International Finance Corporation
World Bank Group

INSOLVENCY REFORM

Overview of Emerging International Standards and Practices

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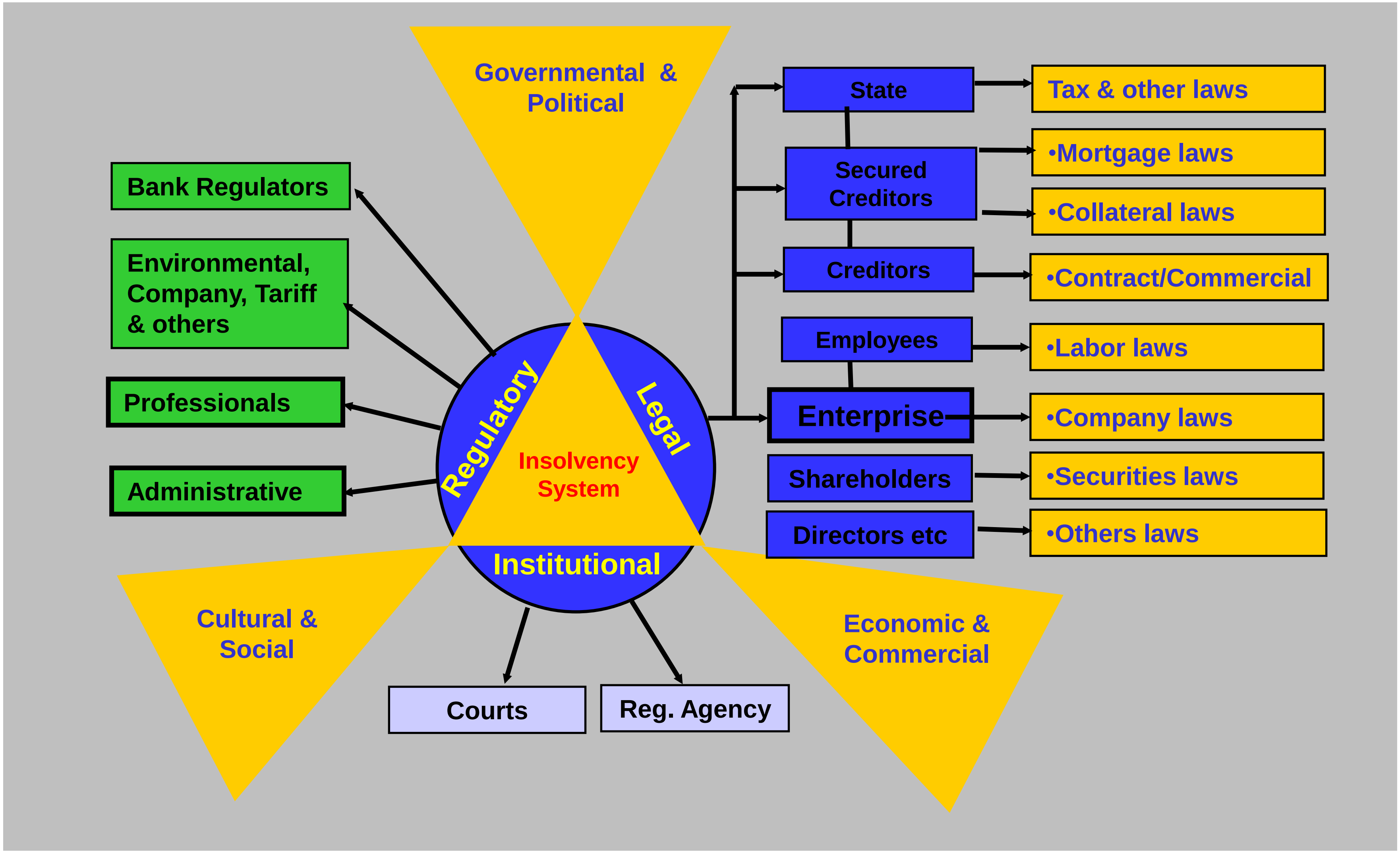
THERE IS NO ONE 'BEST' LAW

Insolvency law governs the intersection of many other laws, policies, and cultural elements as well as the state of the economy: Credit, secured transactions, mortgage, enforcement, tax, labor, environmental, utilities and administrative laws.

Every insolvency law must be drafted consistent with specific country context.

CONTEXT FOR INSOLVENCY SYSTEMS



Source: The World Bank

INSOLVENCY LEGISLATION

HOWEVER: There are emerging agreed upon principles.

