.
- These measures can **weaken incentives for debtors to repay to their full financial capacity** due to a reduced threat of legal action, in which willful defaulters may use the opportunity to default.

These side effects highlight the importance of credible exit strategies

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Policy priorities going forward

Exiting from the current short-term legal measures, including enforcement moratoria

1

1. The **short-term legal measures, including enforcement moratoria, are essentially a crisis tool**, designed as a circuit breaker to avoid unnecessary liquidations. They do not provide a long-term solution

2. Once creditors can again enforce and petition bankruptcies, vis-a-vis debtors that they consider to be non-viable, **the backlog of deferred cases could potentially overload court systems**

3. **Countries have generally stressed the temporary and exceptional nature of these short-term legal measures**

4. **Many countries include sunset clauses with clear end dates**, but the **experiences of Greece and Ukraine illustrate that political pressures can be difficult to contain and that there is a real risk** that these enforcement moratoria become permanent fixtures

5. **Communication is critical to ensure that the short-term legal measures are not perceived as a new normal**, to minimize unintended effects on repayment discipline and to avoid that zombie borrowers are given a fresh lease of life

As in the case of moratoria and other exceptional borrower relief measures, the general principle is that these measures should be unwound as soon as economic circumstances permit

Policy priorities going forward

Incentives to promote restructuring of distressed but potentially viable borrowers

2

Once the initial mitigation measures have been lifted, incentives may need to be provided to promote restructuring of distressed but potentially viable borrowers to support the economic recovery

1 Out-of-court restructuring

- The more **predictable the outcome** of out-of-court restructurings, **the less likely creditors are to resort to lengthy and expensive in-court** debt recovery or insolvency proceedings.
- Nevertheless, establishing a **fully functional out-of-court framework** that yields predictable outcomes is a **multiyear process**.

2 Robust legal framework

- Is **a necessary but insufficient condition for predictability**, since laws need to be interpreted and applied by officials and institutions that are often lacking in capacity, resources, and transparency

3 Non-binding central bank guidelines

- Provide a standstill to debtors and engage in negotiations with good-faith, potentially viable, **borrowers have proven to be insufficient in many countries affected by the GFC**

4 Incentives

- Can be provided to debtors and creditors **in the form of time-bound special regimes** that offer debtors and creditors **one-off benefits**, such as tax benefits, **in exchange for agreed workout plans**.
- Can be **accompanied by moral suasion** on banks and creditors, encouraging them to work towards a feasible solution for distressed but potentially viable borrowers

Policy priorities going forward

Ensuring that collateral can be enforced quickly and efficiently

3

- Several ECA countries (e.g. Latvia and North Macedonia) have been **able to make good progress in collateral enforcement**.
- It has been accomplished by:
  - ✓ Enacting **out-of-court enforcement laws** that limit a debtor's defenses.
  - ✓ Having a **fairly transparent online system of auctioning property.**

- In many other countries in the region, **collateral enforcement continues to be problematic**, due to a **lack or poor implementation of past reforms**.
- It remains the case in many ECA countries that:
  - Collateral enforcement is characterized by **time-consuming processes**.
  - Uncertain outcomes, with **outdated auctioning systems leading to low recoveries**.

The EU proposal for a Directive to strengthen collateral enforcement and promote the introduction of accelerated, extrajudicial collateral enforcement may also be relevant for non-EU ECA countries, although its full implementation and operationalization may take time

Policy priorities going forward

Strengthen the institutions applying insolvency laws and gap between legal modernized frameworks and practices

4

Post-GFC reforms have helped to align insolvency laws in ECA with good practices, but continued efforts are needed to strengthen the institutions that apply these laws

- Although there is **considerable cross-country diversity**, a **considerable gap has often emerged between modernized insolvency laws and practice** due to:
  - × **Skills gaps** and **limited resources** in courts.
  - × **Untrained** and **minimally supervised insolvency administrators**.
  - × **Lack of familiarity** among **creditor and debtor advisors**.
- **Insolvency is still a stigma** in many countries and a resource not used sufficiently to save viable businesses.

Continuous efforts are needed to bridge the gap and enhance the supporting institutional framework

5

Frequent legal reforms can exacerbate the gap between modernized frameworks and actual practices

- While **countries across ECA region have repeatedly reformed their insolvency systems**, **institutions often struggle to keep up** - affecting the predictability and certainty of outcomes.
- **Frequent legislative changes** can also **make it hard for judges to apply the correct legislation** to the multiplicity of cases they need to rule on using different statutes.
- In order to **create a predictable system**, it is **necessary that reforms are absorbed, interpreted, and understood by the banking, business, legal, and judicial communities**.

Continuous efforts to modernize insolvency regimes can be counterproductive if this precondition is not met

Policy priorities going forward

Whether to accomplish further legal reforms

6

The capacity of the institutional framework to uphold and consistently apply the existing body of laws is a key consideration in deciding whether the time is ripe for further legal reforms

Countries still facing serious shortcomings

- Reform efforts should **focus on upgrading the institutional framework**, rather than embarking on complex new laws.

Countries with well-functioning institutions

- **Further legal enhancements can be considered**.

EU Directive on Restructuring and Insolvency

- Overarching objective is to **encourage an earlier initiation of reorganization proceedings**.
- It is difficult to overstate the importance of pre-insolvency proceedings considering that **reorganizations are in practice often initiated at a late stage, when there is little left to save**.
- The new Directive seeks to overcome this problem by **requiring legal changes aimed at enabling the initiation of preemptive reorganizations in the event of imminent** (as opposed to actual) **financial distress**.

