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Introduction

Recent experience has demonstrated the extent to which the absence of orderly and effective insolvency procedures can exacerbate economic and financial crises. Without effective procedures that are applied in a predictable manner, creditors may be unable to collect on their claims, which will adversely affect the future availability of credit. Without orderly procedures, the rights of debtors (and their employees) may not be adequately protected and different creditors may not be treated equitably. In contrast, the consistent application of orderly and effective insolvency procedures plays a critical role in fostering growth and competitiveness and may also assist in the prevention and resolution of financial crises: such procedures induce greater caution in the incurrence of liabilities by debtors and greater confidence in creditors when extending credit or rescheduling their claims.

This report identifies and discusses the key issues that arise in the design and application of orderly and effective insolvency procedures. Although it is based on a comparative study of selected insolvency laws, it is not intended to be a description of those laws. As will be seen, the approaches adopted by countries vary in a number of respects, with these differences being attributable not only to divergent legal traditions but also to different policy choices. Because of these differences, international standards do not exist in this area, and this report does not attempt to propose such standards. However, in its discussion of the key issues in this area, the report weighs the advantages and disadvantages of possible solutions, and, in that context, sets forth conclusions in which preferences are expressed.

Given the multiplicity of questions raised by insolvency proceedings and the diversity of responses in national laws, this report is necessarily selective. It focuses on the most important issues and the principal policy choices that need to be made when resolving these issues. An early caveat regarding labels is necessary: while these policy choices are often described as reflecting an underlying "pro-creditor" or "pro-

debtor" attitude, these terms often have different meanings in different countries and, accordingly, they are not used extensively in this report. For instance, in some countries a pro-debtor insolvency law is understood as favoring the management of the debtor company, thereby allowing it to retain control of the company or to negotiate from a position of strength with its creditors. In other countries, insolvency law will be characterized as being pro-debtor primarily because it allows the enterprise to survive and the employees to keep their jobs, while the managers are replaced by an administrator and, eventually, a new owner of the enterprise. Similarly, pro-creditor laws may differ regarding the way they address the respective rights of secured and unsecured creditors. While secured creditors are often the main beneficiaries of outright liquidation proceedings in which the realization of their collateral will ensure the full and prompt payment of their claims, unsecured creditors may benefit from a rehabilitation procedure that will maximize the value of the debtor's assets and, therefore, the value of the unsecured creditors' claims.

In any event, experience shows that the degree to which an insolvency law is perceived as pro-creditor or pro-debtor is, in the final analysis, less important than the extent to which these rules are effectively implemented by a strong institutional infrastructure. In particular, given the complex and urgent nature of insolvency proceedings, effective implementation requires judges and administrators that are efficient, ethical, and adequately trained in commercial and financial matters and the specific legal issues raised by insolvency proceedings. A pro-debtor law that is applied effectively and consistently will engender greater confidence in financial markets than an unpredictable pro-creditor law.

The scope of this report is limited in a number of important respects.

- Since the IMF is principally concerned with those activities that have the greatest impact on a country's economy, the discussion will address the application of insolvency laws to enterprises rather than individuals. Indeed, while this report does not distinguish between large and small enterprises (and does not argue that an insolvency law should), it recognizes that a number of the issues discussed may only be of particular relevance to a relatively large enterprise that has a number of creditors with divergent interests.
- This report does not discuss legal mechanisms that address the liquidity problems confronted by national or local governments. However, government ownership of an enterprise should not, in and of itself, exempt such enterprises from the disciplinary forces of insolvency laws.

- The insolvency of financial institutions is not discussed in any detail. Because of the unique role that these institutions play in the national economic and financial system, many countries have designed specialized regimes for them. A separate study, in progress, will discuss whether such specialized regimes are merited and, if so, how they should be designed.

- This report does not contain a comprehensive discussion of the important but complex relationship between corporate governance and insolvency. It does, however, briefly discuss the question of whether management should be personally liable for failing to commence proceedings when the financial conditions for commencement have otherwise been met.

- Nor does this report discuss issues relating to the law on secured transactions, which is also closely related to insolvency, particularly in jurisdictions that enable a creditor to obtain a "floating charge" or general security interest over most of the debtor's assets. In a number of these jurisdictions, such secured creditors may enforce their security either by appointing a receiver under a private contract or through the courts of general jurisdiction. In these cases, the enterprise is liquidated without recourse to the general insolvency law.

- Although this report stresses the importance of judicial implementation, it does not contain an extensive analysis of the general features of an independent and competent judiciary. However, it does discuss how the design of an insolvency law needs to take into consideration the capacity of the judiciary and also briefly reviews some of the issues that are specific to the implementation of such laws.

- This report will not discuss in detail the features of out-of-court rehabilitation procedures, which can play a critical role in resolving financial crises. However, it will discuss them indirectly, since the way in which an insolvency law is designed and implemented plays a critical role in defining the leverage of creditors and debtors when they attempt to negotiate out-of-court settlements.

This report consists of six chapters. Chapter 2 contains a discussion of the general objectives and features of insolvency procedures and, in that context, identifies the principal features of the two main types of procedures, namely, liquidation procedures and rehabilitation procedures. These features are described in greater detail in Chapter 3 (liquidation procedures) and Chapter 4 (rehabilitation procedures).

Chapter 5 briefly discusses institutional aspects of insolvency procedures and, in particular, addresses the important role of the court and the administrator. Chapter 6 briefly reviews the major issues raised by cross-border insolvencies, and the Appendix contains a study prepared by the UNCITRAL Secretariat regarding the UNCITRAL model law that is designed to address these problems.