



Annexes: Chapter 3

Annex 3A

How a weak insolvency framework inhibited Mexico's recovery from its financial crisis of 1994–95

In 1994–95, Mexico experienced rapid and widespread business distress as a result of a currency devaluation and the withdrawal of foreign credit and investment. In 1995, the stock market plummeted 40 percent; the gross domestic product (GDP) fell by 6.2 percent; and almost 800,000 jobs were lost.¹ Real interest rates were higher than 30 percent for most of 1995, prompting widespread debtor default.²

Systemic weaknesses, including in bankruptcy law, exacerbated the difficulties. Mexican bankruptcy law prior to the crisis lacked a formal framework for out-of-court workouts, and the formal regime was vulnerable to misuse by debtors seeking to avoid repayment without consequence.³ The capacity of the courts to enforce commercial contracts was unpredictable and slow, and there was a lack of transparency and accountability in judicial decision-making.⁴ At the time of the crisis, credit bureaus were new and not widely used by creditors.⁵

Between 1995 and 2001, Mexico made multiple legislative attempts to facilitate restructuring. In 1995, the Unidad Coordinadora para el Acuerdo Bancario Empresarial (UCABE, Coordinating Unit for the Business Banking Agreement) was established to facilitate the voluntary restructuring of large debtor companies. These large companies held debts representing about 8 percent of the total outstanding loans in the Mexican banking system at the end of that year.⁶ UCABE partly succeeded in reducing the overall debt burden of banks. By the end of 1996, 31 loans had been restructured for a total value of \$2.57 billion.⁷ Meanwhile, the Mexican Banking Commission encouraged banks to commit to a unified approach in dealing with debtors.⁸ However, these efforts largely failed to provide substantive debtor relief or bring down nonperforming loan (NPL) ratios. Indeed, an inability to establish even the ratio of NPLs had the effect of obscuring the true financial soundness of banks.⁹ Measuring NPLs and financial soundness remains an issue to this day (see chapter 2). Reconstructions of NPL ratios suggest that they peaked at over 50 percent in 1996, up from 10–20 percent in 1991–94, and remained at between 30 and 45 percent, until finally declining in 2002.

In December 1998, the Mexican government tried once more to resolve persistently high NPL ratios by means of the Programa Punto Final (Punto Final Program). It sought to encourage debtors to repay their loans by subsidizing up to 60 percent of the loan value.¹⁰ In an attempt to incentivize banks to issue new credit, the government made government assistance contingent on new lending.

Punto Final failed to expand bank lending, which contracted as a share of GDP, from 19 percent in 1998 to between 10 and 15 percent in 2000.¹¹ The situation improved after comprehensive insolvency reforms were introduced in 2001, including recognition of more extensive rights for secured creditors. Domestic credit as a share of GDP bottomed out in 2001, at about 12 percent, and rose steadily thereafter.¹²

The Mexican experience demonstrates the difficulty that governments face in facilitating creditor buy-in to a scheme for resolving NPLs when the underlying legal and judicial mechanisms for debt enforcement are inadequate. Although the initial reform efforts established, in principle, appropriate incentives for creditors to resolve NPLs, they were insufficient to foster concrete restructuring and bring debtors and creditors to the table because of poorly functioning legal, judicial, and bankruptcy systems and the prospects of weak enforcement.¹³

Notes

1. OECD (1999).
2. Santín Quiroz (2017).
3. Tittle (2005).
4. OECD (1999).
5. OECD (1999).
6. Lieberman et al. (2005).
7. Slover (1999).
8. Jones (1996).
9. Only interest in arrears, rather than interest and principal, was counted in the measure of an NPL. See Aldo (2012).
10. Calomiris, Klingebiel, and Laeven (2004).
11. Revised estimates suggest that in 2000 it was 15 percent rather than 10 percent. See World Bank, "Domestic Credit to Private Sector (% of GDP): Mexico," <https://data.worldbank.org/indicator/FS.AST.PRVT.GD.ZS?locations=MX>.
12. See World Bank, "Domestic Credit to Private Sector (% of GDP): Mexico," <https://data.worldbank.org/indicator/FS.AST.PRVT.GD.ZS?locations=MX>.
13. OECD (1999).

