



## Overview of Insolvency and Debt Restructuring Reforms in Response to the COVID-19 Pandemic and Past Financial Crises: Lessons for Emerging Markets<sup>1</sup>

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*This note is part of the series of COVID-19 Notes developed by the World Bank Group’s Equitable Growth, Finance and Institutions (EFI) team.<sup>2</sup> By highlighting concrete examples of insolvency and debt restructuring reforms undertaken in response to the COVID-19 pandemic as well as past crises, this note highlights the importance of sound insolvency and debt restructuring regimes which are lacking in many emerging markets. Countries with under-developed or nascent insolvency frameworks should consider prioritizing the reforms covered in this note to improve their readiness to deal with a spike in business insolvencies.*

*The note reviews insolvency and debt restructuring reforms aimed at addressing the economic effects of the COVID-19 crisis during two stages: the crisis containment stage and the crisis recovery stage. Crisis containment includes short-term insolvency law reforms adopted at the beginning of the COVID-19 outbreak to prevent businesses from being systematically pushed into insolvency. The objective of the reforms implemented during this stage was to “flatten the curve” of insolvency cases and reduce the burden on institutions. Crisis recovery, the second stage, assesses actions taken by some countries during the COVID-19 crisis as well as during previous financial crises to address the medium-to-long term challenges of high levels of firm distress. The objectives of these second-stage reforms are generally to strengthen the institutional capacity and overall functioning of a country’s insolvency regime and to prevent a potential systemic banking crisis caused by elevated levels of non-performing loans.*

*The objective of examining measures over these two stages is to promote understanding that when the temporary emergency measures come to the end, countries will still need the appropriate insolvency and debt restructuring tools available to address the debt overhang.<sup>3</sup> Robust formal insolvency and reorganization procedures should always be a goal, but they may not be enough in times of crisis. These measures also take a long time to implement. By examining lessons learned from past crises and the most recent insolvency and restructuring law reforms, we find that certain types of procedures might be particularly beneficial during the crisis recovery stage:*

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2. Other notes in this series include A. Menezes and S. Muro, “COVID-19 Outbreak: Implications on Corporate and Individual Insolvency” (World Bank, Washington, DC, 2020); F. Dancausa and S. Muro, “COVID-19 Outbreak: Corporate Insolvency How Can Out-Of-Court Workouts Help?” (World Bank, Washington, DC, 2020); and S. Muro, “The Calm before Storm: Early Evidence on Business Insolvency Filings after the Onset of COVID-19” (World Bank, Washington, DC, 2020).

3. Please refer to the Annex 1 of this note for the high-level overview of the most common insolvency and debt restructuring procedures, including their advantages, disadvantages and key considerations for the enabling environment.



- *Hybrid restructuring processes (mixing out-of-court and formal elements);*
- *Simplified restructuring and liquidation processes for MSMEs;*
- *Enhanced Out-of-Court Workouts for corporates; and*
- *Standardized Out-of-Court Workouts for MSMEs.*

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## 1. INTRODUCTION

**The start of the global COVID-19 pandemic saw governments scrambling to mitigate its effects on businesses and the broader economy.** As set out in earlier research,<sup>4</sup> several sectors quickly experienced deep financial distress, such as aviation, tourism and entertainment, with many firms seeing a reduction in demand and severe supply-chain disruptions. A combination of emergency, time-bound legislative and government support measures were implemented in many countries (defined as Phase 1).<sup>5</sup> Some countries have complemented these temporary measures with deeper, permanent insolvency reform. These tools include restructuring tools to save viable firms from being liquidated, and interventions to assist consumers and small businesses facing bankruptcy (defined as Phases 2 and 3).<sup>6</sup> This note develops this earlier research, providing a deeper examination of reforms introduced by governments over the past year. Specifically, it outlines the temporary measures adopted to contain the effects of the crisis and analyzes the institutional and permanent legislative measures implemented to facilitate crisis recovery. In addition, given the link between previous economic crises and financial sector stability, this note outlines other insolvency tools that could be useful if economic recovery is muted and non-performing loans (NPLs) rapidly increase.

**Many of the temporary measures have helped many firms and individuals stave off insolvency during the pandemic.** Based on the data of insolvency filings in 15 economies,<sup>7</sup> in most economies the number of business insolvencies declined in Q2 and Q3 of 2020. This decline can be largely attributed to the unprecedented legislative and government support measures introduced by many countries at the outset of the COVID-19 pandemic.<sup>8</sup> These temporary measures were specifically aimed at “flattening the bankruptcy curve”<sup>9</sup> by preventing viable firms from prematurely being pushed into insolvency and preventing courts from being overwhelmed by insolvency cases.<sup>10</sup>

**Many of these emergency legislative measures have been extended at least once since their introduction.** Given the uncertainty regarding the duration of the COVID-19 pandemic, legislators have been extending the terms of the emergency measures. For example, moratoria on insolvency filings were scheduled to terminate by the end of January 2021 in Germany but have

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4. A. Menezes and S. Muro, “COVID-19 Outbreak: Implications on Corporate and Individual Insolvency” (World Bank, Washington, DC, 2020).

5. *Ibid*

6. *Ibid*

7. S. Muro, “The Calm before Storm: Early Evidence on Business Insolvency Filings after the Onset of COVID-19” (World Bank, Washington, DC, 2020).

8. *Ibid*

9. For instance, many countries created temporary higher barriers for commencing insolvency proceedings (such as preventing creditors from filing for insolvency); put general moratoria in place to prevent debt enforcement; or implemented debt payment forbearance measures. Some of these measures are discussed further in Section 2 of this note.

10. A. Menezes and S. Muro, “COVID-19 Outbreak: Implications on Corporate and Individual Insolvency” (World Bank, Washington, DC, 2020).



been extended until April 30, 2021. They are scheduled to terminate by the end of March 2021 in the Netherlands and the United Kingdom.<sup>11</sup> According to the Financial Stability Board (FSB), most fixed-term measures in the area of lending support and central bank measures have been extended.<sup>12</sup> In terms of both insolvency-related and other relief measures, it appears that authorities continue to adapt to evolving circumstances. According to the Financial Stability Board, relaxation of the measures should be careful and gradual to avoid “economic and financial cliff effects” and cross-border spillovers.<sup>13</sup>

**Evidence suggests that a rise in insolvency filings is likely to have just been postponed, not avoided.**<sup>14</sup> For some firms, temporary liquidity support and a stay on creditors’ enforcement (a period of “hibernation”) will be sufficient to return to economic viability after the pandemic is over. Other firms will find themselves on the brink of insolvency in the coming months (Figure 1) and there is a risk of “zombie firms” remaining in the market.

*Figure 1: Expected Avalanche of Business Insolvencies in 2021*



**Past crises offer valuable lessons for dealing with increased non-financial corporate sector distress and rising levels of NPLs.** Although governments reacted quickly to the current crisis with the emergency measures described above, there is a heightened risk of liquidity problems becoming solvency problems, with mass loan defaults and NPLs reaching systemic levels.<sup>15</sup> In the current context, the high levels of corporate distress can ultimately lead to significant losses in the banking system, weakening the overall financial sector in many countries and potentially causing

11. The terms provided above may not be final or current, as the pandemic continues to evolve.

12. “COVID-19 Pandemic: Financial Stability Impact and Policy Responses,” report submitted to the G20 (November 17, 2020), Financial Stability Board

13. *Ibid*

14. S. Muro, “The Calm before Storm: Early Evidence on Business Insolvency Filings after the Onset of COVID-19” (World Bank, Washington, DC, 2020).

15. “COVID-19 Pandemic: Financial Stability Impact and Policy Responses,” report submitted to the G20 (November 17, 2020), Financial Stability Board



a systemic banking crisis.<sup>16</sup> Elevated NPL levels can prevent the financial system from functioning effectively, and they often reflect bank coordination and market failures.<sup>17</sup> Joseph Stiglitz and Marcus Miller<sup>18</sup> argue that different procedures are required to deal with bankruptcies in normal times and in times of crisis, not only due to the increased number of cases in crises, but also because they suggest that depressed asset prices affect creditors' willingness to restructure.<sup>19</sup>

**While this note primarily focuses on insolvency reforms in response to the economic effects of the COVID-19 pandemic, it also draws on models that addressed business distress during the Financial Crisis of 2007/2008 and the Asian Crisis of 1997/1998.** Past crises show the spectrum of insolvency crisis response measures that countries have implemented. It is recognized that the origins of the Asian Crisis of 1997/1998 and the Global Crisis of 2007/2008 differ from those of the current crisis. The 1998 and 2008 crises arose in the financial sector. The current crisis is due to the effects on the real economy stemming from the COVID-19 health pandemic and ensuing social distancing and other requirements. Nevertheless, past financial crises were often followed or accompanied by comprehensive long-term institutional and law reforms in an effort to prevent the reoccurrence of widespread business distress and increases in NPL levels. When NPLs reach levels such that a systemic banking crisis is likely, research shows that greater centralized responses through government intervention and sector-wide coordination are required.

**This note reviews two stages of insolvency and debt restructuring measures taken to address the economic effects of the COVID-19 crisis: crisis containment and crisis recovery.** The first stage provides an overview of short-term insolvency law reforms adopted at the beginning of the COVID-19 outbreak to prevent businesses from being systematically pushed into insolvency. The second stage examines actions taken by some countries during previous financial crises, as well as the COVID-19 crisis, to address medium- and long-term challenges. Reforms in the second stage fall into three categories: (i) reforms to strengthen insolvency implementing institutions; (ii) reforms to strengthen insolvency legislative frameworks for addressing both corporate and MSME financial distress; and (iii) centralized or government-coordinated frameworks for out-of-court workouts (OCW). In particular, “enhanced OCWs” used during a financial crisis are a specific form of workout that benefit from greater formality, centralized coordination, and government support through various tax and regulatory incentives.<sup>20</sup> As past crises show, OCWs can be effective in resolving both high-value portfolios concentrated in a few borrowers and large-volume, low-value NPL portfolios. Special consideration must also be given to the unique challenges posed in emerging markets with under-developed insolvency laws and weak institutional systems. State-owned asset management companies (AMCs) were particularly

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16. Laeven and Valencia define a banking crisis as an event that meets two conditions: (i) significant signs of financial distress in the banking system (as indicated by significant bank runs, losses in the banking system, and/or bank liquidations); and (ii) significant banking policy intervention measures in response to significant losses in the banking system. See: L. Laeven and F. Valencia, “Systemic Banking Crises Revisited,” IMF Working Paper 18/206 (IMF, Washington, DC, September 14, 2018).

17. M. Miller and J. Stiglitz, “Bankruptcy Protection against Macroeconomic Shocks: The Case for a ‘Super Chapter 11’” (World Bank, Washington, DC, 1998; revised 1999).

18. M. Miller and J. Stiglitz, “Bankruptcy Protection against Macroeconomic Shocks: The Case for a ‘Super Chapter 11’” (World Bank, Washington, DC, 1998; revised 1999).