WORLD BANK	**Principles for Effective Creditor Rights and Insolvency Systems**
UNCITRAL	**Legislative Guide on Insolvency Law**

The UNCITRAL legislative Guide (2004) involved 87 states; 14 intergovernmental organizations; 13 non-governmental organizations. The World Bank Principles (2005) involved 70 international experts, vetted by 700 participants from 75 countries.

INSOLVENCY SYSTEM GOALS

PRIMARY GOAL

MAXIMIZE RETURNS TO CREDITORS

ECONOMIC FUNCTION	▪ BANKRUPTCY LAW IS NOT SOCIAL LEGISLATION ▪ BANKRUPTCY LAW IS NOT CRIMINAL LAW
EFFECT BEYOND DEBTOR - CREDITOR RELATIONS	▪ PUNITIVE SYSTEMS DISCOURAGE CREATIVITY, ENTREPRENEURSHIP AND NEW BUSINESS ENTRY

DESIREABLE BY-PRODUCTS

FINANCIAL SYSTEM STABILITY	FAVORABLE CREDIT TERMS	ATTRACTIVE BUSINESS ENVIRONMENT	ASSETS RECYLED BACK TO PRODUCTIVE USE	ECONOMIC DYNAMISM	INCREASED BUSINESS RISK-TAKING

BUSINESS INSOLVENCY FRAMEWORK

TYPES OF FORMAL COURT PROCEEDINGS

BUSINESS EXIT	▪ Orderly transparent efficient system for business to exit the market when an enterprise cannot be reorganized. (Liquidation) Procedure for the gathering and sale of the debtor's assets and distribution of the proceeds to creditors in accordance with rank and priority.
BUSINESS RESCUE	▪ Reorganization of a company through approval of a plan of creditor repayment by creditor vote and court approval.

INFORMAL NEGOTIATIONS

WORKOUT	▪ Informal (non-court) restructuring of specific debts on a voluntary basis, typically by unilateral contractual agreement. Non-binding on non-participants. Some countries have formalized guidelines and procedures to foster these negotiations.

KEY PROVISIONS FOR EFFECTIVE INSOLVENCY REGIMES

GENERAL SYSTEMIC

- **Balance in Rights.** A proper balance between creditor and debtor rights.
- **Negotiation Framework.** (Amicable out-of-court workout framework to foster negotiations; *conciliation* or *manditere ad hoc*. These operate in the shadow of any formal bankruptcy statutes and procedures that provide the consequences for failure to reach agreement.)
- **Professional Bankruptcy Administrators.** Sufficient power to act, sufficient pay to attract qualified professionals, priority . Qualification standards. Approved list. Regulatory or private association oversight. Consider licensing.
- **Role Alignment: Judge vs. Administrator.** Roles should be properly aligned so that judicial matters (deciding) remain with the court, and pure administration (business) is left to the professional Bankruptcy Administrator.

LEGAL REGIME

- **Lex Specialis.** Bankruptcy regime must override other provisions of law to the extent necessary to function.
- **Ease of access/ Commencement standards.** Liberal commencement criteria: Liquidity, cash-flow, general cessation of payments. "*General failure to pay debts as they come due*." Requirements for creditor petitions (to filter out simple debtor-creditor disputes).
- **Strong Creditor Role.** Strong well-defined role for creditors to assert claims, object, vote, and otherwise participate in the proceedings as a balancing factor to the administrator/debtor.
- **Removal of Punitive elements.** Honest business failure is not a crime. Punish culpable behavior (hiding assets, stealing from the estate).
- **Distribution priorities.** Priorities that respect the relative rank under non-bankruptcy law (secured vs. unsecured). Avoid over-reaching advantage for government claims or other priorities. Equal treatment of similarly situated creditors.
- **Avoidance powers.** Provision to retrieve property improperly transferred; assets held by 3rd parties.
- **Rejection Powers.** Ability to assume or reject contracts (and treat damages as claims in bankruptcy).
- **Cross-Border Provisions.** UNCITRAL Model Law on Cross-Border Insolvency.