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Annex 3B

Using data and technology to improve court performance and to strengthen alternative dispute resolution

Using data to reduce court adjournments

An adjournment describes the situation in which a judge orders that court proceedings be delayed to a later point in time. There are many sensible reasons why adjournments occur—for example, the unavailability of a key witness, the need to gather further evidence, or the need to set aside time to resolve certain issues preliminary to the main dispute. However, added together, adjournments can become a substantial source of delay and wasted cost, particularly in emerging economies.¹

In partnership with the Kenyan judiciary and McGill University, the World Bank team supporting Data and Evidence for Justice Reform (DE JURE) as part of Development Impact Evaluation (DIME) used the large amount of data produced by administrative courts in Kenya to promote a reduction in court adjournments, which were creating large case backlogs. The partnership team examined key performance indicators on each court to identify the top three reasons for adjournments. The team's one-page feedback reports included the performance information and conclusions. The team then studied whether this simplified, action-oriented information could reduce adjournments and improve judicial performance.

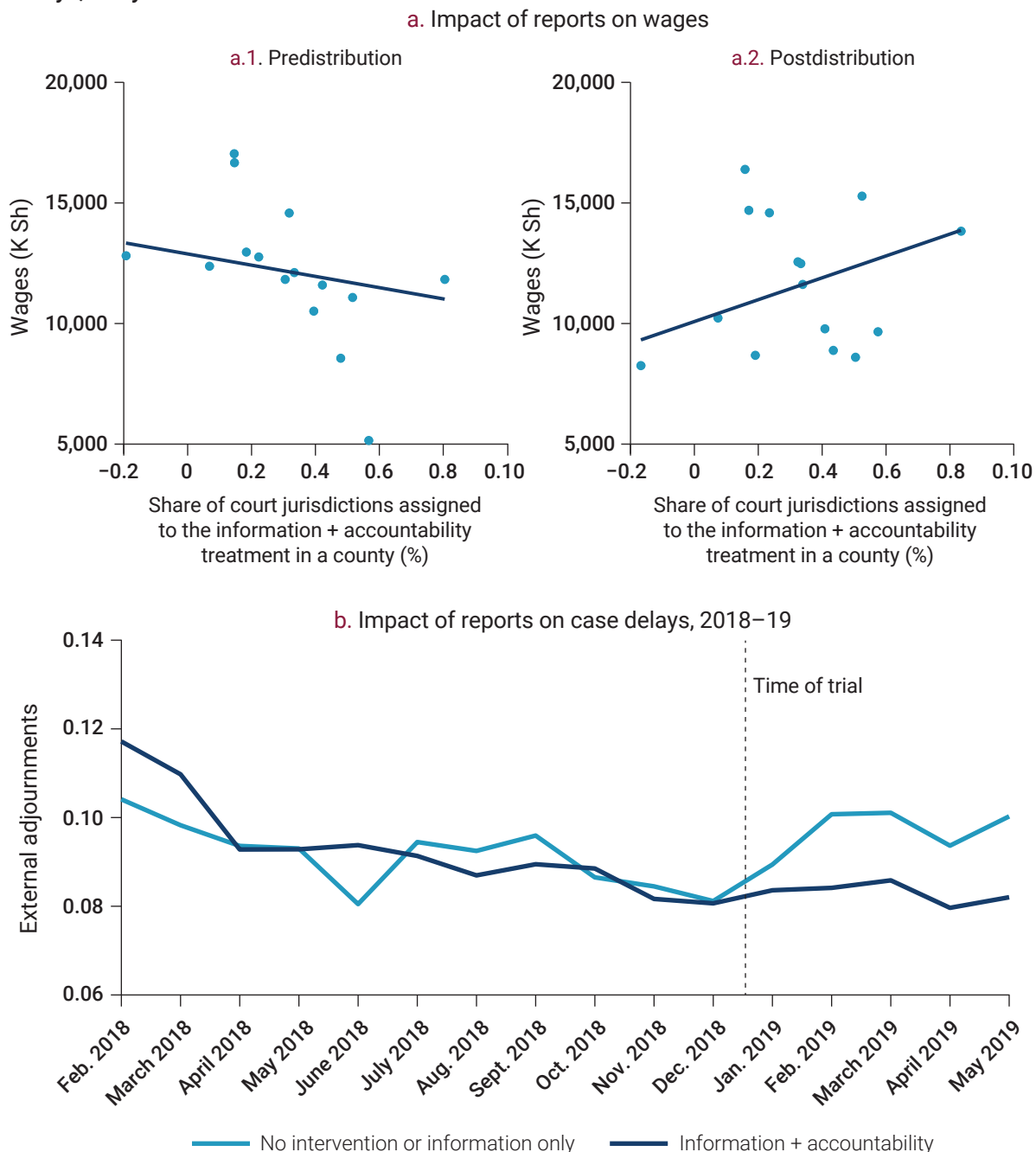
In a randomized controlled trial across all 124 court stations in Kenya, the team compared the impacts of sharing the feedback reports only with judges and supervisors and sharing the reports with court user committees as well. The latter were acting as an additional accountability mechanism. The team found that sharing the feedback reports with the court user committees lowered the number of adjournments by 17 percent over a four-month period and increased the number of cases resolved. It then concluded that the reports are more effective if both the tribunals and the court user committees receive them.