19. K. Van Zwieten, “Systemic bankruptcy: a review of the literature” (2021). Internal briefing paper.

20. For the World Bank Toolkit on Out-of-Court-Workouts, see <https://openknowledge.worldbank.org/handle/10986/28953> (updated version forthcoming in June 2021)

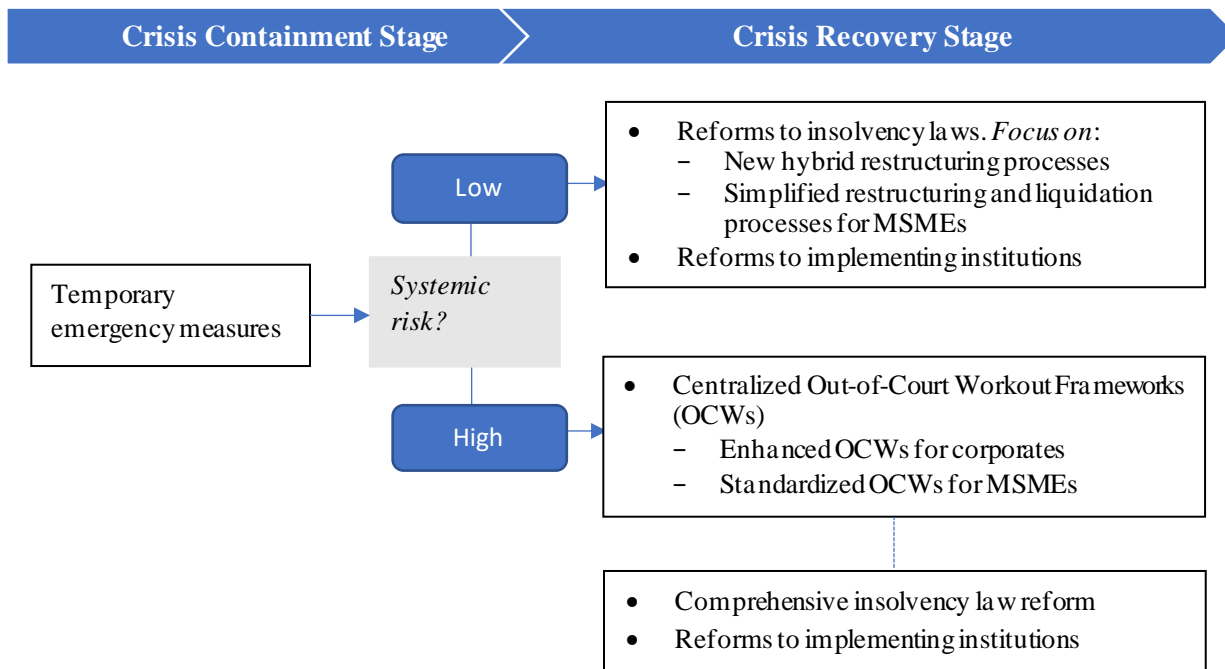


prevalent in previous financial crises as a vehicle for addressing wide-scale bank distress. However, AMCs are outside the scope of this paper, which focuses primarily on the insolvency and debt restructuring processes used during these crises.<sup>21</sup>

**It is vital – in both developed and emerging markets - that corporate insolvency and MSME insolvency regimes are operational and that the necessary institutional fabric is in place to address any sharp influx of insolvencies.** Some countries are now in the process of implementing reforms aimed at facilitating crisis recovery, one objective of which is to ensure insolvency regimes continue to play a market stability and efficiency role by restructuring viable firms and allowing non-viable or “zombie” enterprises to exit as quickly as possible.

**While this note categorizes insolvency measures in terms of low or high systemic risk (Figure 2), many countries may implement measures from either stage to address the challenges they are either experiencing or anticipating at a particular point in time.** For instance, enhanced or hybrid OCW frameworks might be used to address NPLs both where the risk of a systemic banking crisis is low and where it is high. Because OCW frameworks, as opposed to formal legal procedures, can be implemented relatively quickly and can be tailored to the existing debt restructuring needs, they can be particularly useful tools when the systemic risk is high and there is limited time and institutional capacity to implement a comprehensive insolvency law reform.

**Figure 2: Continuum of Responses Based on the Stage of the Crisis and the Risk of Sector-Wide Systemic NPL Levels**



21. On asset management companies, see Cerruti, Caroline; Neyens, Ruth. 2016. Public Asset Management Companies : A Toolkit. World Bank Studies; Washington, DC: World Bank.



## 2. CRISIS CONTAINMENT: TEMPORARY EMERGENCY MEASURES

- *Objective: To “flatten the curve” of insolvency cases and reduce the burden on institutions*

**As an initial policy response to curb business distress arising out of COVID-19, many countries introduced emergency interim measures in early/mid 2020.** These measures were intended to provide a “breathing space” both for debtors facing unexpected upheavals to their business operating models in light of social distancing and other behavioral changes and for institutions, including courts, justice administrations, and other institutions charged with carrying out insolvency and debt enforcement activities, facing the possibility of being overwhelmed by insolvency cases. The type and scope of these measures varied greatly across jurisdictions depending on the impact of the pandemic and country-specific circumstances. The following are some commonly adopted measures.<sup>22</sup>

- (i) *Temporary barriers to creditor-initiated insolvency filings.* Some countries (e.g., Italy, Spain, Switzerland, Turkey) suspended creditors’ rights to initiate insolvency proceedings, while others imposed restrictions on those rights. The restrictions include increasing thresholds for creditors to initiate insolvency proceedings (e.g., India) or extending statutory periods to respond to written demands, or both (e.g., Australia and Singapore).
- (ii) *Suspension of the directors’ duty to file for insolvency.* Several countries suspended the statutory requirement for directors to initiate insolvency proceedings once a company is insolvent (e.g., Bulgaria, France, Germany, Luxembourg, Poland, Portugal, Russia, Spain, Switzerland).
- (iii) *Suspension or relaxation of liability for wrongful trading.* Some countries that make directors liable for trading while insolvent<sup>23</sup> have suspended or relaxed these provisions (e.g., Australia, New Zealand, Singapore, United Kingdom). This temporary amendment did not change the directors’ liability for fraudulent trading, i.e., in breach of directors’ fiduciary duties and obligations.
- (iv) *Moratoria or restrictions on debt enforcement actions.* Many countries have imposed moratoria not only on insolvency filings, but also on specific debt enforcement actions outside of insolvency (foreclosures, evictions, debt collections) to protect debtors against enforcement of debt or security interests and to prevent social disruption. The scope of these moratoria varies greatly across the countries (e.g., Argentina, Bangladesh, Belgium, Brazil, Bulgaria, Egypt, France, Germany, Guatemala,

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22. This information is based on the INSOL International and World Bank Group report “Global Guide: Measures Adopted to Support Distressed Business Through the COVID-19 Crisis” (April 2020) and the COVID-19 Insolvency Reforms Tracker prepared by the Insolvency & Debt Resolution team of the World Bank Group (updated as of May 2020). The Guide uses contributions from a sample of 38 countries, while the Tracker uses a sample of 45 countries.

23. If directors of an insolvent company are proven to have failed to take all reasonable steps to minimize losses to creditors, they may face personal liability under the wrongful trading provisions.



Indonesia, Italy, Kenya, Latvia, Malaysia, New Zealand, Nigeria, Portugal, Singapore, Spain, Sri Lanka, Switzerland, Thailand, Turkey, Uganda, United States).

***Box 1. Temporary Insolvency Measures in Spain to Address the Effects of the COVID-19 Pandemic***

Spain was severely affected by the COVID-19 pandemic, which caused a sharp fall in corporate turnover and exposed many firms to the risk of insolvency. In March 2020, the Spanish Government adopted the Royal Decree-Law 8/2020 on urgent special measures to tackle the economic and social impact of COVID-19. The Decree introduced a broad moratorium on debt enforcement that covered loans with or without a mortgage guarantee, including consumer loans (albeit with a special regulation) held by debtors in the situation of economic vulnerability due to the health emergency, as well as the principal debtors' guarantors.

In addition, Spanish Royal Decree-Law 16/2020 of April 28, 2020, established an insolvency moratorium for all debtors, both firms and individuals. It suspended until December 31, 2020, the requirement that debtors must file for insolvency, and it prevented their creditors from initiating filings before that date. The Decree also introduced a series of measures relating to insolvency proceedings. These included: (i) option for debtors to propose amendments to the existing refinancing agreements and out-of-court payment agreements (the types of pre-insolvency arrangements available in Spain); (ii) incentives to financing provided during the pre-insolvency negotiations during the State of Emergency, even if provided by related persons — if an insolvency arrangement approved or amended within two years of the declaration of the State of Emergency is breached, such financing will be considered a claim against the estate; (iii) expedited processing of ancillary proceedings; (iv) preferential processing of actions that help facilitate the continuity of economic activity; (v) preference for the extrajudicial sale of asset (the auction of assets and rights of the insolvency estate must be extrajudicial in insolvency proceedings declared within a year of the declaration of the State of Emergency and in those underway during that period, even where the liquidation plan establishes otherwise); and (vi) expedited approval of liquidation plans.<sup>24</sup>

24. Clifford Chance, "Spain Coronavirus: Insolvency Measures" (April 2020), <https://www.cliffordchance.com/content/dam/cliffordchance/briefings/2020/04/COVID-19-Insolvency-measures.pdf>; M. García-Posada Gómez, "Analysis of Insolvency Proceedings In Spain Against the Backdrop of the Covid-19 Crisis: Insolvency Proceedings, Pre-Insolvency Arrangements and the Insolvency Moratorium" (Banco De España, 2020), <https://www.bde.es/f/webbde/SES/Secciones/Publicaciones/PublicacionesSeriadas/DocumentosOcasionales/>.





### 3. CRISIS RECOVERY: REFORMS TO IMPLEMENTING INSTITUTIONS

- *Objective: To strengthen the institutional capacity (whether the risk of a systemic banking crisis is low or high)*

**Strengthening institutional capacity should be a significant part of an effective crisis recovery response in emerging markets.** In many developing countries, the institutional frameworks for insolvency and credit infrastructure are weak or face substantial challenges.<sup>25</sup> The credit infrastructure institutional framework includes courts and enforcement agencies, collateral registry and credit reporting systems, insolvency regulators, and insolvency practitioners. Strengthening courts' capacity by hiring more judges and court staff, increasing judicial specialization and using modern technology should be a part of the comprehensive risk mitigation strategy in dealing with a steep increase in business insolvencies as it can considerably decrease the time of insolvency case resolution. For example, after the implementation of the judicial reform program in Indonesia, the time to resolve the insolvency of small and medium-sized enterprises (SMEs) decreased steadily in Jakarta, from 72 months in 2004 to 13 months in 2012.<sup>26</sup>

**Crises are often followed by greater specialization in judiciaries as specialized courts or tribunals are established.** For example, after the Asian financial crisis, a new bankruptcy court was established in Thailand, a bankruptcy division was established in the Republic of Korea, and commercial courts were set up in Indonesia, the Philippines, and Malaysia. This is because a limited number of competent judges can gain expertise more quickly and because the type of training that can be provided to these judges is more cost-efficient than training a large number of judges who may never hear an insolvency case in their careers. Specialized courts are also better placed to shape judicial precedent. When the volume of cases does not justify creating a specialized court, it is generally recommended that a system of case allocation be established to assign bankruptcy cases to a small group of judges who can then develop some level of specialization.

