



WORLD BANK GROUP
Finance & Markets

Secured Transactions and Insolvency: a case for coordinated reform

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Presentation Outline

1. Secured transactions and insolvency: Essential coordination
2. Insolvency at the WBG and its links with secured transactions: Standard Setting (ROSC, FSAP), lending, TA work and the Doing Business report.
3. Lessons learned on challenges to coordinated legal reforms: most common obstacles and “tips” on how to discuss with policy makers

SECURED TRANSACTIONS AND INSOLVENCY: ESSENTIAL COORDINATION

Insolvency and secured transactions: intrinsically intertwined

1. Both systems are paramount for credit infrastructure: predictability of commercial transactions, cost of credit, and investment climate.
2. Tension in final objectives: secured creditor's satisfaction does not equal collective creditor's satisfaction. Maximizing value for all creditors vs. doing so for one creditor
3. A crucial principle: Recognition of substantive rights during insolvency. Non-intrusion... but...
4. Breathing time involves stay
5. Continuation as a going concern may involve secured assets essential for the continuation of the company
6. Treatment of secured creditors' participation in/voting reorganization plans isn't consistent across the World
7. Order of priorities is a policy choice

A few major issues related to secured transactions and insolvency reforms (not exhaustive)

1. Pre-insolvency:

- Incentives (priorities); and
- When inefficient enforcement, no threat and creditors may resort to insolvency as means for debt collection

2. During insolvency:

- Effects of commencement: Stay of enforcement actions. For how long? How are secured creditors “protected”? (perishable assets, non-essential assets, etc.)
- Effects of commencement: Rights over secured property: suspension of interests?
- If restructuring, treatment of voting of secured creditors. Can secured creditors be bound? By whom (classes)? Impaired vs. non-impaired.
- Avoidance actions: A security validly constituted under the sec trans system can be invalidated during insolvency.
- Enforcement during insolvency:
 - When can the secured asset be sold? Suspension of initiated / pending enforcement?
 - Who sells? Costs?

Some usual problems with insolvency systems

1. Outright absence of a modern insolvency system, outdated laws, punitive approach with little or no restructuring alternative;
2. Laws that have been copy/pasted or are not rooted in a legal tradition
3. Lack of clarity on aspects such as priorities (or simply “below preferential creditors”), voting classes (where secured creditors can be imposed abusive agreements), extreme debtor protective laws such as those contemplating indefinite stays, etc.
4. Implementation / interpretation of the insolvency law is deficient: Excessive formalism, absence of trained Insolvency administrators, lack of court capacity, lack of knowledge of commercial matters: Case of Automatic postponements, for example.

Some usual problems with insolvency systems (cont)

1. Unclear insolvency tests– no balance sheet or illiquidity, but judicial discretion.
2. No operational reorganization: mere rescheduling or “evergreening”.
3. No provision for “fresh funding” or “superpriority” for DIP Financing.
4. No personal insolvency systems
5. Insolvency being used as a collection tool, sometimes, for the tax authority
6. Few regulatory or disciplinary functions for IPs officeholders who fail to perform adequately