Sharing performance information with courts may be effective in improving efficiency, but it is particularly effective if the information is also shared with court stakeholders and civil society. The results were viewed as proof of the concept that the way data are utilized to provide information to judicial actors can reduce adjournments and increase the speed of judicial resolution and that this has a downstream impact on the economic outcomes among citizens and firms, including wages (figure 3B.1).

In Chile, where the COVID-19 pandemic has led to an increase in adjournments and case backlogs, the World Bank's DIME DE JURE team has been examining whether the way information is presented to courts matters. In partnership with the Department of Institutional Development of the Chilean judiciary, the team has been using the electronic Quantum platform to encourage court managers to identify ways to improve court performance. Quantum displays comprehensive indicators on court performance, such as the number of cases filed, the case clearance rate, the average duration of cases decided within one month, and the percentage of cases heard. It also allows users to compare performance across courts in a same jurisdiction. Following the launch of Quantum in 2018, take-up was limited: 20 percent of court managers never logged on, and for those who did there was an average of only 20 log-ins per court manager over 14 months. The platform was technologically well developed and rich in information, yet it was unclear what impact the platform had on the management and efficiency of courts.

During the research, the DE JURE team evaluated the impact of the new information on judges and court administrators in family courts in Chile by embedding an experiment in the Quantum platform. During the experiment, the team tested three new versions of the dashboard used to provide information in different ways to the courts: (1) one-third of the courts received the control or placebo dashboard,

Figure 3B.1 Impacts of sharing court performance feedback reports on wages and case delays, Kenya



Source: World Bank, DIME DE JURE (Development Impact Evaluation, Data and Evidence for Justice Reform) project, “Data Science for Justice: Evidence from a Randomized Judicial Reform in the Kenyan Judiciary.”

Note: Panels a and b show the impact of the dissemination of the one-page feedback reports in the randomized controlled trial in Kenya. Panel a shows the impact on the wages of individuals in the Kenyan Continuous Household Survey. Panel b shows the impact on case delays in the 124 court stations measured. The trial (in January 2019) involved providing the one-page reports only to judges or to judges and court user committees (so that the judges were, in effect, accountable to others), and correlates with a reduction in the volume of external adjournments, compared to either doing nothing or only providing feedback to judges. Judge-only dissemination is labeled “information,” and judge plus court user committee dissemination is labeled “information + accountability.”

which shows statistics on tribunal performance, without any comparisons or data-driven pop-ups; (2) another third received access to a new, improved dashboard that summarizes the main statistics and compares individual courts with a reference group of courts; and (3) the remaining third received access to the new dashboard, but also to a pop-up that highlights three performance indicators, one of which shows the tribunal that performed the best during the previous month on each indicator (that is, revealing its main strength), while the other two indicators show which tribunals had performed the worst (that is, revealing its main weaknesses) during the previous month relative to similar courts.

Preliminary results show that the new dashboard with or without the pop-up for comparison improved court performance according to key efficiency indicators, such as the rate of the timely resolution of cases and the case clearance rate. The pop-up that compared the top and bottom areas of a tribunal's performance relative to the performance of other courts was associated with improvements that were similar to the improvements generated through the new dashboard, although it was also associated with a reduction in log-ins into the platform. The team concluded that this reduction in log-ins indicated that tribunals prefer that they not be compared with other tribunals, especially on indicators showing areas in which they underperform. Overall, the experiment proved that the new, redesigned dashboard improved the efficiency of family courts in Chile. It also demonstrated that the way performance information is displayed and shared with courts can directly influence the timely resolution of disputes among parties.