**A number of jurisdictions have recently been strengthening their courts' capacity by hiring more judges and court staff and digitalizing many court and debt enforcement services.** Incorporation of technology to increase the efficiency of insolvency and debt enforcement processes has accelerated globally.<sup>27</sup> This includes increasing use of electronic case management, online auctions, electronic voting, and automated court proceedings (including video hearings and electronic case filings). For example, anticipating an increase in insolvency filings, by August 2020 Mexico enabled the federal courts to carry out court hearings, filing of claims and access to the electronic cases and other services through a digital platform.<sup>28</sup> Germany planned to increase

25. For example, only 101 of the 190 economies measured by Doing Business have a specialized commercial jurisdiction and only 31 economies have a specialized bankruptcy court handling insolvency cases (based on Doing Business 2019 data, World Bank), <https://www.doingbusiness.org>.

26. Doing Business 2019 Case Study "Enforcing Contracts and Resolving Insolvency: Training and efficiency in the judicial system." World Bank, Washington, DC, 2019.

27. See Teresa Rodríguez de las Heras Ballell, "Draft Paper on Impact of Technology on Enforcement," UNIDROIT 2020 Study LXXVIB, W.G.1, Doc. 3 (November 2020); available from the author.

28. Luciano Pérez Gómez, Javier Arreola Espinosa, "Trends and Developments: Mexico" (last updated November 19, 2020). Chambers and Partners Practice Guides. Available at <https://practiceguides.chambers.com/practice-guides/insolvency-2020/mexico/trends-and-developments>.



the staff of its insolvency courts and move towards predominantly written proceedings using digital means.<sup>29</sup> In Canada, the Ontario Superior Court of Justice, the country's largest venue for insolvency proceedings, declared that all urgent matters will be conducted either in writing or by teleconference or videoconference, unless the court orders otherwise.<sup>30</sup> In Hong Kong, the High Court conducted hearings via telephonic conferencing and qualified the use of telephones as an "obvious" solution during the current crisis when physical hearings are not permissible on health grounds.<sup>31</sup> The U.S. Bankruptcy Court for the District of Delaware, where many of the biggest insolvent companies seek court protection, announced that it will conduct upcoming hearings via telephone or video chat unless the presiding judge orders otherwise.<sup>32</sup>

**During the recovery stage, technology can play an important role in providing MSMEs with greater access to financial expertise by linking small business debtors with low-cost expertise, filling information gaps between MSMEs and lenders, and facilitating restructuring negotiations.** For example, the 2019 EU Directive on Preventative Restructuring Frameworks requires European Union member states to establish early-warning tools (EWTs) that would signal to debtors their risk of financial distress early on.<sup>33</sup> In Denmark, the Early Warning system currently provides free, impartial, and confidential help to SMEs with the goal of helping them avoid bankruptcy and move their companies onto a new course toward growth. The system uses financial information provided by the Danish Business Registrar to detect potential distress and generates a list of potentially distressed companies, which are then filtered by technical assistance providers. Companies are then contacted by the assistance providers (through Danish Regional Hubs) and invited to initiate the process. This may include screening, analysis, overview of the business and its financial situation; definition of the business's problems; matching the business with an expert lawyer/mentor; and coaching, action planning, follow-up, and assistance with debt restructuring.<sup>34</sup>

#### 4. CRISIS RECOVERY: REFORMS TO INSOLVENCY LAWS

- *Objective: To address high levels of financial distress and prevent a potential systemic banking crisis caused by elevated levels of NPLs*

**During crisis recovery, policymakers should consider informal or hybrid restructuring processes and simplified restructuring and liquidation processes for MSMEs.** Unlike judicial reorganization and full-fledged liquidation procedures, informal and hybrid restructuring processes and simplified processes for MSMEs are faster and reduce burden on the court system while helping achieve preservation of distressed viable businesses and facilitating quick exit of non-viable ones. The surge in the number of bankruptcy cases can be especially problematic in

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29. A. Menezes and S. Muro, "COVID-19 Outbreak: Implications on Corporate and Individual Insolvency" (World Bank, Washington, DC, 2020).

30. *Ibid*

31. *Ibid*

32. *Ibid*

33. A. Menezes, N. Mocheva, and S.S. Shankar, "'Under Pressure': Integrating Online Dispute Resolution Platforms into Pre-insolvency Processes and Early Warning Tools to Save Distressed Small Businesses," *Vikalpa* 45, no. 2 (Indian Institute of Management, Ahmedabad, April-June 2020).

34. *Ibid*



countries where insolvency laws do not effectively fulfill these two goals. A more comprehensive reform of insolvency law, including formal insolvency procedures, should be on a policy agenda of many developing countries, but it is usually a time-intensive process and requires considerable institutional capacity and expertise within courts and among insolvency practitioners.

**While both out-of-court and hybrid solutions discussed in this section require a degree of functionality within institutions and law, they reduce reliance on formal insolvency processes and can be put in place relatively quickly.** The specific features informal or hybrid mechanisms could be adapted to the country context - for example, some countries are adopting ADR<sup>35</sup> procedures, such as mediation, to facilitate negotiation processes and solve some of the coordination problems (see Germany and Colombia examples in Box 2), appointing an SME restructuring advisor (see Myanmar example in Box 3) or another independent entity that has public trust and capacity and giving it temporary flexible powers to either facilitate an agreement or liquidation (see Singapore example in Box 3).

**In tandem with COVID-19 temporary emergency measures or upon the expiration of these measures, several countries have amended their insolvency laws to provide distressed firms with hybrid restructuring procedures and simplified restructuring and liquidation processes for MSMEs that could serve as useful examples in other countries seeking to reduce reliance on formal insolvency processes and court system.** From the reforms reviewed, two types of insolvency law reforms have been identified. (A) Because of the COVID-19 pandemic, some countries (for example, Germany, the Netherlands, and the UK) have accelerated adoption of previously planned insolvency law reforms that include new or revised quasi-judicial or hybrid restructuring procedures that resemble the US Chapter 11 “pre-pack” process<sup>36</sup> and give effect to the framework outlined in the European Union Directive (EU) 2019/1023 on Preventative Restructuring Frameworks.<sup>37</sup> (B) Taking another tack, several countries introduced simplified restructuring and liquidation procedures targeting MSMEs specifically.

#### **A. STRENGTHENING INSOLVENCY FRAMEWORKS BY INTRODUCING NEW HYBRID RESTRUCTURING PROCESSES**

**Well-developed insolvency and restructuring frameworks frequently include an out-of-court debt restructuring process sanctioned by a court or other independent institution as one of the tools for reorganizing firms that are either insolvent or not yet insolvent but experiencing financial distress (pre-insolvency).** These processes typically involve informal, private creditor restructuring negotiations (with or without a creditor vote on the restructuring plan) within formal insolvency proceedings and are often referred to as “hybrid” restructuring processes. They are usually made accessible to both larger firms and SMEs.

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35. ADR is commonly defined as any process or procedure for resolving a dispute other than adjudication by a judge in a statutory court.

36. Chapter 11 of the US Bankruptcy Code provides formal debt restructuring under a court supervision.

37. The Directive is available at <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32019L1023>. The national laws of the European Union members states must be aligned to comply with the Directive by July 17, 2021.



**The advantages of incorporating informal out-of-court restructuring negotiations in a formal process is that a formal “standstill” period can usually be invoked.** This is done by filing a notice to the court to commence a period of negotiation with specific financial creditors who are then subject to a moratorium or stay. In some jurisdictions (e.g., Spain) the commencement of pre-insolvency proceedings is public, and in others (e.g., France) it is confidential and cannot be publicly disclosed. Recently, with the introduction of the EU Directive on Preventative Restructuring, several countries have taken steps to introduce preventative hybrid restructuring procedures or to improve already existing ones.

Typical features of these processes include the following.

- The restructuring plan is negotiated outside of formal bankruptcy proceedings.
- It is possible to impose a court-ordered stay or a time-limited moratorium on individual enforcement actions.
- The process is accessible to a debtor facing imminent insolvency.
- The agreed-upon restructuring plan can be made binding on dissenting minority creditors, including across classes of creditors (termed a “cross-class cram down”).
- No court assessment occurs at the very start of the procedure.
- The process does not affect the directors’ ordinary management powers; i.e., the debtor remains in control of day-to-day business operations. Where necessary, a neutral third party — a mediator or a supervisor — can be appointed by the court.
- Specific provisions protect new financing from avoidance actions.

### ***Box 2. Examples of New Quasi-Judicial or Hybrid Restructuring Procedures***

#### **United Kingdom**

In June 2020, the UK’s Corporate Insolvency and Governance Act 2020 (“CIGA”) came into force after being fast-tracked through Parliament. (Although the Act was not originally designed to respond to COVID-19 effects, it now includes some temporary measures in response to the pandemic.)<sup>38</sup> Permanent measures of the Act include the following new restructuring tools: (i) a short moratorium (the initial period is 20 days) for companies, giving them breathing space from creditors while they seek a rescue or restructure; (ii) an *ipso facto* provision that removes the contractual right of suppliers of goods and services (with an exception for small suppliers) to terminate contracts for the supply of goods or services with companies that enter into the procedure, to enable those companies to continue trading during the moratorium; (iii) a new restructuring plan procedure.

The restructuring plan is a new restructuring tool introduced by CIGA that includes the possibility for the court to approve and impose a restructuring plan on dissenting classes (a

38. C. Butler and K. Farmer, “What You Need to Know about Corporate Insolvency and Governance Act 2020,” Ashfords LLP, the Gazette (October 8, 2020), <https://www.thegazette.co.uk/insolvency/content/103601>. The UK Corporate Insolvency and Governance Act (2020) is available at <https://www.legislation.gov.uk/ukpga/2020/12/contents/enacted>.



cross-class cramdown). This possibility does not feature in the pre-CIGA schemes of arrangement.

### **The Netherlands**

A new restructuring mechanism in the Netherlands had been planned since mid-2019, and at the beginning of the COVID-19 outbreak it was marked by the Ministry of Justice as urgent. It was adopted by the Senate in October 2020 and entered into force on January 1, 2021. The mechanism enables debtors to offer tailor-made restructuring plans to their creditors outside the formal insolvency procedure and have the plans later confirmed by the court in a formal proceeding. Creditors and shareholders whose rights are affected by the restructuring plan are entitled to vote on it. If all classes accept the plan, the court confirms it unless there are other grounds to refuse confirmation (for example, if certain creditors or shareholders would be worse off under the plan in the event of liquidation). If one or more classes of creditors reject the plan, a requirement for judicial confirmation of the plan is that it has been accepted by at least one class of creditors that can be expected to receive a distribution, at least in part, in the event of liquidation. The minority opposing creditors (including all creditors and shareholders) can be bound to accept a discount on their claims — only employee rights cannot be modified. This is the key feature of the new restructuring framework because in the preexisting Dutch debt restructuring rules, only the rights of unsecured creditors could be impaired. A court order can be requested to support the out-of-court process on any procedural or substantial matter.