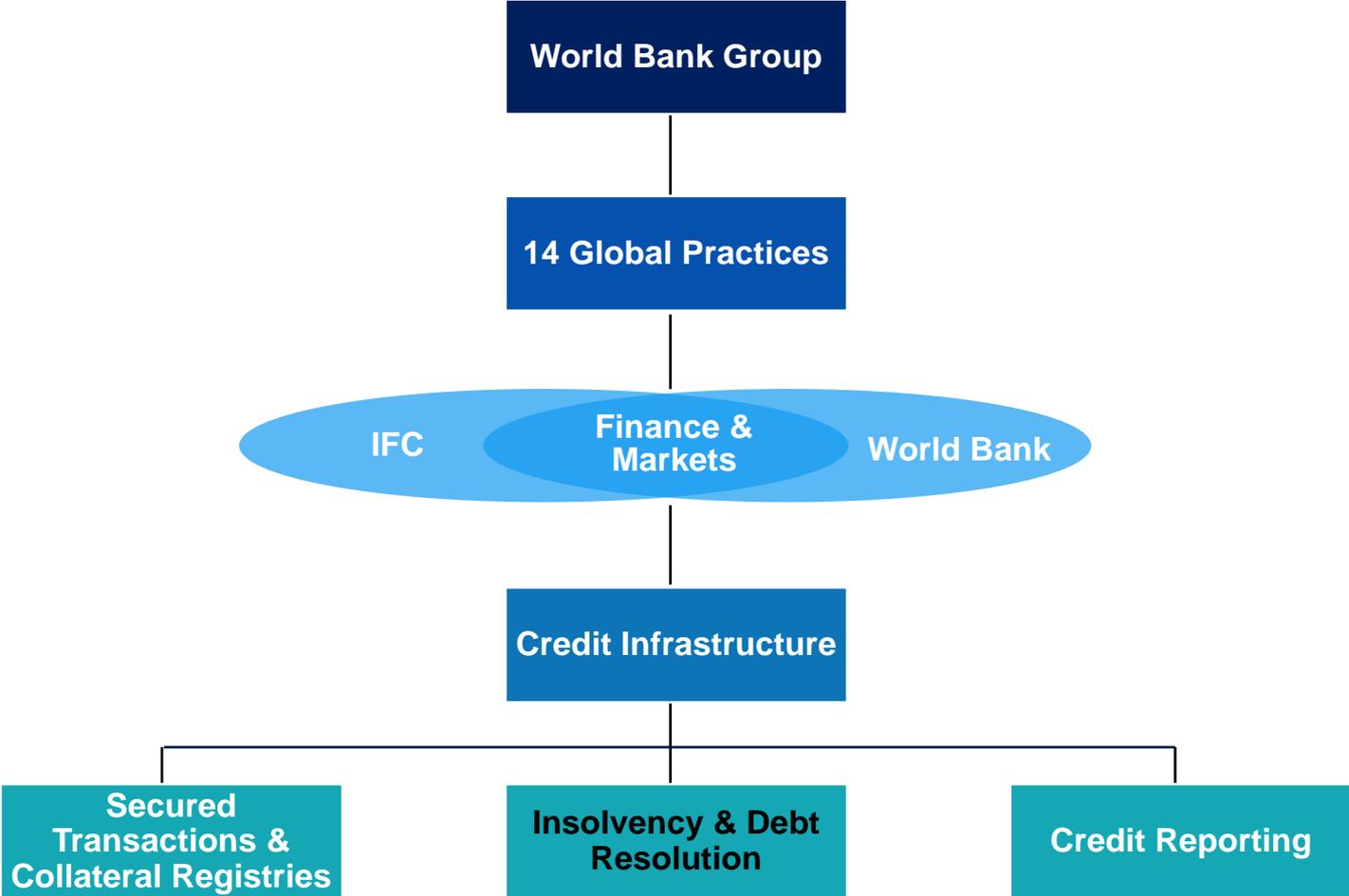
WBG: INSOLVENCY/SECURED TRANSACTIONS REFORM: TOOLS TO ADDRESS THEM TOGETHER

Credit infrastructure plays a crucial role in financial inclusion and access and financial sector stability