Policy priorities going forward

Data collection systems improving insolvency frameworks

7

Enhanced data collection systems can help to assess the performance of insolvency frameworks in practice and inform further reforms

1. The current practice in most countries is that insolvency law, and creditor-debtor law in general, is **designed without the support of detailed data on the actual performance of the system or challenges experienced in its application**

2. The continuous **collection and analysis of data** can **help policymakers in targeting legislative changes to address specific problems**

3. **Aggregate statistics** about the number of **insolvency**, **collateral enforcement**, and **restructuring cases** would be very **helpful in assessing the performance of insolvency frameworks in practice**

4. It would be important to **closely monitor the number of agreed** and, ultimately, **performed restructurings**, indicating whether the **mechanisms in place are effectively used** to restore the commercial viability of distressed borrowers

Policy Note "**COVID-19 and Non-Performing Loan Resolution in the Europe and Central Asia region**" is available:

- on the FinSAC website (link).

Policy Note "**Borrower Relief Measures in ECA Region**" is available:

- on the FCI internal website (link);
- on the FinSAC website (link).

Thank you!

Annex

1. Enduring enforcement moratoria for natural persons
2. Insolvency and debt resolution in reform

Annex: enduring enforcement moratoria for natural persons

Lessons from the GFC

Following the GFC, some countries suspended creditors' ability to enforce against certain debtors

- Countries affected by the GFC sometimes saw their **currencies suffer sharp depreciations**.
- Against a backdrop of widespread forex-denominated lending, these depreciations led to the emergence of forex-induced credit risk.
- Consequently, **unhedged retail borrowers** with incomes in domestic currency experienced increasing **difficulties in meeting their debt service obligations**.
- In **Ukraine**, for example, a **moratorium preventing the enforcement of forex-denominated mortgages** against natural persons was imposed in 2014, and has been extended so it remains in force.
- Similarly, there have been specific moratoria in other countries' affected sectors preventing creditors from enforcing against them or from petitioning their bankruptcy.
- **Greece** issued the **Katseli law in 2010**, which provided for a stay in the enforcement of all claims against eligible debtors (natural persons). This moratorium lasted a decade, and there seems general agreement that it was abused by bad-faith debtors.

These experiences illustrate that exiting from enforcement moratoria is politically challenging

- **Absent proper communication that stresses the temporary and exceptional nature** of these measures, the risk looms large that these enforcement moratoria are perceived as a "new normal", preventing their timely withdrawal and fueling strategic behavior by willful defaulters that are financially able to repay but opt not to.
- In addition, **enforcement moratoria prevent creditors from exercising their rights** as agreed in the original contract and, therefore, create unpredictability in the system.
- While legitimate social considerations may have justified their introduction, **experiences in Greece and Ukraine highlight that these measures can be prone to political pressures** favoring their prolongation.

Avoiding a repetition of such a scenario should be a top priority for policymakers in countries that have introduced enforcement moratoria in the aftermath of the pandemic

- **Expectations need to be managed carefully** and policymakers will need to clearly communicate the time-bound and exceptional nature of the measures to borrowers.
- The **experiences of Greece and Ukraine illustrate that absent such efforts**, pressures to prolong enforcement moratoria are difficult to resist.

Annex: insolvency and debt resolution in reform

Post-GFC experiences in ECA

1 Far-reaching structural reforms to revamp their insolvency laws

Several countries in ECA region embarked on far-reaching structural reforms to revamp their insolvency laws:

- The increase in NPLs following the GFC brought home the need to reform insolvency regimes to allow banks to work out rising volumes of NPLs, preserve financially distressed but potentially viable businesses, and curb credit losses for banks.
- Albania, Armenia, Bulgaria, Cyprus, Kazakhstan, Latvia, and Romania among others, opted to significantly modernize their insolvency laws by repealing old statutes and passing new legislation, generally aiming to move away from traditional liquidation regimes and incorporate modern insolvency creditor/debtor regimes with an emphasis on reorganization.

2 Reforming insolvency legislation in several rounds

In countries most deeply affected by the GFC, the general trend has been to reform insolvency legislation in several rounds:

- ECA countries such as Serbia, Ukraine, and others introduced a series of modifications to their legislation in the years following the GFC.
- Most eliminated complex provisions incorporated in their insolvency systems by putting in place simpler and more straightforward procedures, including pre-arranged reorganizations (also called “prepacks”), and then making further amendments to their systems as challenges emerged.

3 A more targeted reforms of their insolvency regime

A handful of countries opted for more targeted reforms of their insolvency regime

- Some countries, such as Estonia, Croatia, and Poland, made major amendments to their systems aimed at avoiding unnecessary liquidations of viable companies.
- This was done, for example, through the creation of additional pre-insolvency proceedings, which the EU later (2019) incorporated in a Directive.

4 Use of out-of-court frameworks to alleviate the pressure on courts in the EU

- System-wide increases in NPL volumes lead to a surge in the number of filings and can overburden court systems, which subsequently struggle to fulfill their basic functions properly.
- Several EU countries that experienced steep increases in NPL volumes in the aftermath of the GFC (including Greece, Latvia, Portugal, Romania and Slovenia) remodeled their out-of-court workout frameworks.
- Out-of-court workouts are particularly useful in times of crises as they involve no judicial intervention and thus offer a faster, cheaper, and more flexible alternative compared to formal insolvency proceedings.