The new scheme can be used to terminate onerous contracts (except for employment contracts), although such termination is subject to judicial consent upon the confirmation of the plan. If certain requirements are met, the restructuring plan can be confirmed by the court, making it binding on all affected parties. One of the flexible elements of the new mechanism provides an option to choose between a public and a private (confidential) procedure. A public procedure involves a public hearing and publication in the public Insolvency Register, the Dutch Government Gazette, and the Trade Register. The private procedure involves a private court hearing without any publication and better suits situations in which the creditor group is limited. The new mechanism can be compared to the English Scheme of Arrangement and the US Chapter 11 procedure.<sup>39</sup>

### **Germany**

On January 1, 2021, Germany introduced a new preventative restructuring regime (“Stabilization and Restructuring Framework”) and temporary proceedings for companies affected by COVID-19. Temporary proceedings for these companies, available until December 31, 2021, allow even legally insolvent debtors to access the preventative restructuring framework. Germany’s new preventative restructuring regime resembles the preventative frameworks adopted in the Netherlands and the United Kingdom. It provides

39. R.J. Van Galen, “The Act on the Confirmation of Out-of-Court Restructuring Plans,” *NautaDutilh N.V.* (a copy of the article is available with the authors of this note).



for a cross-class cram down<sup>40</sup> (without affecting employee claims), stay, rejection of burdensome contracts, protection from claw-back claims, suspension of enforcement of *ipso facto* clauses and court confirmation of the restructuring plan. The appointment of a restructuring practitioner is optional. The plan can be confirmed by the court if the majority of creditor classes voted in favor of the plan, the plan complies with the absolute priority rule (with limited exceptions) and no creditors or shareholders would be worse off under the plan in the event of liquidation.<sup>41</sup>

Separately from the preventative restructuring framework, the new legislation also introduces a process similar to the French procedure of conciliation. The debtor is now able to apply for a court-appointed mediator (“restructuring facilitator”) to assist for up to three months in negotiations with creditors. If agreement is reached, the court can confirm the mediated settlement to protect the contract and any transfer under it from avoidance or liability claims.<sup>42</sup>

## Poland

In June 2020, the Polish government introduced a temporary simplified restructuring procedure, also known as “proceedings for the approval of arrangement.” The new procedure is a simplified version of the already existing “arrangement sanctioning proceeding” that has been available in Poland since 2016 and aims to reduce reliance on courts constrained by the COVID-19 crisis.

The new simplified procedure permits any enterprise facing the risk of insolvency (which may not necessarily be related to the COVID-19 pandemic) to enter into an agreement with a restructuring advisor and commence a simplified restructuring proceeding through an announcement in the Court and Commercial Gazette. After conclusion of the agreement with the restructuring advisor,<sup>43</sup> and from the moment of the announcement, an automatic 4-month stay applies to all the enforcement actions against the debtor. Creditors may apply to court for lifting the moratorium with respect to their claim on very limited grounds. The debtor continues to manage its assets but under the supervision of the licensed restructuring advisor. The advisor formally acts as an arrangement supervisor - works with the debtor to prepare a

40. A cross-class cram down is a mechanism that enables one or more classes of creditors to make the plan binding on other classes of creditors that do not support the restructuring plan (see UNCITRAL Legislative Guide on Insolvency, p. 226). Under the Germany’s new Stabilization and Restructuring Framework, if the required majorities are not achieved in every class, the plan will be deemed approved if certain other conditions are met, especially if more than 50% of voting classes have accepted the plan.

41. See “The German “Scheme” Overview on the German preventative restructuring framework (Corporate Stabilization and Restructuring Act – StaRUG),” presentation by Sidley (January 2021). Available at: <https://www.sidley.com/en/insights/newsupdates/2021/01/german-stabilization-and-restructuring-framework-the-german-scheme>

42. For more information, see S. Madaus, “A Giant Leap for German Restructuring Law? The New Draft Law for Preventive Restructuring Procedures in Germany,” University of Oxford Faculty of Law (October 26, 2020), <https://www.law.ox.ac.uk/business-law-blog/blog/2020/10/giant-leap-german-restructuring-law-new-draft-law-preventive>.

43. The restructuring advisor must be chosen from the official list of the insolvency administrators provided by the Ministry of Justice.



list of creditors, collects and counts votes in favor of a plan, and determines whether it has been accepted.

Contrary to the arrangement sanctioning proceeding, the simplified procedure allows restructuring of all of the secured debt without the secured creditors' consent as long as the new payment terms provide that such creditors would receive 100% of their principal debt, interest and other ancillary claims at a future date or the proposed repayment level is not less than could have been obtained from enforcement of collateral. The restructuring plan can be approved by more than half of all voting creditors holding at least two-thirds of all voting claims. The court involvement in this procedure is limited to hearing motions to lift the automatic stay for cause, approval of the arrangement plan following creditors' voting or dismissal of the proceeding if 4 months have elapsed without a motion to approve the arrangement.

The simplified restructuring procedure is intended to be temporary and is set to expire by June 30, 2021. In the first 6 months since the adoption of the new procedure, at least 60 cases were processed through it. Based on a report prepared by the Central Economic Information Centre on restructuring proceedings in 2020 in Poland,<sup>44</sup> the simplified restructuring proceedings accounted for nearly 50 percent of all restructuring proceedings opened in 2020 – thus being the most preferred form of court restructuring. In 2020 alone, 392 simplified restructuring proceedings were opened, with the highest monthly figure in December 2020 – as many as 118 proceedings of that type were initiated in the last month of the year. It should be emphasized that restructuring generally is gaining a lot of traction in Poland in recent years: in 2019, there were 465 restructuring proceedings, while in 2020, the number reached 800.<sup>45</sup>

### Colombia

Colombia's Law No. 1116 of 2016 on Corporate Insolvency Regime<sup>46</sup> provides for a pre-packaged arrangement procedure. Under the procedure, the debtor and its creditors can reach a restructuring agreement and request the court to confirm it. The agreement can be confirmed if it is approved by the requisite majority of creditors. The court holds a confirmation hearing. The court confirms the agreement if: (1) the negotiations were open and had enough publicity; (2) all creditors of the same class have the same rights; and (3) the agreement is not abusive and is subject to the rule of law. Once the agreement is confirmed by the court it has the same power as a settlement executed after a judicial reorganization

44. Report by the Central Economic Information Centre ([https://www.coig.com.pl/2020-restrukturyzacje-firm\\_grudzien.php](https://www.coig.com.pl/2020-restrukturyzacje-firm_grudzien.php)).

45. *Ibid.* The rest of the paragraphs are based on the information collected through the WBG project work in Poland (contributions by Nina Mocheva, EFNFI) and report by Squire Patton Boggs "Impact of COVID-19 on Insolvency Laws: How Countries Are Revamping Their Insolvency and Restructuring Laws to Combat COVID-19," October 6, 2020 (<https://www.squirepattonboggs.com/-/media/files/services/practices/restructuring--insolvency/reset-your-business/covid19-impact-of-global-insolvency-laws-poland.pdf>)

46. Law 1116 of 2006 of Colombia, Official Gazette No. 46.494. Available at: [https://www.sic.gov.co/recursos\\_user/documentos/normatividad/Ley\\_1116\\_2006.pdf](https://www.sic.gov.co/recursos_user/documentos/normatividad/Ley_1116_2006.pdf)



proceeding - it binds the debtor and its creditors, including those that did not participate in its negotiation or voted against it. The pre-packaged arrangement procedure is considerably shorter than the judicial reorganization procedure which may last about 14 to 18 months. The disadvantage of the pre-packaged arrangement procedure is that it does not offer the protection of the automatic stay during the negotiation of the restructuring plan.<sup>47</sup>

On April 15, 2020, Colombia partially amended the Law 1116 of 2016 by introducing a temporary (two-year) insolvency regime to aid the recovery of businesses affected by COVID-19. The Government Decree of April 15, 2020<sup>48</sup> established two new out-of-court processes: (1) extra-judicial emergency restructuring; and (2) business recovery proceeding before the Chamber of Commerce. In extra-judicial emergency restructuring, the debtor may request the judge for an emergency negotiation – for up to three months - of a reorganization agreement if it is in default or in imminent inability to pay. During the negotiation, the processes of execution, coercive collection, restitution of possession and execution of guarantees against the debtor are suspended. Payments of obligations for administrative expenses that the debtor deems necessary may be deferred, except for payment of salaries, tax contributions and obligations to the social security system. The agreement can be confirmed by the judge subject to the majority requirements of Law 1116 of 2016. In business recovery proceeding, negotiations are facilitated through mediation under the framework of rules created by the Chamber of Commerce. Mediators must be trained in insolvency. An agreement reached through mediation can be validated by the Superintendence of Commerce or the civil court through an expedited confirmation procedure.<sup>49</sup>

## B. SIMPLIFIED RESTRUCTURING AND LIQUIDATION PROCESSES FOR MICRO, SMALL, AND MEDIUM-SIZED ENTERPRISES (MSMES)

**SMEs are estimated to generate roughly 7 out of 10 jobs in emerging markets,<sup>50</sup> and are therefore a key layer of the economy.** These businesses, however, are more vulnerable to financial shocks. Insolvency regimes help maximize creditor recovery and mitigate lending risk, but traditional insolvency regimes are inaccessible to many micro and small businesses. These hurdles are discussed in more detail in the World Bank report on the Treatment of MSME Insolvency.<sup>51</sup>

47. Nicolás Polonia and Camilo Martínez, “A business can be salvaged through an ordinary reorganization process or by a prepackaged arrangement,” interview by Leader League (posted on September 23, 2020; last accessed on February 11, 2021). Available at: <https://www.leadersleague.com/en/news/a-business-can-be-salvaged-through-an-ordinary-reorganization-process-or-by-a-prepacked-arrangement>

48. Decree No. 560 of the Ministry of Justice of Colombia, April 20, 2020. Available at: <https://www.funcionpublica.gov.co/eva/gestomormativo/norma.php?i=113637>

49. The information in this country example is based on contributions by Susana Hidvegi Arango, Superintendence of Insolvency, Colombia (based on interview conducted on November 2, 2020 and written comments provided on February 27, 2021)

50. Small and Medium enterprises (SMES) Finance. World Bank. <https://www.worldbank.org/en/topic/sme/finance>

51. World Bank Group, “Report on the Treatment of MSME Insolvency” (World Bank, Washington, DC, 2017), <https://openknowledge.worldbank.org/handle/10986/26709>.





**The majority of insolvency systems, even in developed jurisdictions, are not prepared to handle a wave of MSME bankruptcies.** MSMEs are particularly fragile in the context of COVID-19, in light of severe value-chain disruptions and the hard hit taken by the largely MSME-dominated vulnerable sectors (hotels, restaurants, entertainment, etc.). In normal times MSMEs are vulnerable because they have limited access to capital markets and smaller operating margins and lack reserves and expertise.<sup>52</sup> COVID-19 has exacerbated these vulnerabilities. The Future of Business Survey — covering more than 30,000 small business leaders from over 50 countries — reported that small businesses experienced reduced sales and that over 25 percent of them closed during the first five months of 2020.<sup>53</sup> As a result, MSMEs could be a significant channel for transmitting economic shock.