Using technology to improve court-annexed mediation

Court-annexed mediation (mediation provided by courts as part of court proceedings) promises to speed up the resolution of disputes, reduce the cost of access to judicial institutions, and provide space for parties to find creative solutions to their grievances. However, there is limited research on the potential of technological innovations to enhance the efficiency and productivity of mediators and the downstream impact on the resolution of disputes between parties.

In partnership with the Kenyan court-annexed mediation team, the World Bank's DIME DE JURE team is testing Cadaster, an open-source, web-based data management and analytics platform that aims to support the decision-making process in court-annexed mediation. In addition to an Excel-like user interface for data structure definition and entry, Cadaster contains a dashboard for real-time performance monitoring that is able to issue alerts if metrics cross preset thresholds. The platform allows any mediation team to monitor mediator performance across the country. The data it produces can guide management decisions on mediator accreditation and the assignment of disputes to mediators.

In many mediation systems, mediators are assigned to cases randomly by managers or administrators. Mediator performance in case resolution is not tracked in any consistent, systematic manner. However, if a mediator is observed to be particularly successful in certain types of cases, machine learning has the potential to be more accurate in assigning such cases to the mediator. Cadaster includes this innovative feature. Using historical information on each mediator and their past performance across different types of cases, the Cadaster algorithm can determine which mediator would be better suited to take on a particular case. By relying on technology and machine learning, Cadaster can thus improve the capacity of parties to reach reasonable agreements and the timely resolution of disputes.

In partnership with the Ministry of Justice and Human Rights of Peru, the DE JURE team has been testing the impact of another web-based, data-driven platform, the Conciliator App, which is aimed at enhancing the efficiency of individual mediators and the mediator process in Peru. The Conciliator App provides easy-to-use, in-depth visual and textual analysis of the legal services offered by mediation centers and informs mediators about their performance. Users of the app, who include mediators and supervisors, can view key metrics on the performance of individual mediators, mediation centers, or

the entire network of mediation services through dashboards. Mediators can also use the app to share questions and strategies with their colleagues on how to handle a particular type of case. Providing mediators with rolling performance reviews can increase the significance of outlier characteristics, such as unusually lengthy average resolution times relative to those of colleagues. The reviews are an effort to raise the awareness of mediators of their own abilities, making them better self-managers who can proactively address shortcomings, disseminate effective strategies, and prioritize casework that optimizes their limited time. Furnishing managers with real-life, granular data on employee performance can enable efficient allocation of resources and assignment of tasks.

Through randomized controlled trials, the DE JURE team is examining the impact of these apps on the efficiency and quality of mediation. These innovations have the potential to improve the performance of mediators and the success of alternative dispute resolution mechanisms throughout the world. Courts and mediation agencies could use the technology to reduce the number of cases that are backlogged in courts, improve the efficiency with which such cases are resolved, and raise the satisfaction and economic outcomes of the parties involved in disputes. These opportunities are particularly promising because of the increased availability of administrative data, which make them feasible in many countries.

Note

1. Laws (2016).

Reference

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Annex 3C

Alternative dispute resolution and insolvency

Insolvency has historically been a court-led process. Even though courts have increasingly adopted alternative dispute resolution (ADR) methods over the past 30 years, this trend has been slow to permeate insolvency proceedings relative to other areas of jurisprudence, where mediation is booming. In 2016, the European Commission described mediation in insolvency as underdeveloped.¹ But that has begun to change. This change is in part a function of the growing evidence that, under the appropriate circumstances, mediation can be successful in the insolvency context and in part a function of deliberate policy actions to facilitate and develop ADR processes.²

The United States adopted mediation in insolvency early on. In 1986, the Bankruptcy Court for the Southern District of California established a mediation program. The first prominent case in which the program was used arose in 1990 when Greyhound Lines entered into bankruptcy. The company was beset by thousands of claims of personal injury and property damage, and so it created a mediation plan to resolve these claims efficiently out of court. In 1998, with enactment of the Alternative Dispute Resolution Act, all civil proceedings in a US federal court (all bankruptcy proceedings are under federal jurisdiction) had to be allowed to undergo mediation. Some jurisdictions built on this foundation by making it mandatory for mediation to be attempted in all cases, such as in Delaware in 2004.³

