



STUDY REPORT

ON THE LEGAL FRAMEWORK FOR THE ENFORCEMENT OF COMMERCIAL CREDITORS' CLAIMS IN SELECTED EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT COUNTRIES OF OPERATIONS (ALBANIA, CROATIA, CYPRUS, GREECE AND UKRAINE)

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This publication has been produced with the assistance of the European Bank for Reconstruction and Development in connection with its technical assistance project to analyse the enforcement framework in selected countries of operations. The contents of this publication are intended to serve as a general guide to the issues encountered in the enforcement systems of the relevant countries and do not constitute any legal or financial advice. Any person considering the analysis set out in this publication must obtain and rely on its own legal and/or financial advice as to the suitability and validity of such analysis and may not rely upon the contents of this publication.

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A GENERAL INTRODUCTION

1. REPORT STRUCTURE

This Preliminary Study Report (the "**Report**") contains information on a "country-by-country" basis on enforcement of creditors' claims within a commercial or business context in five European Bank for Reconstruction and Development (the "**EBRD**") countries of operations: Albania, Croatia, Cyprus, Greece and Ukraine (the "**Target Countries**").

Each of the country reports is divided into: (A) a Legislative Review and (B) an Institutional Framework Review. Key analysis and recommendations are included in these sections and summarised in an executive summary at the beginning of each of the reports.

The "**Legislative Review**" focuses on the main legislative acts including secondary legislation governing the enforcement of creditors' claims. This section also covers legislative developments expected to be introduced in the near future relating to the enforcement of creditors' claims (whether secured or unsecured) that could impact the study.

The "**Institutional Framework Review**" addresses issues relating to offices and institutions which are engaged in, or whose assistance is needed for the creation of security, its perfection and enforcement of creditors' claims, such as courts, administrators of registers, notaries, enforcement agencies etc.

Both the Legislative Review and the Institutional Framework Review incorporate feedback collected from country stakeholders and local experts. They present problems and obstacles with enforcement in practice as well as suggestions on how to remedy these and make enforcement more effective within the relevant jurisdiction. A list of written sources and local stakeholders and experts consulted are provided at the end of each country report.

2. BACKGROUND

The EBRD, together with its consultants DLA Piper, has conducted a study project "**Regional: Study on the legal framework for the enforcement of creditors' claims in selected EBRD countries of operations**" (the "**Study**"). The Study focuses on enforcement of business loans in the Target Countries. Retail or consumer loans, which are subject to different policy considerations, fall outside the scope of the Study.

In order to get the complete and relevant information on Target Countries, DLA Piper consulted local law firms in four jurisdictions, while the report on Ukraine was conducted by DLA Piper. In Albania, DLA Piper consulted law firm Tashko Pustina; in Croatia law firm Glinska & Mišković; in Cyprus law firm Pamboridis LLC; and in Greece DLA Piper consulted Karatzas & Partners Law firm. Each of the local law firms conducted the study for the relevant jurisdiction under the guidance and coordination of DLA Piper. The relevant studies were then compiled by DLA Piper, who provided the introductory part, relevant information on international best practice and constructed the final report.

Each of the five jurisdictions or Target Countries selected for this Study has high levels of non-performing loans ("**NPL**"), namely bank loans which have not been repaid or which are unlikely to be repaid in full by the debtor. According to the results of the research set out in the Vienna Initiative 2.0,¹ the average corporate and retail NPL figures for the period of 31 March 2017 to 31 March 2018 reveal Ukraine to have the highest NPL ratio of 56.4%, followed by Greece with an NPL ratio of 46.0%, Cyprus with an NPL ratio of 38.9%, Albania with an NPL ratio of 13.4% and Croatia with an NPL ratio of 11.3%.

¹ <http://npl.vienna-initiative.com>.

Enforcement of claims is one of the principal ways for banks or NPL-acquirers to resolve NPLs. Other options for NPL resolution include restructuring, where a consensual solution to amend the terms of the financing can be reached between the bank and the debtor so that it becomes once again performing and, in more severe cases of debtor financial distress, formal insolvency aimed at either reorganisation or liquidation of the borrower's business. Given the importance of enforcement as a tool for NPL reduction, the study of the enforcement and legislative frameworks in these jurisdictions is highly relevant.