**Several countries have taken action to shore up their insolvency systems by introducing new fast-track insolvency (restructuring and liquidation) procedures specifically for MSMEs.** The simplified restructuring procedures currently being introduced fall outside typical formal insolvency proceedings and are debtor-in-possession processes. Their complexity is further reduced by providing easier access (i.e., it is not necessary to meet the insolvency threshold and documentation requirements are reduced), easier plan approval mechanisms, and reduced costs to engage facilitators/insolvency practitioners. Some of the common features of these procedures include: (1) a temporary stay or standstill is imposed against creditor actions and directors' wrongful trading liability is suspended; (2) the debtor management remains in possession; (3) some supervision by a regulated professional (insolvency or restructuring practitioner) is required; (3) fresh financing is protected; and (4) minimal or no reliance is made on formal insolvency procedures/courts.

**Unlike simplified restructuring procedures, simplified liquidation procedures entail greater court involvement but with lesser procedural complexity as compared to the regular liquidation process.** Several countries are streamlining liquidation processes to facilitate market exit and avoid the build-up of so-called “zombie firms” in the market.

***Box 3. Examples of Simplified Restructuring and Liquidation Processes for MSMEs***

**Australia**

In September 2020, the Australian Government announced that it will introduce new legislation, effective January 1, 2021, that for the first time introduces a rescue process exclusively for SMEs and a more cost-effective and quicker liquidation process.

The new, simplified restructuring process draws on key features of the US Chapter 11 process. The insolvent small business now has 20 days to prepare a restructuring plan, and within 15 days following that, creditors must vote on whether to accept it. A restructuring

52. *Ibid*

53. The Future of Business Survey is a collaboration between Facebook, OECD, and the World Bank. The biannual survey provides information on how firms with a digital presence assess the current state and future outlook of their businesses, the main challenges they face, and their involvement in international trade. For more information, see <http://www.oecd.org/industry/business-stats/the-future-of-business-survey.htm>.



plan can be approved if accepted by 50 percent of creditors voting in one class. The liquidators' investigative processes, mandatory meetings, and reporting requirements have been simplified.

The new restructuring process provides a pathway for distressed small businesses that historically would never have entered voluntary administration due to the costs and the loss of control associated with the regular procedures.

The simplified liquidation process retains the general framework of the existing liquidation process, with modifications to reduce time and costs. The small business can appoint a liquidator to take control of the company and realize the company's remaining assets for distribution to creditors. The liquidator investigates and reports to creditors about the company's affairs and its failure. Time and cost savings are achieved through reduced investigative requirements, requirements to call meetings, and reporting functions.<sup>54</sup>

### **Myanmar**

In March 2020, Myanmar adopted a simplified out-of-court restructuring procedure for MSMEs that is assisted by a restructuring advisor appointed by the debtor. The procedure is similar to the one adopted in Australia, but with lesser threshold requirements for MSME access and less stringent requirements for the negotiation facilitator (restructuring advisor).<sup>55</sup>

### **Singapore**

The Insolvency, Restructuring and Dissolution (Amendment) Bill (“Bill”) was introduced in Parliament in October 2020 and came into effect in December 2020. It establishes a Simplified Insolvency Program to assist micro and small companies that require support to restructure their debts to rehabilitate the business or to wind up the company if the business has ceased to be viable. This is done through two new, temporary processes adapted and modified from the earlier framework in the Insolvency, Restructuring and Dissolution Act of 2018. The simplified debt restructuring procedure is easier to access than the typical scheme: instead of the two applications to the High Court typically required, the prepackaged process requires only one. It also includes a lower creditor approval threshold (two-thirds in value). The program is intended to be temporary, lasting six months after coming into force, but with a possibility of extension. The program will be administered by the Official Receiver, who may assign private insolvency practitioners to administer the cases accepted

54. Contributions by Scott Atkins, Partner and Head of Risk Advisory (based on interview conducted on October 19, 2020), Norton Rose Fulbright Australia, and the website of the Treasury of the Government of Australia; <https://ministers.treasury.gov.au/sites/ministers.treasury.gov.au/files/2020-09/Insolvency-Reforms-fact-sheet.pdf>.

55. Contributions by Scott Atkins, Partner and Head of Risk Advisory (based on interview conducted on October 19, 2020), Norton Rose Fulbright Australia,



into simplified debt restructuring and simplified winding up. Applicant companies under the program are subject to a co-payment component.<sup>56</sup>

### United States

In 2019, the Small Business Reorganization Act (SBRA) was adopted, creating a fast-track reorganization path for small businesses. Because Chapter 11 of the US Bankruptcy Code was too costly and complex for small business debtors, the SBRA created an alternative procedure for small business debtors by adding new Subchapter V.3 to Chapter 11 (titled “Small Business Debtor Reorganization”).

In response to the COVID-19 crisis, the Coronavirus Aid, Relief, and Economic Security Act, also known as the CARES Act, was adopted in March 2020, with an objective to further expand small businesses’ access to Chapter 11 process. The CARES Act provides for several (temporary) amendments to Chapter 11, including an increased debt ceiling for businesses filing under the small business provisions of Chapter 11.<sup>57</sup> It also temporarily increases the debt ceiling under the SBRA from \$2,725,625 to \$7,500,000, allowing more businesses to file for reorganization under the legislation.

**The law and the courts should also recognize the possibility of quickly resolving no-income, no-asset cases and provide for a discharge and fresh start for all natural-person entrepreneurs.** In emerging markets, many MSE finances are intermingled with household/personal finances and personal guarantees are sought for the MSE business loans. Therefore, personal debts must often be treated in the context of liquidating a small business. Many emerging markets lack modern consumer bankruptcy frameworks. In common law jurisdictions, typically sole proprietorships that are facing financial difficulties need to resolve these through the consumer bankruptcy framework rather than the corporate insolvency regime, and therefore do not have much-needed tools or options. For instance, a bankruptcy discharge releases the debtor from personal liability for specified types of debts, and the debtor is no longer required to pay those discharged debts. Discharges can be calibrated according to country priorities so that certain debts continue, even after the discharge, to avoid either systemic or moral hazard risks.<sup>58</sup> At the

56. Ministry of Law of Singapore Press Release (October 5, 2020), <https://www.mlaw.gov.sg/news/press-releases/simplified-insolvency-programme>, and Singapore Statutes Online, <https://sso.agc.gov.sg/Acts-Supp/39-2020/Published/20201207?DocDate=20201207>.

57. M. Haut, “Assisting Small Businesses Impacted by the Coronavirus Pandemic,” LexisNexis (posted on 6-12-2020), <https://www.lexisnexis.com/lexis-practical-guidance/the-journal/b/pa/posts/assisting-small-businesses-impacted-by-the-coronavirus-pandemic>.

58. A. Menezes and S. Muro, “COVID-19 Outbreak: Implications on Corporate and Individual Insolvency” (World Bank, Washington, DC, 2020).



European Union level, the EU Directive 1023/2019 outlines the key requirements for discharge provisions.<sup>59</sup>

**The World Bank Group has expanded its Principles for Effective Insolvency and Creditor/Debtor Regimes (ICR Principles) to provide best-practice legislative standards for addressing the insolvency of micro and small enterprises (MSEs).** As the World Bank is the Financial Stability Board designated standard-setter in the field of insolvency, alongside the United Nations Commission on International Trade Law, the ICR Principles provide high-level, best-practice guidance to countries for developing legislative principles for addressing the insolvency of both legal and natural-person MSMEs in the crisis recovery stage. Central features include simplifying procedural formalities and reducing the cost of proceedings, using technology to support institutions, encouraging a debtor-in-possession restructuring model, promoting out-of-court solutions, and providing for an automatic discharge of the good-faith natural-person entrepreneur following liquidation.

## 5. CRISIS RECOVERY: ENHANCED, CENTRALLY COORDINATED OCWs TO ADDRESS SYSTEMIC RISKS

- *Objective: To address large volumes of NPLs that pose the risk of a systemic banking crisis or when a financial crisis has already materialized*

**Enhanced OCWs were used in the aftermath of the Asian Financial Crisis in 1997/1998 and the Global Financial Crisis of 2007/2008, when corporate and MSME NPLs in several countries reached levels that risked a systemic banking crisis.**<sup>60</sup> Experience from past crises shows that out-of-court workouts with “enhanced” features, such as inter-creditor framework agreements, typically facilitated through an institutional framework or special purpose vehicle, are effective in resolving large volumes of NPLs relatively quickly. Contrary to informal contractual agreements, which rely on a case-by-case approach in negotiations with debtors, these approaches rely on a centralized, strategic approach in the banking sector.<sup>61</sup> The two types of enhanced OCW frameworks reviewed in this section share many characteristics. Subsection (A) describes enhanced OCW frameworks targeting all types of corporate loans — large, medium, and small (although the OCW framework examples in this subsection targeted mostly large loans); subsection (B) covers standardized OCW frameworks designed specifically for MSMEs.

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59. The EU Directive (EU) 2019/1023 On Preventive Restructuring Frameworks establishes parameters on discharge of debt and disqualifications. Article 20 of the Directive provides that “Member States shall ensure that insolvent entrepreneurs have access to at least one procedure that can lead to a full discharge of debt in accordance with this Directive. Member States in which a full discharge of debt is conditional on a partial repayment of debt by the entrepreneur shall ensure that the related repayment obligation is based on the individual situation of the entrepreneur and, in particular, is proportionate to the entrepreneur's seizable or disposable income and assets during the discharge period and takes into account the equitable interest of creditors.”

60. For example, in 1998, NPLs as shares of total loans reached 30-40% in the Republic of Korea; 33% in Thailand; and 23-33% in Malaysia.

61. These centralized interventions to address NPL levels are often accompanied by such significant policy measures as deposit freezes and/or bank holidays, significant bank nationalizations, bank restructuring fiscal costs, extensive liquidity support, significant guarantees and significant asset purchases; see <https://www.imf.org/en/Publications/WP/Issues/2018/09/14/Systemic-Banking-Crises-Revisited-46232>.



Subsection C provides a brief overview of the insolvency law reforms introduced in parallel with enhanced OCW frameworks and following previous crises. As explained above, the use of AMCs was particularly relied upon in previous financial crises, whereby the state typically acquired some pre-crisis debt from existing creditors and took over the role of that creditor in the restructuring negotiations.<sup>62</sup> Although examining these vehicles is outside the scope of this note, AMCs often included an enhanced OCW framework as part of their design. It should be noted, however, that AMCs tend to be costly to set up and are operationally complex to implement. They are prone to management and governance risks. Based on the experience of past crises, the reasons for establishing AMCs are complex and multi-faceted.<sup>63</sup> These factors likely make them ill-suited in many EMDEs where strong insolvency laws and institutions, skilled management and/or adequate funding are lacking.<sup>64</sup>

**OCWs, as opposed to formal legal procedures, can be implemented relatively quickly, given sufficient cooperation from the banking sector, and can be tailored to existing debt restructuring needs.** In practice, OCWs can vary greatly in formality, from informal, non-binding restructuring guidelines adopted by the banking sector (e.g., the London Approach) to more interventionist schemes, such as workouts in the Republic of Korea based on its Corporate Restructuring Promotion Laws (discussed in more detail below). These variations, specific features and practical considerations for the implementation of OCWs are explained in more detail in the World Bank’s Toolkit for Out-of-Court Workouts that was published in 2016 and is currently being updated.<sup>65</sup>

**Depending on their design, enhanced OCWs are less suitable as long-term solutions if their design includes considerable government involvement and broad debt relief measures.** As shown by the example of the Iceland’s Voluntary Debt Restructuring Scheme (discussed below), it is important that these types of workouts have a defined term to accelerate settlements and reduced reliance on debt relief measures. In non-crisis situations with moderate levels of NPLs, scaled-down versions of an OCW may be more appropriate.