The United Nations Convention on International Settlement Agreements Resulting from Mediation entered into force on September 12, 2020. Also known as the Singapore Convention on Mediation or the Singapore Convention, it facilitates and harmonizes the international approach to enforcing agreements reached in the course of mediation. Experts suggest it may facilitate the role of mediation in a cross-border restructuring and insolvency context because in signatory jurisdictions mediated settlements will now have teeth, allowing mediation to become harnessed effectively in various stages of cross-border insolvency and restructuring processes.⁴

Arbitration—a more formal version of dispute resolution that is led by a third party with a greater capacity for ruling on the factual matters in a case—is becoming a more frequent component of insolvency frameworks. The insolvency law in Chile, which has been in force since 2014, provides for arbitration in liquidation or reorganization proceedings. The arbitration pathway may be sought by debtors or creditors and may cover all aspects of a proceeding.⁵ Meanwhile, in the United States Chapter 11, Subchapter V, was introduced in February 2019 to enable small businesses to conduct a streamlined reorganization. The original debt limit in Subchapter V was \$2,725,625, but the limit was raised to \$7,500,000 as part of the COVID-19 relief legislation.

Schemes that have a degree of court involvement but enable flexible resolution of bankruptcy disputes out of court are also becoming more common. The World Bank's *Toolkit for Out-of-Court Workouts*, updated in 2022 and retitled *Toolkit for Corporate Workouts*, is a comprehensive guide to the full range of such schemes.⁶ In Europe, this trend will continue, in particular at the pre-insolvency stage, in line with European Union (EU) Restructuring Directive 2019/1023, which obliges EU member states to rely on pre-insolvency restructuring schemes. For example, the insolvency law in France provides for two special procedures: the ad hoc mandate and conciliation. The French system includes incentives to support restructuring negotiations out of court.⁷ Amendments to Greece's insolvency law (Law 4469/2017), which was passed in 2017, provide for a voluntary restructuring scheme that occurs out of court.

Other recent examples of initiatives in mediation or arbitration processes are the following:

- Section 12-A of India's Commercial Courts, Commercial Division, and Commercial Appellate Division of High Court (Amendment) Ordinance, 2018, prevents the filing of any suit relating to a commercial dispute under the act (unless it involves urgent interim relief) if the parties have not first utilized the pre-institutional mediation mechanism. This applies to insolvency proceedings.
- Insolvency Law 2020, section 118, adopted in Myanmar in 2020, permits the appointment of a mediator or rehabilitation adviser to mediate disputes arising in the course of a company's rehabilitation.
- In Bosnia and Herzegovina, the Center for Financial and Credit Counseling provides mediation services for overindebted micro-, small, and medium enterprises.⁸

Notes

1. EC (2016).
2. Heath (2021) has canvassed case studies of large, high-profile, successful mediations.
3. Jokubauskas (2017).
4. Grassgreen and Atkins (2021).
5. Ley No. 20.720, Ley de Reorganización y Liquidación de Empresas y Personas (Law 20.720, law for the reorganization and liquidation of assets of companies and individuals).
6. World Bank (2016, 2022).
7. An example is the médiateur du crédit (credit mediator), an ombudsman assisting debtors in negotiations with creditors.
8. Menezes, Mocheva, and Shankar (2020).