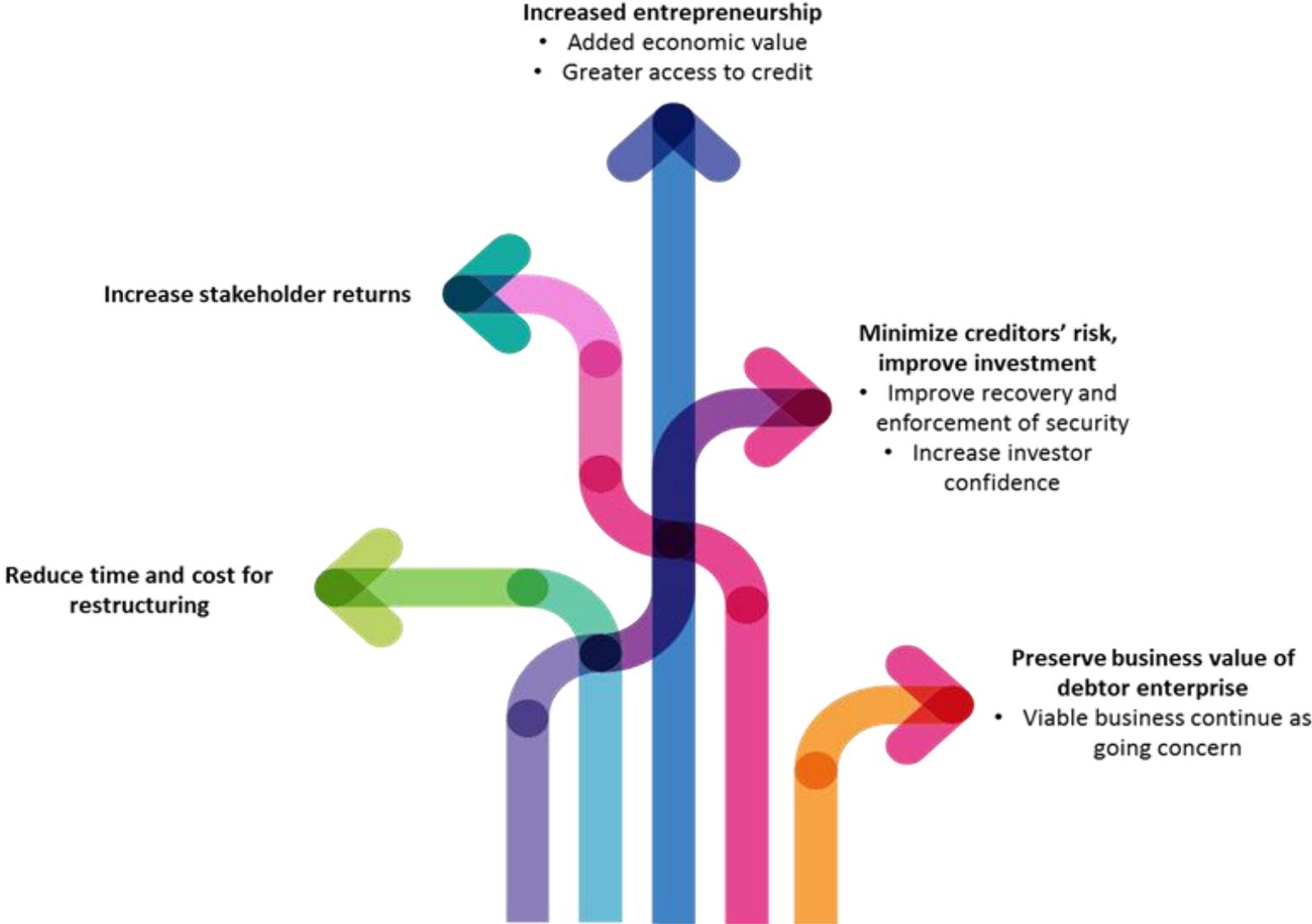
- WBG: Reduction of poverty linked with job creation, preservation and financial inclusion and access.
- Finance and Markets GP of the WBG focuses on building deep, diversified, inclusive, efficient and stable financial systems: Credit infrastructure (C. Info, Sec. Trans, Insolv) is a key part of it. GP improved on this.
- High levels of Non Performing Loans can undermine the effectiveness of the banking sector and, in some cases, pose systemic risks / compromise financial sector stability.
- Modern day financial crises have stressed the importance of collateral, debt enforcement and insolvency regimes.



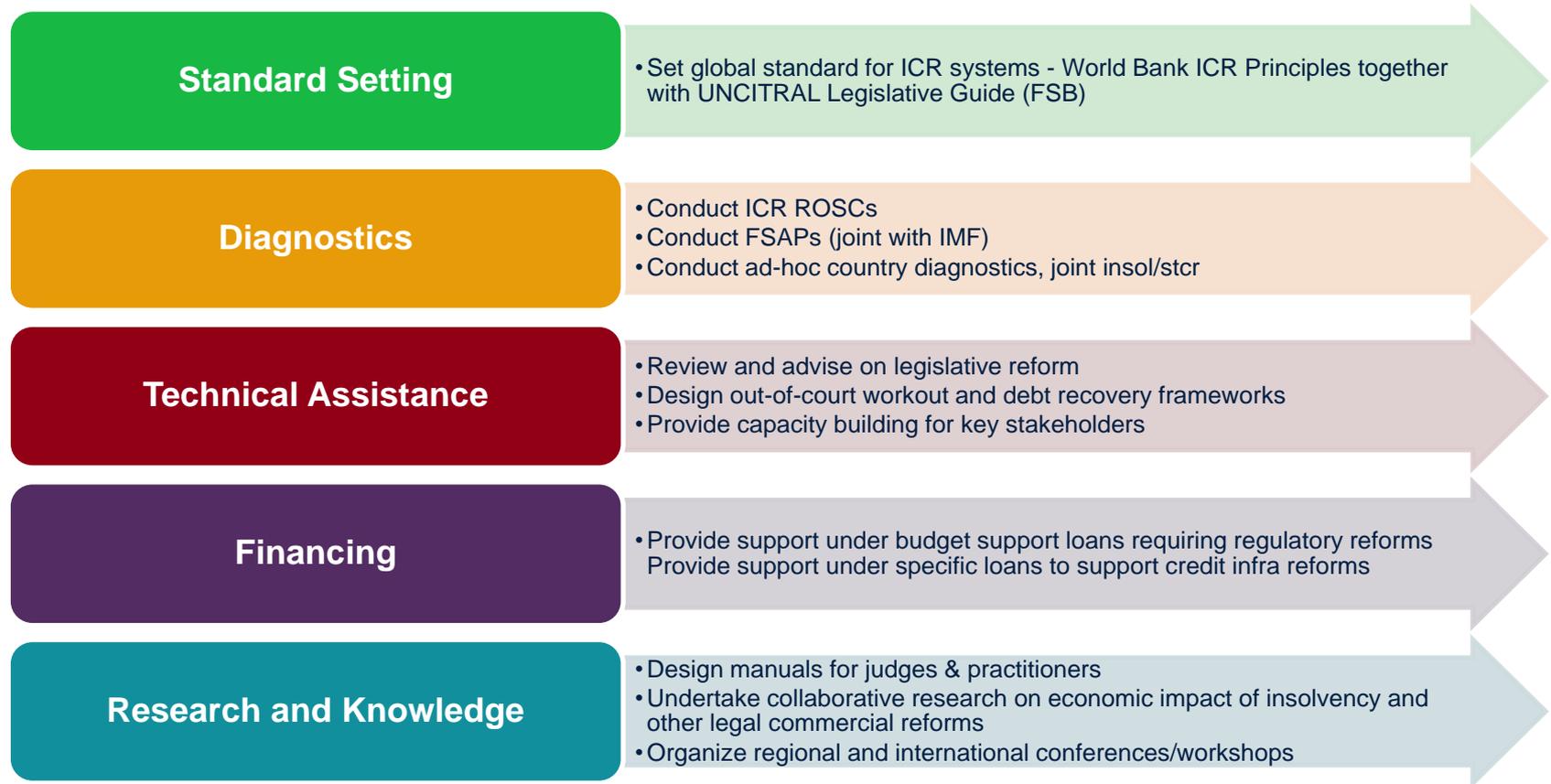
Credit Infrastructure within the World Bank Group