**In countries with underdeveloped financial regulation and corporate governance, market-based approaches may pose risks of asset stripping.** As an example, these factors have reportedly undermined the success of the Indonesia’s out-of-court debt restructuring mechanism, the Jakarta Initiative Task Force.<sup>66</sup> In the context of weak institutional environments and financial crises, some authors<sup>67</sup> recommend simple resolution mechanisms, such as across-the-board debt

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62. K. Van Zwieten, “Systemic bankruptcy: a review of the literature” (2021)

63. *Ibid*

64. See D. Klingebiel, “The Use of Asset Management Companies in the Resolution of Banking Crises Cross-Country Experiences,” Washington, DC: World Bank, 2001)

65. Toolkit for Out-of-Court Restructuring (World Bank, 2016) (updated version forthcoming in June 2021)

66. S. Claessens and D. Klingebiel, “Crisis Resolution, Policies, and Institutions: Empirical Evidence,” in *Systemic Financial Crises: Containment and Resolution*, ed. Patrick Honohan and Luc Laeven (Cambridge, UK: Cambridge University Press, print 2005; online August 2009), 169–94.

67. C. Calomiris, D. Klingebiel, and L. Laeven, “Seven Ways to Deal with a Financial Crisis: Cross-Country Experience and Policy Implications,” *International Monetary Fund Journal of Applied Corporate Finance* 24, no. 4 (Fall 2012).



forgiveness accomplished through debt redenomination, which helps resolve outstanding debts with little discretion to government officials.<sup>68</sup>

***Box 7. Addressing High Micro and Small Business NPLs Through Government-Sponsored Debt Forgiveness Programs***

**Mexico**

After the Mexican financial crisis in 1998, the government initiated the Punto Final Program, intended to finalize the country's bailout of the banking sector and its debtor relief program. The Punto Final program targeted mortgage holders, agribusiness, and SMEs, and allocated loss sharing between the government and the banking sector to achieve recognition of loan losses by banks and clean up borrowers' and banks' balance sheets. Mexico's implementation of the Punto Final Program coincided with a complete reform of the bankruptcy process and the laws for perfecting collateral interests.<sup>69</sup>

**Republic of Korea**

The Korea Credit Card Debt program was initiated in the context of the credit card debt crisis in 2002 that had been caused by a rapid expansion of the credit card market. While distress in the credit card market affected Korean commercial banks, they were able to absorb the losses, whereas the stand-alone credit card companies were at the brink of collapse. In 2002, Korean authorities allowed credit card issuers to roll over delinquent credit card loans, a practice known as "re-ageing" (a form of regulatory forbearance) to ease the burden of provisions and charge-offs of these loans for issuers.

The program did temporarily ease the burden of provisions and charge-offs on issuers. By 2005, credit card companies returned to profitability. The program, accompanied by tighter standards for credit card debt and improved credit information reporting and sharing, helped reduce delinquency rates from around 28 percent in late 2003 to 9 percent by the end of 2005. On the other hand, it was criticized for exacerbating the lack of discipline and transparency in the market, inflating credit card issuers' assets, and facilitating the transfer of credit risks to third-party securities investors.<sup>70</sup>

68. S. Claessens and D. Klingebiel, "Crisis Resolution, Policies, and Institutions: Empirical Evidence," in *Systemic Financial Crises: Containment and Resolution*, ed. Patrick Honohan and Luc Laeven (Cambridge, UK: Cambridge University Press, print 2005; online August 2009), 169–94.

69. C. Calomiris, et al., "Taxonomy of Financial Crisis Resolution Mechanisms: Cross-Country Experience," World Bank Policy Research Paper 3379 (World Bank, Washington, DC, 2004); L. Laeven and T. Lareya, "Principles for Household Debt Restructuring," IMF Staff Position Note (IMF, Washington, DC, 2009).

70. L. Laeven and T. Lareya, "Principles for Household Debt Restructuring," IMF Staff Position Note (IMF, Washington, DC, 2009); IMF, Republic of Korea: 2006 Article IV Consultation (IMF, Washington, DC, 2006); T. Kang and G. Ma, "Credit Card Lending Distress in Korea in 2003," Bank for International Settlements Paper 46 (2009).



## A. ENHANCED OCWS FOR CORPORATES

**Enhanced OCWs are particularly suited to dealing with a lower volume, higher value concentration of debt.** Enhanced OCWs are often referred to as “second generation” restructuring frameworks because they enhance what is termed the London Approach<sup>71</sup> by adopting a more institutionalized framework for corporate restructuring. Enhanced OCWs were widely adopted in the aftermath of the Asian Financial Crisis. In some enhanced OCWs (e.g., Thailand), the financial supervisors persuaded the financial institutions subject to the central banks’ supervision to adhere to the scheme contractually and to commit to negotiating restructuring plans with debtors and the other financial institutions.<sup>72</sup> In other enhanced OCWs (e.g., in Korea), the joint restructuring scheme was reinforced by statutory rules. In many models, banks signed inter-creditor agreements under which they agreed to abide by specific workout procedures and principles (for example, such agreements were signed between financial institutions in Indonesia, Malaysia, and Thailand). Enhanced OCW frameworks were typically coordinated by a designated public or nonpublic institution or commission. Governments also incentivized banks to participate, usually with some form of regulatory forbearance or with financial incentives. It should be noted that these systemwide enhanced OCWs were often accompanied or followed by long-term comprehensive reforms of the insolvency legal system, as happened in Iceland, Republic of Korea, and Thailand (see Section 5.C).

### ***Box 4. Examples of Enhanced OCWs for Corporates***

#### **Republic of Korea**

In the Republic of Korea, a voluntary agreement among financial institutions on corporate restructuring (Financial Institutions’ Agreement for Promotion of Company Restructuring – the *Agreement*) was entered into by 210 banks in 1998. The Agreement committed creditors to the use of specific workout procedures. It provided for an obligation of assenting creditors to purchase the debts of dissenting creditors and an obligation to contribute pro rata to new financing. The state incentivized workouts with tax exemptions and reductions, modified labor standards, and greater protections for minority shareholders. However, the implementation of workouts under the Agreement raised problems of free-riding by institutions that did not participate in it. The government therefore codified the Agreement in law in 2001, in the form of a Corporate Restructuring Promotion Law (CRPL). Further CRPLs were enacted subsequently, in the period to 2018. They made it obligatory for all financial institutions to participate in workouts.

According to the Financial Supervisory Service data, the successfully reorganized companies have shown good performance in debt service capacity and business operations. The key success factors in these workouts were relatively strong insolvency laws, debt enforcement laws, and a strong judiciary. Default structures for failure to reach an agreement

71. A non-statutory and informal framework designed by the Bank of England in the 1970s (it was developed further in the 1980s and 1990s).

72. J. Garrido, *Out-of-Court Debt Restructuring* (Washington, DC: World Bank, 2012).



were foreclosure, liquidation, or referral to an asset management company with super-administrative powers. Additional success factors included active promotion of workouts by the state, strong support from the Financial Supervisory Committee, and favorable regulation.<sup>73</sup>

### Thailand

In 1999, the Bank of Thailand, together with local and foreign financial institutions, formulated a binding framework of debtor-creditor and inter-creditor agreements. The Bank of Thailand established the Corporate Debt Restructuring Advisory Committee (CDRAC) to monitor the restructuring process and facilitate negotiation among parties. The CDRAC framework modified the pre-existing Bangkok rules, a framework for voluntary workouts modeled on the London Approach. The new framework reinforced the existing elements of the Bangkok rules through a contractual approach, after it became clear that the non-binding consensual approach of the Bangkok rules was not producing sufficient progress.<sup>74</sup>

Creditors taking part in CDRAC agreements agreed to abide by the CDRAC process in their negotiations with debtors and not seek recourse to the Bankruptcy Courts until the avenue of negotiations within CDRAC closed. The Agreements introduced mechanisms for dealing with breaches of the agreed process, for example, warnings and fines imposed by the Bank of Thailand for noncomplying creditors. The restructuring scheme introduced by CDRAC was comparable to the US Chapter 11 proceeding. Debt restructuring cases that followed the guidelines issued by the Bank of Thailand qualified for prearranged tax benefits and duty-stamp exemptions and reductions of land transfer fees.

It has been reported that by April 2002, 10,109 cases with debt worth THB1.3 trillion had been restructured under the CDRAC framework while CDRAC's target debtors owing approximately THB1 trillion worth of debt were taken to court by creditors.<sup>75</sup> The scheme gained credibility because of the threat of litigation (loan collection, liquidation, or reorganization) if a restructuring plan was not adopted. CDRAC introduced firm timetables with the threat of fines in case of noncompliance, mediation to resolve disputes between debtors and creditors, and arbitration to resolve disputes between creditors. Thai bankruptcy laws were amended in 1998, 1999, and 2004 to facilitate court supervised reorganization. About half of all court-supervised restructurings came from CDRAC referrals.<sup>76</sup>

73. See M. Pormeleano and W. Shaw (eds), "Corporate Restructuring Lessons from Experience," Chapter 4 by William P. Mako "Emerging-Market and Crisis Applications for Out-of-Court Workouts: Lessons from East Asia, 1998-2001" (World Bank, Washington, DC, 2005); Dongsoo Kang, "Key Success Factors in the Revitalization of Distressed Firms: A Case of the Korean Corporate Workouts" (Korean Development Institute, November 2003); N. Jassaud and K. Kang, "A Strategy for Developing a Market for Nonperforming Loans in Italy," IMF Working Paper WP/15/24 (IMF, Washington, DC, February 2015); K. O-Kyu, "Corporate Restructuring in Korea" (Korean Development Institute, 2016); <https://www.iflr1000.com/NewsAndAnalysis/Extension-of-Corporate-Restructuring-Promotion-Act/Index/5376>.

74. William Mako, "Uses and Limitations of Out-of-Court Workouts" (World Bank 2003).

75. J. Charoenseang and P. Manakit, "Financial Crisis and Restructuring in Thailand," *Journal of Asian Economics* (August 2002).

76. Tumnong Dasri, "Maximizing Value of Non-Performing Assets: Informal Workouts and Insolvency Reform Initiatives to Address NPL Problems in Thailand" (Corporate Debt Restructuring Group of Bank of Thailand, Forum for Asian Insolvency





### Turkey

The Banking Sector Restructuring Program was initiated in 2002, following serious bank profitability deterioration and a financial crisis. The Banking Regulatory and Supervision Agency (BRSA) approved an Inter-Creditor Agreement, a framework agreement among Turkey’s financial institutions. The Agreement established a scheme for a voluntary, out-of-court process for restructuring distressed companies. The scheme was reinforced by creating a special arbitration panel, with the mandate to approve the workout plans agreed on by the majority of creditors and to “cram down” dissenting creditors.