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Annex 3D

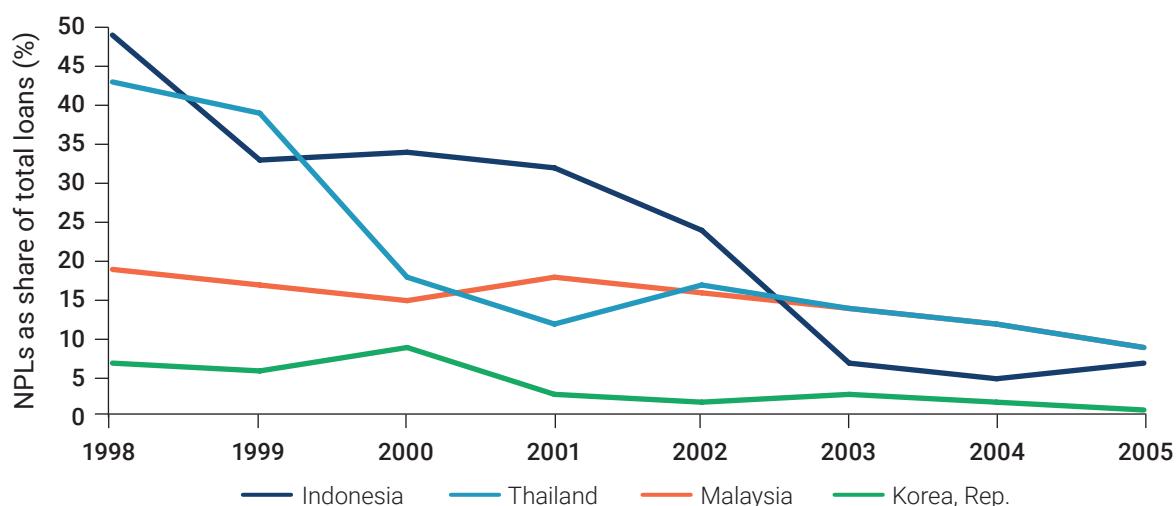
Lessons learned from MSME insolvency reform during the Asian financial crisis

Firms in Southeast Asian countries experienced widespread debt distress in the late 1990s and early 2000s—distress reflected in nonperforming loan (NPL) ratios that exceeded 40 percent in some jurisdictions (figure 3D.1). Micro-, small, and medium enterprises (MSMEs) faced the unavailability of credit or inaccessibly high interest rates. In Indonesia, the number of MSMEs fell by about 7 percent between 1997 and 1998 and did not return to their former levels until 2000.¹ In Thailand, 1998 saw a greater proportion of MSMEs than large enterprises reduce their number of employees (55 percent versus 45 percent).²

In response, countries adopted various reform measures. For example, Malaysia took an approach that was segmented by firm size and characterized by a (relatively) interventionist regulator. Medium and large debt cases were managed by a government agency and asset management company, while smaller cases were left for banks to resolve.³ The Corporate Debt Restructuring Committee (CDRC) was established to provide a forum and framework for debt workouts.⁴ The CDRC handled large cases involving either high debt levels or multiple creditors. The requirements for creditor agreement were lowered, and, in some cases, an asset management company intervened to buy out dissenting creditors.⁵ The CDRC was ultimately successful in resolving 57 cases involving a total debt of RM 45.8 billion.⁶ The central bank also used persuasion and its soft power to apply pressure on holdout creditors.⁷

The Republic of Korea deployed a segmented approach as well in which the restructuring framework was effectively reserved for large debtors in the early phase of their crisis. A select group of complex cases—firms with a substantial debt level or firms with a complex organizational structure—went through formal court insolvency proceedings. The widespread creditor buy-in was facilitated by strong regulators. In July 1998, 210 local financial institutions, including banks, insurance companies, investment trust companies, and merchant banking corporations, signed a corporate restructuring agreement, encouraged by the Financial Supervisory Commission.⁸ By the end of 2000, of the 108 companies that had entered a workout process as a result of the July 1998 commitments, 36 had exited the process and

Figure 3D.1 Nonperforming loans, selected Asian countries, 1998–2005



Source: Lee and Rosenkranz 2019.

Note: NPLs = nonperforming loans.

resumed ordinary operations.⁹ Smaller, simpler companies were subject to more lenient arrangements in which creditors were encouraged, and in some instances required, to extend loan terms or provide a grace period for initial nonrepayment. But this approach at first failed to bring down the bankruptcy rate among small and medium enterprises (SMEs), which rose from 14.0 percent in 1996 to 39.9 percent in 1997 and 38.0 percent in 1998.¹⁰

Thailand's approach went through stages, beginning with a consensual debt resolution scheme involving creditors and debtors and subsequently turning to more targeted and intrusive measures. One of the measures introduced was a simplified restructuring framework for MSMEs. The Corporate Debt Restructuring Advisory Committee, formed in June 1998, introduced a simplified process to reach agreements within 45 days and identified 12,000 cases for follow-up. Of those cases, 74 percent had been completed or were in process of completion by the end of 2001.¹¹ The Bank of Thailand also set targets for financial institutions to resolve 15,000 SME cases each month. In practice, about 12,000 were resolved. Of the Southeast Asian jurisdictions, Thailand did the least to address restructuring, and the country did not enforce any changes in management. This approach is attributed to deficiencies in the formal insolvency framework and the lack of political will to force change in large companies.¹²