The importance of insolvency reform, beyond STCR



Relevant Work-Streams



Doing Business: Getting credit – 2 insolvency issues covered

A report covering 190 economies, capturing reforms on topics such as insolvency and secured transactions www.doingbusiness.org

“Getting Credit” indicator: Measures the legal rights of borrowers and lenders with respect to secured transactions through one set of indicators.

Are secured creditors paid first (i.e. before tax claims and employee claims) when a business is liquidated?

Are secured creditors subject to an automatic stay on enforcement when a debtor enters a court-supervised reorganization procedure? Does the law protect secured creditors’ rights by providing clear grounds for relief from the stay and/or sets a time limit for it?

Doing Business: Strength of insolvency framework index

A significant determinant of insolvency rankings in the DB report is the “strength of insolvency framework” index

❖ This indicator assesses the countries’ legislation in 4 major categories:

- Commencement of proceedings

Insolvency proceedings should be available to debtors and creditors and on the basis of both balance sheet insolvency and illiquidity

- Management of debtor’s assets

The law should allow the debtor or IP to accept or reject ongoing contracts, avoid preferential or undervalued transactions and obtain post-commencement financing on priority terms

- Reorganization proceedings

The law should allow all creditors to vote on the reorganization plan and also provide equal and fair treatment to dissenting creditors

- Creditor participation

The law must require creditors to approve the selection of IP, the sale of crucial assets and also allow them to object to the admission of claims

CHALLENGES / LESSONS LEARNED IN DISCUSSIONS ABOUT LEGAL REFORMS WITH POLICY MAKERS

Discussing legal reforms with policy makers

1. A caveat: Lessons learned from insolvency, many applicable to secured transactions.
2. Make sure that you have a champion. Someone that can make tough decisions. And a technical team willing to study and endorse proposals.
3. Be upfront on legislation that needs to change: Differences between insolvency and STCR. In some countries, reforms to civil codes or other legislations are extremely difficult to pursue (i.e. aggravated majorities).
4. Explain role and composition of international organizations (i.e. UNCITRAL)

Discussing legal reforms with policy makers (CONT)

1. Sometimes STCR and insolvency may be led by different areas within the same ministry or even by different ministries: How to coordinate this?
2. Convey understanding of the particularities of the specific legal system. It's not about copy-paste solutions.
3. Inherent tension: Involves as many stakeholders as possible, so they provide inputs (and do not block the process later on). Challenge: How to avoid eternal discussions (i.e. 1,000 pages of comments to a regulation). Don't draft by committee!
4. Coordinate with other donors/key participants



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THANK YOU

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