Between 2002 and 2005, a total of 322 firms owned by 30 holding companies participated in the program. The restructured loans were valued at US\$6 billion, of which US\$5.4 billion belonged to large conglomerates. One factor behind the program’s success was the large concentration of NPLs in a few borrowers. Nevertheless, the program faced a number of challenges. Some key obstacles were: (1) Turkey’s weak bankruptcy framework (debtors sought shelter from their creditors through the bankruptcy framework, and banks sought government and international institutions to bail them out), and (2) the banks’ reluctance to provide new financing to facilitate workouts.<sup>77</sup>

## B. STANDARDIZED OCW FRAMEWORKS FOR MSMEs

**Standardized OCW frameworks are particularly effective for MSMEs in distress.** These workout frameworks provide restructuring schemes that are adopted by the financial sector or at the centralized level and include standardized restructuring plans based on the debtors’ common characteristics. Given that MSMEs’ business models are relatively simple and repetitive, standardized out-of-court restructuring processes are good candidates for dealing with the large volumes and low value of MSME distress on a portfolio basis.

### *Box 5. Examples of Standardized OCW Frameworks for MSMEs*

#### Iceland

Iceland was the first country to graduate from the IMF Economic Recovery Program following the financial crisis in 2008. Many factors determined its successful recovery: monetary policy measures such as introduction of capital controls, fiscal measures, and financial sector restructuring were complemented by corporate and household sector

Reform (FAIR), Seoul, Korea, November 2013); J. Charoenseang and P. Manakit, “Financial Crisis and Restructuring in Thailand,” *Journal of Asian Economics* (August 2002); J. Garrido, *Out-of-Court Debt Restructuring* (Washington, DC: World Bank, 2012); “Thailand: Selected Issues,” IMF Staff Country Report No. 00/21 (IMF, Washington, DC, 2000); “Thailand Develops Court-Supervised Restructuring” (March 1, 2012), <https://www.dlapiper.com/en/us/insights/publications/2012/03/thailand-develops-courtsupervised-restructuring/>.

77. L. Karadayi, “Dealing with Private Debt Distress in the Wake of the COVID19 Pandemic Crisis: Lessons from the Istanbul Approach from the Country Economics and Engagement Team,” IFC Note (2020).



restructuring programs.<sup>78</sup> Iceland's Voluntary Debt Restructuring Scheme (2010) was adopted after the collapse of almost its entire financial system. In 2010, the government, banks, and social partners entered into a voluntary (nonbinding) debt restructuring scheme based on "joint rules on the financial restructuring of companies," specifically targeting SMEs with less than approximately US\$8 million in liabilities.<sup>79</sup> Under the agreement, all SMEs were to be reviewed and loans to viable SMEs would be written down to the net present value (NPV) of their cash flows as estimated by the corresponding lender.<sup>80</sup> Lenders received equity stakes in exchange for writing down debt, reducing the incentive for solvent SMEs to take advantage of the system.<sup>81</sup> The scheme included an arbitration committee to resolve disputes among parties involved. The government supported the scheme by requiring banks to distinguish between viable and non-viable firms, introducing various tax incentives (for example, not taxing gains from debt write-downs, and restructuring tax arrears like other debts), and subjecting banks to monthly targets for SME restructurings.<sup>82</sup>

Preliminary 2013 data showed write-offs to SMEs equaled 12.5 percent of the country's GDP, and write-offs for household equaled about 11 percent of GDP. By the end of 2017, household and corporate debt levels (which had reached 350 percent of GDP in 2008), had declined by more than half. These positive results could be attributed to multiple factors, including debt write-downs, government-initiated debt relief measures, increased savings from households, and rising GDP.<sup>83</sup> Despite the slow start, the Voluntary Debt Restructuring Scheme was a successful private sector–debtor restructuring example because it helped, along with other interventions, solve a large private sector–debt overhang problem and restore bank balance sheets. According to IMF, the program's overall design was "instrumental in mitigating the risks, striking an appropriate balance between short- and medium-term objectives."<sup>84</sup>

The European Commission's evaluation of the country's performance under the Small Business Administration Act for Europe (SBA, a EU strategy to improve the business environment for SMEs), identified Iceland as a strong performer in all areas, including:

78. "Iceland: Ex Post Evaluation of Exceptional Access Under the 2008 Stand-by Arrangement," IMF Country Report No. 12/91 (IMF, Washington, DC, April 2012).

79. Bergthaler, W., K Kang, Y Liu and D Monaghan "Tackling small and medium sized enterprise problem loans in Europe," IMF Staff Discussion Note, IMF (2015).

80. OECD Economic Surveys: Iceland (2011).

81. *Ibid*

82. IMF Country Reports No. 11/263, August 2011 (IMF, Washington, DC) and No. 12/91, April 2012 (IMF, Washington, DC); Bergthaler, W., K Kang, Y Liu and D Monaghan "Tackling small and medium sized enterprise problem loans in Europe," IMF Staff Discussion Note, IMF (2015).

83. P. Baudino, J.T. Sturluson, and J.-P. Svoronos, "The Banking Crisis in Iceland," FSI Crisis Management Series 1 (Financial Stability Institute, Bank of International Settlements, March 2020).

84. "Iceland: Ex Post Evaluation of Exceptional Access Under the 2008 Stand-by Arrangement," IMF Country Report No. 12/91 (IMF, Washington, DC, April 2012).



entrepreneurship, “second chance,” responsive administration, access to finance, skills, and innovation.<sup>85</sup>

### Republic of Korea

In 1999, Korea’s Financial Supervisory Commission instructed the banks to evaluate the financial soundness of SMEs, identify targets for workouts, and set up special task forces to deal with SME restructuring. Banks identified about 40 percent of SMEs (out of about 22,000) as viable candidates for workouts. Restructuring options included rolling over SME loans by a certain date, providing grace periods for repayment, reducing interest rates, and, for larger banks, injecting liquidity by providing new money. Working capital was made available to SMEs through government-sponsored credit guarantees and corporate restructuring funds that provided for both debt and equity investments (via convertible bonds and debt-equity swaps).

The 1999 scheme was criticized for its high level of government financial support and for introducing barriers for entry of new firms because state guarantees were available to SMEs with ties to larger corporates and were constantly rolled over. Government loan guarantees rose from 12 percent of lending to SMEs in 2007 to 16 percent in 2010. A 2012 study of the Bank of Korea found that about 63 percent of SMEs survived for a decade while failing to earn enough income to cover their interest payments.<sup>86</sup> Another study by the government found little difference in the performance (in terms of profitability and growth) between firms that received government financial support and those that did not during the period from 2003 to 2009.<sup>87</sup> According to the Bank of Korea, the banks’ implementation of the scheme was too lenient, and, as a result, many nonviable SMEs received debt relief.<sup>88</sup>

85. Sources include IMF Staff Reports on Iceland (IMF, Washington, DC, 2010, 2011, and 2013); P. Baudino, J.T. Sturluson, and J.-P. Svoronos, “The Banking Crisis in Iceland,” FSI Crisis Management Series 1 (Financial Stability Institute, Bank of International Settlements, March 2020); W. Bergthaler, K. Kang, Y. Liu, and D. Monaghan, “Tackling Small and Medium Sized Enterprise Problem Loans in Europe,” IMF Staff Discussion Note (IMF, Washington, DC, 2015); European Commission SBA Factsheet 2016; C. Adams, et al., “Managing Financial and Corporate Distress: Lessons from Asia” (2000); M. Pormeleano and W. Shaw, “Corporate Restructuring Lessons from Experience” (World Bank, Washington, DC, 2005); OECD Economic Surveys: Iceland (2011); IMF Staff Discussion Note (IMF, Washington, DC, 2011, 2012); T. Matthiasson, “Iceland’s Debt Relief Lessons for Eurozone,” *The Guardian* (August 21, 2012), <https://www.theguardian.com/business/economics-blog/2012/aug/21/iceland-debt-relief-lessons-eurozone>.

86. R. Jones and M. Kim, “Promoting the Financing of SMEs and Start-Ups in Korea,” OECD Economic Department Working Papers 1162 (2014).

87. K. O-Kyu, “Corporate Restructuring in Korea” (Korean Development Institute, 2016).

88. C. Adams, et al., “Managing Financial and Corporate Distress: Lessons from Asia” (2000); W. Bergthaler, K. Kang, Y. Liu, and D. Monaghan, “Tackling Small and Medium Sized Enterprise Problem Loans in Europe,” IMF Staff Discussion Note (IMF, Washington, DC, 2015); A. Chopra, et al., “From Crisis to Recovery in Korea: Strategy, Achievements and Lessons,” IMF WP/01/154 (IMF, Washington, DC, 2001); K. O-Kyu, “Corporate Restructuring in Korea,” Korean Development Institute (2016); M. Pormeleano and W. Shaw, “Corporate Restructuring Lessons from Experience” (World Bank, Washington, DC, 2005).



### C. INSOLVENCY LAW REFORMS DURING PAST FINANCIAL CRISES

**The Asian Crisis and the Global Financial Crisis triggered broad insolvency law reforms in parallel to centralized measures as well as following the crisis.** As out-of-court restructuring takes place in the “shadow” of the law,<sup>89</sup> a strong formal insolvency framework is critical to prevent a future build-up of corporate distress levels. A good example is Iceland during the 2008 crisis: its Voluntary Debt Restructuring Scheme (discussed above) was only part of the wide-reaching legal and regulatory reforms that helped produce long-term positive results. In addition to temporary non-performing loan restructuring measures, entire corporate and MSME insolvency regimes were also revised in Korea and Thailand to create a credible threat of bankruptcy for uncooperative debtors. Several countries in East Asia and the Pacific region introduced simplified or abbreviated processes for SME debt restructuring (for example, Japan, Korea, Lao People’s Democratic Republic, Thailand), provided for a discharge of individual entrepreneurs (e.g., Japan, the Philippines) and established informal, court-approved restructuring processes (e.g., Japan, Republic of Korea, Thailand).

## 6. CONCLUSION

**This note takes stock of insolvency measures that countries implemented to address the economic effects of a crisis, which have applicability in both developed and emerging markets.** It divided these measures into two categories: crisis containment and crisis recovery. In particular, it focuses on the COVID-19 pandemic while recognizing that the full effects and extent of that crisis are still unknown. To date, countries have focused on containing the crisis through short-term emergency measures and are preparing to better address high levels of business distress by improving their insolvency implementing institutions and insolvency legislation, using, for example, new restructuring processes and regimes that better address the needs of MSME insolvency. Nonetheless, some countries with high levels of business distress risk a significant rise in NPLs, to the point of a possible systemic banking crisis in the financial sector.

**Countries with underdeveloped insolvency regimes and implementing institutions should proactively assess them, focusing on preventative measures to build the processes and capabilities needed to resolve situations of severe corporate distress in a timely and effective manner.** Existing institutional frameworks should be strengthened by increasing courts’ capacity, judicial specialization in insolvency and commercial matters and by leveraging technology. During crisis recovery, informal or hybrid restructuring process and simplified processes for MSMEs should be prioritized over fully-fledged judicial procedures in order to quickly achieve preservation of distressed viable businesses, facilitate quick exit of non-viable ones and reduce burden on the court system. The law and the courts should also recognize the possibility of quickly

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89. This means that the restructuring framework is informal and not set out in the formal insolvency legislation. Ultimately, the strength of the informal scheme depends on the “stick” of a well-functioning formal framework.



resolving no-income, no-asset cases and provide for a discharge and fresh start for all natural-person entrepreneurs.