In recent years governments and policymakers have considered ways to manage the problem of NPLs, including changes to insolvency and enforcement frameworks. In March 2017, the European Central Bank ("**ECB**") published the "*Guidance to banks on non-performing loans*", which outlines measures, processes and best practices for banks when tackling NPLs, calls on banks to implement realistic and ambitious strategies for NPL reduction and serves as basis for on-going supervisory dialogue with banks and also looks at issues such as governance.² In particular, it stresses the importance of dedicated NPL workout units within banks acting in a timely manner to improve debt collection and maximise debt recovery/minimise loss in accordance with a debt recovery/enforcement policy. While not prescriptive, the ECB guidance foresees a range of available options for NPL workout units to resolve problem loans, including voluntary asset sale, forced asset sale via receivers/court proceedings, foreclosure of assets, debt collection, debt to asset/equity swap and sale of loan/loan portfolios to a third party. An Addendum to the Guidance containing ECB prudential supervisory expectations for NPL provisioning was also published in March 2018.³

The ECB guidance was followed in July 2017 by the adoption by the European Council of an "*Action Plan on reducing NPLs in Europe*", which called upon various EU regulators in addition to the ECB to take appropriate measures to address the challenges of high NPLs in Europe. In March 2018, the European Commission responded by publishing a package of proposed measures to address the risks related to the high levels of NPLs in Europe, including a proposal for a directive on credit servicers, credit purchasers and the recovery of collateral (the "**NPL Directive Proposal**").⁴

As recognised by the NPL Directive Proposal, high stocks of NPLs can weigh on bank performance by generating less income for a bank than performing loans, thus reducing the bank's profitability, and potentially causing losses that reduce its capital. NPLs also tie up significant amounts of a bank's resources, both human and financial, which reduce the bank's capacity to lend, including to small and medium-sized enterprises. Accordingly, the NPL Directive Proposal provides for two ways to prevent excessive future build-up of NPLs, namely by extrajudicial collateral enforcement to increase the efficiency of debt recovery procedures, or by development of efficient and transparent secondary markets for NPLs. Title V of the NPL Directive Proposal addresses accelerated extrajudicial collateral enforcement and among other matters sets out: (i) the conditions for the voluntary use of accelerated extrajudicial collateral enforcement; (ii) the means and procedure of such extrajudicial enforcement i.e. private sale or public auction. The existence of the NPL Directive Proposal highlights the importance of enforcement frameworks to NPL resolution and the need to find a common solution to inefficiencies within existing enforcement systems highlighted by this Study.

² ECB, Guidance to banks on non-performing loans (2017) (https://www.bankingsupervision.europa.eu/ecb/pub/pdf/guidance_on_npl.en.pdf).

³ ECB, Addendum to the ECB Guidance to banks on nonperforming loans: supervisory expectations for prudential provisioning of non-performing exposures (2018) (https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.npl_addendum_201803.en.pdf).

⁴ EC, proposal for a Directive of the European Parliament and of the Council on credit servicers, credit purchasers and the recovery of collateral COM/2018/0135 final - 2018/063 (<https://eur-lex.europa.eu/legal-content/en/TXT/?uri=CELEX%3A52018PC0135>).

3. STRUCTURE

3.1 Key Determinants

The Study covers matters relating to the regulatory and institutional framework for enforcement of both (1) unsecured and (2) secured creditors' claims in Albania, Croatia, Cyprus, Greece and Ukraine, with a particular focus on the following parameters influencing the effectiveness of the procedure (together the "**Key Determinants**"): speed, simplicity, cost and overall predictability of the enforcement process.

3.2 Key Factors

For the purpose of this analysis, the Study covers a variety of the factors affecting enforcement. They may be grouped into two categories: (i) process-related and (ii) scope-related factors (together the "**Key Factors**"). This differentiation is important because the scope-related factors determine to some extent which category of security or collateral can be created and enforced, whereas the process-related factors determine the obstacles in the creation and enforcement of recognised categories of claims and security interests.

Critical to the overall efficiency of a collateral system is the recognition of priority attached to competing security interests in relation to the recovery and distribution of proceeds, and accordingly this represents a key factor, which needs to be analysed both from a scope-related and a process-related perspective.