A comparison of the Thai reforms with others in Southeast Asia reveals that the Thai reforms resulted in the most rapid reduction in NPL ratios (figure 3D.1). However, there was a long tail, and ratios remained above 10 percent until 2005. Only 48 percent of NPLs in Thailand were resolved by mid-2003. By contrast, 77 percent of the debt referred to Malaysia's CDRC had been resolved by that time. In Korea, by mid-2003 restructuring agreements had been reached for about 80 percent of registered cases, representing about 95 percent of the total (corporate) debt. The absence of substantive restructuring of large companies in Thailand likely delayed resolution.

Notes

1. Tambunan (2019).
2. Bakiewicz (2005).
3. Mako (2005).
4. Mako (2005).
5. Mako (2005).
6. See the CDRC website, <https://www.cdrc.my>.
7. Mako (2005).
8. Akama, Noro, and Tada (2003); Shaw (2005).
9. Mako (2002).
10. Gregory, Harvie, and Lee (2002).
11. Claessens (2005).
12. Mako (2005).

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Annex 3E

UNCITRAL’s “Legislative Guide” and the World Bank’s “Principles”

The Asian financial crisis revealed the critical role that effective insolvency systems can play in preventing elevated bankruptcy rates from leading to widespread financial sector failure. Prior to the crisis, the focus of international efforts on insolvency laws had been limited to the harmonization of the rules on cross-border insolvency. After the crisis, there were substantial efforts to develop and promote global best practice standards and principles on domestic insolvency law. That work continues.

The Financial Stability Board (FSB) is an international institution responsible for monitoring financial stability. The board discharges this function in part by acting as a compendium of standards for financial systems. Insolvency systems are one such standard that falls within this remit because insolvency and creditor and debtor regimes are “fundamental to robust and diverse modes of financial intermediation, responsible access to finance, and financial stability.”¹ In 2011, following the global financial crisis, the FSB created the Insolvency and Creditor Rights Standard (ICR Standard), which it designated as a key standard for a sound financial system.

The two entities responsible for work on the ICR Standard are the United Nations Commission on International Trade Law (UNCITRAL) and the World Bank. The unified global standard for insolvency is represented by two international instruments: the World Bank’s “Principles for Effective Insolvency and Creditor/Debtor Regimes,” first published in 2001 and periodically revised thereafter, and the UNCITRAL “Legislative Guide on Insolvency Law,” which was first adopted in 2004.

The principles and the legislative guide are complementary despite the substantial changes in form. The principles are concise, covering a wider range of commercial law systems, and they are intended to be sufficiently flexible to be applied in all countries. The legislative guide is more granular, containing specific recommendations for the content of insolvency law and an examination of the various options and approaches.

The year 2021 was an important one for insolvency standard setting. Both the World Bank and UNCITRAL published updates of the respective instruments. The World Bank published revised principles, and UNCITRAL adopted legislative recommendations to be added to its legislative guide.² Both updates were entirely focused on micro- and small enterprises (MSEs). Although work on both updates began before onset of the COVID-19 pandemic, that crisis has amplified the importance of insolvency systems that are inclusive of MSEs because MSEs have been disproportionately harmed by the pandemic.

The 2021 World Bank principles and the UNCITRAL legislative guide collectively provide guidelines, principles, and recommendations on an insolvency framework aimed at assisting micro-, small, and medium enterprises (MSMEs) in insolvency. Drawing on these sources, chapter 3 sets out priority areas for reform in the context of the COVID-19 recovery. The principles and legislative guide provide substantial flexibility in how an MSME insolvency framework might be achieved. For example, achieving a simplified liquidation framework might involve establishment of a new stand-alone process for MSMEs, or, alternatively, exempting MSMEs from onerous or inappropriate provisions in the process instituted for large businesses. Governments should also set their own rules for the entities eligible for the simplified process. In any case, it is critical that eligibility criteria be easy to understand and apply.

Notes

1. FSB (2011).
2. See UNCITRAL (2021); World Bank (2021). The UNCITRAL document is a draft, and the final is expected soon. See UNIS (2021).

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