**Large-scale banking and corporate distress could be dealt with via interim solutions (combining out-of-court restructuring tools and fiscal and regulatory measures) to help prevent the likely wave of bankruptcies and the possibility of systemic bankruptcies that could cause externalities across whole sectors of the economy.** Past banking crises found many countries unprepared, and they were forced to react to the large-scale banking and corporate distress by hastily adopting novel, typically centralized, out-of-court restructuring measures to address sector-wide distress. It is difficult to qualify the success of these measures due to attribution problems. Most of these measures were introduced in the contexts of financial crises along with significant regulatory, financial, and legal reforms. Lessons from past crises, however, show that centralized OCWs work better when: (1) they are driven by banks with indirect support from and coordination with government; (2) the regulatory and legal frameworks are adequate; (3) viable and non-viable firms are differentiated; and (4) financial and operational restructurings occur simultaneously in combination. In many countries, these extraordinary measures have been followed by more comprehensive and permanent insolvency law reforms. Because of the insolvency law reforms that took place after the 1997/1998 Asian Crisis and the 2007/2008 Global Financial Crisis, some countries now find themselves better prepared to deal with the possible wave of insolvencies arising from the COVID-19 pandemic. Others will be forced to adopt quick solutions in the interim while placing insolvency legislative and institutional reform on the longer-term agenda.


## 7. ANNEX 1: SPECTRUM OF RESTRUCTURING AND INSOLVENCY PROCESSES

Formality	Procedure	Advantages	Disadvantages	Level of Distress	Key Considerations for Enabling Environment*	
	<b>Out-of-court workouts</b>	E.g. The London Approach; INSOL Principles)	<ul style="list-style-type: none"> <li>- No legislative process required (in some cases non-binding guidelines may be adopted by a government agency to encourage standardized multi-creditor behavior)</li> <li>- No court involvement</li> <li>- Confidential, flexible and fast</li> <li>- Cost-effective (no court or insolvency practitioner costs)</li> <li>- Option to select creditors to negotiate with</li> </ul>	<ul style="list-style-type: none"> <li>- Coordination problems and risk of creditor holdout</li> <li>- Risk of creditor actions during the negotiation period (insolvency filing or individual debt enforcement actions)</li> <li>- Risk of avoidance actions in subsequent insolvency (unless insolvency law impedes revocation of good-faith informal workouts)</li> <li>- No scrutiny of management's behavior pre-restructuring</li> </ul>	<div style="display: flex; justify-content: space-between;"> <div style="background-color: #ffff00; padding: 5px;">Financial difficulty</div> <div style="background-color: #ffa500; padding: 5px;">Imminent insolvency</div> </div>	<ul style="list-style-type: none"> <li>✓ Negotiation culture among creditors and debtors</li> <li>✓ Availability of financial information (refer to WB-ICR Principle B1**)</li> <li>✓ Existence of contract rules that allow modification of debts and establish good faith requirements for the parties to the contract</li> <li>✓ "Shadow of law" (availability of recourse to debt enforcement, liquidation and/or reorganization proceedings)</li> </ul>
	<b>Enhanced workouts</b>	E.g. Republic of Korea Financial Institutions' Agreement for Promotion of Company Restructuring; Thailand's CDRAC; Istanbul Approach)	<ul style="list-style-type: none"> <li>- No legislative process required (but in some cases corporate restructuring laws may be passed to enhance the effectiveness of the system)</li> <li>- No court involvement (but often another coordinating institution involved, e.g. financial supervisor)</li> <li>- Cooperation reinforced by fiscal and regulatory incentives (e.g. tax exemptions, regulatory forbearance, modified labor standards) to restructure and/or penalties for failure to meet deadlines</li> <li>- Possible to bind dissenting creditors that are part of the inter-creditor accord</li> </ul>	<ul style="list-style-type: none"> <li>- Fiscal and regulatory incentives can distort incentives of market participants and prop-up non-viable businesses</li> <li>- Often involve fiscal costs</li> <li>- Restructurings only cover certain creditors as part of the inter-creditor accord – trade creditors, tax claims, labor claims normally excluded</li> <li>- Debtor not a party to the inter-creditor accord and therefore does not have a say on the workout process</li> <li>- Limited effectiveness for borrowers with only one financial creditor (often micro and small enterprises)</li> </ul>	<div style="display: flex; justify-content: space-between;"> <div style="background-color: #ffff00; padding: 5px;">Financial difficulty</div> <div style="background-color: #ffa500; padding: 5px;">Imminent insolvency</div> </div>	<ul style="list-style-type: none"> <li>✓ A strong, proactive coordinating agency (usually a central bank/ financial supervisor) (refer to WB-ICR Principle B4.1)</li> <li>✓ Cooperative FIs (inter-creditor accords should cover all or almost all FIs)</li> <li>✓ "Shadow of law" (availability of recourse to debt enforcement, liquidation and/or reorganization proceedings)</li> </ul>
	<b>Hybrid workouts</b>	E.g. US Chapter 11 pre-packaged bankruptcies; UK scheme of arrangement; Singapore's scheme of arrangement (2017); Dutch confirmation of extra-judicial restructuring plan procedure (2021); French conciliation procedure	<ul style="list-style-type: none"> <li>- Combines speed, flexibility and informality of purely contractual restructurings with the benefit of access to formal processes in court to preserve the going concern business value</li> <li>- Reduced stigma and publicity while negotiations are ongoing</li> </ul>	<ul style="list-style-type: none"> <li>- Due to informality, may lead to inefficient and/or unfair outcomes for minority creditors</li> <li>- The court may find that pre-bankruptcy disclosure was inadequate and refuse approval of the restructuring plan (see, for e.g. Section 1125(a) of the US Bankruptcy Code)</li> </ul>	<div style="display: flex; justify-content: space-between;"> <div style="background-color: #ffff00; padding: 5px;">Financial difficulty</div> <div style="background-color: #ffa500; padding: 5px;">Imminent insolvency</div> </div>	<ul style="list-style-type: none"> <li>✓ Adequate expertise and capacity of courts</li> <li>✓ Availability of financial information (refer to WB-ICR Principle B1)</li> <li>✓ Enabling legislative framework (refer to WB-ICR Principles B3 and B4)</li> <li>✓ Availability of recourse to debt enforcement, liquidation and/or reorganization proceedings</li> </ul>

\* It should be noted that country approaches to the design of insolvency and restructuring processes vary. It is important that countries, when adopting these processes, consider the unique context of their legal and commercial systems.

\*\* The World Bank Principles for Effective Insolvency and Creditor/Debtor Regimes. Available at: [www.worldbank.org/insolvency](http://www.worldbank.org/insolvency)

## 7. ANNEX 1: SPECTRUM OF RESTRUCTURING AND INSOLVENCY PROCESSES



Formal insolvency procedures	Preventative hybrid workouts	E.g. Germany's pre-insolvency scheme ("StaRUG"); French safeguard procedure	<ul style="list-style-type: none"> <li>- Provides for court-imposed stay</li> <li>- Includes statutory protection of new finance</li> <li>- Can bind dissenting creditors ("cram-down" feature)</li> <li>- May provide for court and insolvency practitioner oversight and assistance (e.g. judicial resolution of disputes) while debtor continues to control its assets and business operations (debtor-in-possession)</li> </ul>	<ul style="list-style-type: none"> <li>- Same as above</li> <li>- Can be costly as usually an insolvency practitioner must be appointed</li> <li>- Usually public (which can be associated with stigma)</li> </ul>	Financial difficulty	Imminent insolvency	<ul style="list-style-type: none"> <li>✓ Adequate expertise and capacity of courts (refer to WB-ICR Principles D1-D6)</li> <li>✓ Availability of qualified insolvency practitioners (refer to WB-ICR Principles D7-D8)</li> <li>✓ Enabling legislative framework</li> <li>✓ Availability of recourse to debt enforcement, liquidation and/or reorganization proceedings</li> </ul>
	Judicial reorganization	E.g. France's judicial reorganization procedure - <i>redressement judiciaire</i> ; US Chapter 11 judicial reorganization procedure; UK administration procedure	<ul style="list-style-type: none"> <li>- Provides access to all formal mechanisms to preserve the going concern value of business (stay, challenge of fraudulent or preferential transactions, continuation of essential contracts, etc.)</li> <li>- Protects new finance</li> <li>- Plan can bind dissenting creditors</li> <li>- Allows amendment of contracts</li> <li>- Provides for substantial court and insolvency practitioner oversight                             <ul style="list-style-type: none"> <li>- Some aspects may be simplified for micro and small enterprises</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>- Usually costly and lengthy</li> <li>- Can be disruptive to business operations</li> <li>- Sometimes delays inevitable liquidation</li> <li>- Publicity, stigma</li> <li>- The process is driven by court and insolvency practitioners (debtor removed from management in some systems)</li> </ul>	Imminent insolvency	Insolvency	<ul style="list-style-type: none"> <li>✓ Adequate expertise and capacity of courts (refer to WB-ICR Principles D1-D6)</li> <li>✓ Availability of qualified insolvency practitioners (refer to WB-ICR Principles D7-D8)</li> <li>✓ Insolvency legislation enabling and detailing the formal reorganization procedure (refer to WB-ICR Principles, Part C)</li> </ul>
	Liquidation	E.g. UK liquidation procedure; Republic of Korea bankruptcy proceeding	<ul style="list-style-type: none"> <li>- Enables orderly exit of non-viable business from the market and distribution of the proceeds to creditors</li> <li>- In some cases, sale of business as going concern can be achieved, thereby preserving its continuity                             <ul style="list-style-type: none"> <li>- Some aspects may be simplified for micro and small enterprises</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>- Low creditor recovery (quick diminution in value)</li> <li>- Can be lengthy</li> <li>- Auction process can be non-transparent</li> <li>- Bailiffs/sheriffs might not have adequate training or protections for the seizure and sale process</li> <li>- Movable property might not be traceable</li> </ul>	Insolvency		<ul style="list-style-type: none"> <li>✓ Adequate expertise and capacity of courts (refer to WB-ICR Principles D1-D6)</li> <li>✓ Availability of qualified liquidators (refer to WB-ICR Principles D7-D8)</li> <li>✓ Insolvency legislation enabling and detailing the liquidation procedure (refer to WB-ICR Principles, Part C)</li> </ul>

### Definitions

**Out-of-court workout** – a privately negotiated restructuring between the debtor and all or some of its creditors

**Enhanced workout** – a workout with the involvement of an administrative authority but with no provision for a court to play a role

**Hybrid workout** – a procedure that involves private negotiation of a restructuring agreement and provides for a court role short of supervision of the full procedure

**Preventative hybrid workout** – hybrid procedure aimed at restructuring, while under court protection, of a debtor's business that is in financial distress but not yet in a technical state of insolvency

**Judicial reorganization** – a court-supervised restructuring process aimed at restoring the financial well-being and viability of a debtor's business

**Liquidation** – a court-supervised process by which assets are sold and disposed for distribution to creditors, in accordance with a ranking of claims established by law

\* It should be noted that country approaches to the design of insolvency and restructuring processes vary. It is important that countries, when adopting these processes, consider the unique context of their legal and commercial systems.

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