Process-related factors	Scope-related factors
Creditor control: The ability of the creditor to control or influence the conduct of the enforcement procedure	Scope of collateral: The ability of enforcing against a group of assets including future acquired assets of the same or similar type included in the general description of the collateral
Debtor obstruction: The ability of the debtor to prevent, slow down or otherwise obstruct enforcement proceedings to the detriment of the pledge holder e.g. by relying on procedural defences or loopholes	Receivables and Bank Accounts: An assessment of the simplicity/ease and legal predictability of the enforcement process for a pledge over receivables and/or bank accounts
Institutions and Professionals: The reliability, integrity and level of knowledge and training within the courts and other institutions necessary to the enforcement process including courts, private or public bailiffs, notaries, auctioneers, accountants and experts	Ranking of claims: The priorities of creditors' claims (secured and unsecured) and third party claims pre- and post- the insolvency of the debtor. The impact of the debtor's insolvency on the enforcement process
Involvement of courts: Availability and effectiveness of out-of-court enforcement and private sale compared with court-driven enforcement and public sale	Inventory/movables: An assessment of the simplicity/ease and legal predictability of the enforcement process for a pledge over inventory
Level of IT development: the extent to which the authorities' work is conducted in an electronic manner e.g. so that any registry of debtors' property and registry system for movables/immovables is automated, reliable, efficient and transparent	Immovables: An assessment of the simplicity/ease and legal predictability of the enforcement process for a pledge over immovable property (mortgage)
Creditors' access to information: The creditors' ability to obtain information on the borrower's assets and any insolvency procedure in a timely manner	

3.3 Terminology used

In order to keep the Report and the responses set out herein consistent and to avoid ambiguity, a terminology section has been included at the beginning of each of the five individual country reports. Any definition is provided solely to clarify the terms used in report for a particular jurisdiction and should not be relied upon for any other purpose.

4. RATING METHODOLOGY AND APPROACHES OF ASSESSMENT

4.1 Introduction

There is no universally agreed 'model enforcement' system or set of rules. However, in order to identify any gaps in legislation and/or weaknesses in institutions for the enforcement of creditors' claims, the evaluation team has systematically analysed the statutory provisions, legal principles and relevant institutions of each specific country in line with the Key Factors and Key Determinants above and the International Benchmarks set out at paragraph 5.2 below.

The authors of the Report have performed their assessments using two types of methods – an assessment of law on the books and an empirical questionnaire aimed at capturing market practice.

4.2 Review

The core of this Report is based on:

- review of national legislative acts and, parliamentary material;
- review of EU legislation to the extent applicable; and
- the review of judicial decisions and academic analysis, to the extent publicly available,

in each case as detailed further at the end of individual country reports.

4.3 The Questionnaire

For the market review which is aimed at identifying practical implementation issues, the authors of the Report have relied mostly on the feedback received from Market Participants (as defined at Clause 4.3.2 below) based on a questionnaire prepared by the EBRD and the authors of this Report (the "Questionnaire").

A uniform core Questionnaire, with some national variations was developed for all five Target Countries to ensure comparability of the results. Most of the questions were structured in a way to allow for comments and explanations so as to ensure a higher level of precision and reliability. The Questionnaire itself has two parts. The first part contains most of the core questions and is uniform for all the Target Countries. The shorter, second part, however, was tailored to meet the needs of specific jurisdictions. Since the statutory regimes regarding the enforcement of creditors' claims vary quite substantially between Target Countries, a completely uniform Questionnaire could not be adopted. While this may reduce the comparability of the results, it ensures greater accuracy and reliability of the findings.

4.3.1 The process of delivering questionnaires and obtaining feedback

Prior to delivering the Questionnaire, contact was established with all Market Participants via phone or email to explain the purpose of this Report and the Questionnaire, to ensure their cooperation and to confirm the recipient's email address.

Both delivering the Questionnaire and obtaining the responses was conducted via email. A formal letter by the EBRD was requested by some entities as well. Non-completion was

followed-up by emails, phone calls (contacting via publicly available numbers) and texts, depending on the entity in question. In some cases where the Questionnaire was still not completed, a part of it or the entire Questionnaire was completed via a phone interview with the assistance of the authors of the Report.

4.3.2 Types of market participants

In every Target Country different respondents, including the business community, legal and enforcement professionals and national authorities were contacted. They were classified into five categories, namely: (i) governmental authorities (ministries, national banks, courts, registries, agencies etc.), (ii) associations (banking associations, notary associations, bar associations etc.), (iii) banks, (iv) financial advisors and (v) other market participants (collectively the "**Market Participants**").

In each country, several participants from all of these five groups were selected in order to ensure that the collected data was evenly balanced and the represented interests of the market participants were as broad as possible.