KEY PROVISIONS FOR EFFECTIVE INSOLVENCY REGIMES

BUSINESS RESCUE SPECIFIC

- **Moratorium / Stay of Enforcement.** Needed to create breathing space to formulate a plan of reorganization. Limited duration; not absolute.
- **Cure Default / *Ispo facto* clauses.** Needed to unwind automatic punitive provisions that prevent reorganization (penalty interest rates).
- **Plan Subject to Creditor Vote**. Preparation of a fully transparent plan for the payment of creditor claims that is approved by a vote of creditors.
- **Over-rule of Dissenting Creditors.** Provisions that provide for approval of a plan by sufficient majority voting creditors overruling dissenting minority creditors. This prevents a minority creditor hold-out acting a veto to an acceptable plan.
- **Approved Plan Binding.** Provisions of an approved plan must be binding on all creditors to properly function.
- **Flexible Reorganization Measures.** Full flexibility should be afforded to the methods used to reorganize.
- **New Funding**. A high priority or super-priority (rare exception) for new funds as an incentive for lending in an insolvency context.
- **Tax and Securities Laws**. Forgiveness of indebtedness pursuant to a reorganization plan should not create tax liability. Security laws governing ordinary public offerings should be liberalized to accommodate debt-to-equity swaps the issuance of new shares to creditors.

CULTURAL / RELIGIOUS ELEMENTS

- **Sharia compliant.** Provisions that are consistent with religious and cultural practices.

TYPICAL METHODS FOR REORGANIZATION

- retention of all or part of the property;
- sale of assets or transfer in satisfaction of claims;
- closure of unprofitable operations or changing business activities;
- cancellation or reformulation of burdensome or unfavorable contracts or leases;
- deferment of debt payments or providing for repayment by installments;
- modification of maturity dates, interest rates, or other terms of a loan or security instrument;
- full or partial debt forgiveness;
- satisfaction or modification of pledges, liens or security interests;
- conversion of unsecured loans into secured loans;
- pledge of unencumbered assets;
- conversion of debt to equity;
- obtaining new credit;
- obtaining new investment;
- challenge and invalidation of claims lacking in legal validity;
- curing of defaults;
- termination of employment;
- amendments of the debtor’s charter, by laws or other founding or governing documents;
- merger or consolidation with one or more entities;
- transfer of all or part of the property to one or more existing or newly formed entities;
- cancellation or issuance of new securities;
- any other measures not prohibited by law.

IFC ADVISORY SERVICES: DEBT RESOLUTION & BUSINESS EXIT

Effective advisory assistance tailored to enabling business rescue or efficient exit

KEY PROGRAM PILLARS

Modernization of Laws and Regulations	Technical advisory and drafting assistance for the development of efficient and effective insolvency regimes consistent with modern international standards, including laws that enable the reorganization of financially distressed firms to preserve going-concern value and save jobs, where possible, and efficient cost-effective legal mechanisms for unviable firms to exit the market when necessary.
Capacity building for insolvency Practitioners	Technical assistance in developing high-quality regulatory frameworks for effective oversight of insolvency practitioners, as well as skills training necessary build cadres of competent, qualified professionals.
Out-of-Court Workout Regimes	Technical advisory and drafting assistance for the development of a effective frameworks or debtors and creditors to resolve distressed debt situations without the formalities, costs and delays associated with traditional court proceedings, while minimizing business interruption and public stigma.

IFC has become the world's largest multilateral institution focused on private sector development, with a clear vision focused on poverty reduction and life improvement

Vision — ***People should have the opportunity to escape poverty and improve their lives***

We foster sustainable economic growth in developing countries by supporting private sector development, mobilizing private capital, and providing advisory and risk mitigation services to businesses and governments

Structure

- Owned by 183 member countries
- IFC is the main driver of private sector development in the World Bank Group
- Collaborates with other members of the group, including the World Bank (IBRD and IDA, MIGA and the International Centre for Settlement of Investment Disputes)
- Global: Headquartered in Washington, D.C.
- Local: More than 100 offices worldwide in 92 countries

Number Highlights

- Investments: 518 new projects in 102 countries
- Advisory services: $207 million in project expenditures
- $18.7 billion in financing: $12.2 billion for IFC's own account, $6.5 billion mobilized
- $55.2 billion committed portfolio, representing investments in 1,737 firms

Key Milestones

1956	IFC launched - 12 years after the Bretton Woods Conference created the World Bank to finance post-WWII reconstruction and development by lending to governments. Original mandate: Supporting development by encouraging private investment (a new part of the global economic agenda)
1980s	IFC coins the term "emerging markets"
1990s	IFC increases in size, importance after fall of Berlin Wall
Today	IFC is the world's largest multilateral institution focused on private sector development, widely seen as an essential source of job creation, growth, and poverty reduction