4.3.3 Responses received

The response rate of contacted Market Participants was at the initial stage rather low. We note several possible reasons. Firstly, the Questionnaire is quite comprehensive and many Market Participants chose not to invest their time to complete it. Accordingly, the follow up methods set forth above at 4.3.1 were used. The ultimate response rates between the Target Countries varied between 24% and 64%.

Given the great variety of the respondents and the length of the Questionnaire, it was not mandatory for Market Participants to answer all of the questions

4.3.4 Confidentiality

The purpose of the Questionnaire was explained to Market Participants, which agreed that the responses could be published.

Any data that was deemed potentially sensitive and not absolutely necessary to accomplish the purpose of this Study was not included in this Report in order not to pose a risk or be in any way harmful to the Market Participants.

4.3.5 Difficulties on obtaining data on duration of proceedings

Official statistics for judicial enforcement do not offer a clear picture regarding the duration of enforcement proceedings, mostly due to the fact that statistics are aggregated for all types of enforcement proceedings. Such statistics therefore do not take into the account the differences in duration and complexity between enforcement regarding natural persons and commercial subjects. Generally, enforcement proceedings against natural persons are much less complex, faster and more efficient, as opposed to those against legal persons.

Other sources, mostly professional associations, provided estimates on the duration of enforcement proceedings for business loans. Estimates, where possible, were confirmed with other attorneys/legal professionals.

5. ANALYSIS AND BENCHMARKING

5.1 Introduction

As discussed above, there is no universally recognised model enforcement system and there are diverging approaches to the issue of enforcement between common law and civil law systems, as well as within the different civil law systems covered by this Study. The starting point for the analysis of enforcement frameworks was the evaluation team's identification of a core set of topics of relevance for the efficiency and performance of all Target Countries' enforcement systems including: security registration and perfection fees, registration system, available security, enforcement, impact of any insolvency (including pre-insolvency) proceedings on enforcement and financial collateral regimes (together the "**Enforcement Topics**").

These Enforcement Topics were then analysed against the International benchmark documents published by the EBRD, the World Bank ("**WB**") and the United Nations Commission on International Trade Law ("**UNCITRAL**") below.

5.2 International benchmark documents

In formulating recommendations the authors of the Report have been guided by:

- (a) the EBRD Core Principles for a Secured Transactions Law ("**EBRD Core Principles**");⁵
- (b) the World Bank Principles for Effective Insolvency and Debtor Creditor Regimes (the "**WB Principles**");⁶
- (c) the UNCITRAL Legislative Guide on Secured Transactions (the "**UNCITRAL Legislative Guide**");⁷
- (d) the UNCITRAL Guide on the Implementation of a Security Rights Registry (the "**UNCITRAL Guide**");⁸
- (e) the UNCITRAL Model Law on Secured Transactions (the "**UNCITRAL Model Law**");⁹
- (f) the UNCITRAL Model Law on Secured Transactions Guide to Enactment ("**Guide to Enactment**");¹⁰
- (g) the UNCITRAL Legislative Guide on Insolvency Law ("**Insolvency Guide**");¹¹

⁵ EBRD, EBRD Core Principles for a Secured Transactions Law (1997) (<http://www.ebrd.com/what-we-do/legal-reform/access-to-finance/transactions.html>).

⁶ WB, Principles For Effective Insolvency And Creditor/ Debtor Regimes (2015) (<http://documents.worldbank.org/curated/en/518861467086038847/pdf/106399-WP-REVISED-PUBLIC-ICR-Principle-Final-Hyperlinks-revised-Latest.pdf>).

⁷ UNCITRAL, UNCITRAL Legislative Guide on Secured Transactions (2010) (https://www.uncitral.org/pdf/english/texts/security-lg/e/09-82670_Ebook-Guide_09-04-10English.pdf).

⁸ UNCITRAL, UNCITRAL Guide on the Implementation of a Security Rights Registry (2014) (<http://www.uncitral.org/pdf/english/texts/security/Security-Rights-Registry-Guide-e.pdf>).

⁹ UNCITRAL, UNCITRAL Model Law on Secured Transactions (2016) (http://www.uncitral.org/pdf/english/texts/security/ML_ST_E_ebook.pdf).

¹⁰ UNCITRAL, UNCITRAL Model Law on Secured Transactions. Guide to Enactment (2017) (http://www.uncitral.org/pdf/english/texts/security/MLST_Guide_to_enactment_E.pdf).

¹¹ UNCITRAL, UNCITRAL Legislative Guide on Insolvency Law (2005) (https://www.uncitral.org/pdf/english/texts/insolven/05-80722_Ebook.pdf).

and

- (h) Article 9 on secured transactions of the US Uniform Commercial Code ("UCC"),¹²

together the "International Benchmarks".

5.3 Benchmarks

5.3.1 Introduction

In order to assess the effectiveness and efficiency of the enforcement of security rights throughout the five Target Countries, the International Benchmarks were analysed to extract certain best practice guidance with respect to: (i) the definition of security rights; (ii) the registration of security rights; (iii) the methods of realization or enforcement of security rights; (iv) the interaction between insolvency and enforcement; (v) the role of the court in enforcement of security rights; and (vi) the training and expertise of judges, bailiffs and registrars operating in this field.

5.3.2 Registration of security interests

- (a) To promote optimal conditions for asset-based lending, *there should be an effective means of publicising the existence of security rights*, i.e. a centralised, efficient, transparent, and cost-effective public registration system.¹³ While many countries have a separate land and mortgage registry, charge registry and specialized registries for certain types of assets such as ships, aircrafts or vehicles it is recommended to limit the number of registries as far as possible. For example, the UNCITRAL Guide recommends a single centralised registry for registering all types of security interest in all movable assets.¹⁴ This centralized approach is followed in the UNCITRAL Model Law and Guide to Enactment which contemplate a single public registry relating to registration of notices with respect to security rights.¹⁵ While the World Bank contemplates that special registries are beneficial in the case of highly mobile assets e.g. aircraft and ships, it argues that ideally the registry system should be centralized and computerized.¹⁶
- (b) *The registration system should be digitalized and integrated so that all information can be stored in electronic form and be accessible* to enable users to submit notices and search requests directly over the Internet or via networking systems. Digitalisation of the registry system helps to ensure transparency and assists parties to ascertain quickly the existence and priority of secured interests. It also helps to eliminate the risk of registry staff error in entering the information contained in a paper notice into the registry record. This results in more efficient access to registry services by users and greatly reduces the operational costs of the registry, translating into lower fees for registry users.¹⁷

¹² Uniform Commercial Code (ed.2017-2018) (<https://www.law.cornell.edu/ucc/9/>).

¹³ *Supra* note 5, EBRD Core Principle 8 page 2; *Supra* note 6, WB Principles, A4 page 15; *Supra* note 8, UNCITRAL Guide, para. 10 page 7.

¹⁴ *Supra* note 7, UNCITRAL Guide, para.7 page 150.

¹⁵ *Supra* note 10, Guide to Enactment, Article 28, page 49.

¹⁶ *Supra* note 6, WB Principles, A5, page 15.

¹⁷ *Supra* note 6, WB Principles, A5, page 15; *Supra* note 7, UNCITRAL Legislative Guide, pages 149-178; *Supra* note 8, UNCITRAL Guide, paras.135-150, page 53, para.150 page 57, paras.151-152 page 58, paras.39-43 pages 159-160; *Supra* note 10, Guide to Enactment, paras.145 and 146 pages 49 and 50.

- (c) *Security should be notice based and, in the case of movables, not based on possession.* In case of notice based security, the registration of a single notice should be sufficient to achieve the third-party effectiveness of security rights in the assets described in the notice, whether created under a single security agreement or multiple unrelated security agreements between the same parties, even if entered into at different times.¹⁸ Non-possessory security which gives a remedy attached to the charged asset is an essential element of a modern secured transactions law.¹⁹
- (d) The UNCITRAL Model Law²⁰ sets out Model Registry Provisions governing notice to third parties, which stipulate, among other matters, that the registration system should contain the following:
 - (i) registration of an initial notice with respect to a security right is only effective if authorized by the grantor of that security right in writing;
 - (ii) a single registered notice is sufficient to achieve the third-party effectiveness of security rights created under multiple security agreements;
 - (iii) advance notice may be registered i.e. before the creation of a security right to which notice relates;
 - (iv) the conditions for access to registry services should cover, *inter alia*: satisfying the required identity information submitted by registrants with a registration number, providing the grantor of the security with the right to register an amendment or cancellation notice, appointing an authority responsible for the appointment and dismissal of the registrar, providing guidance on when the effectiveness of a registration may be challenged owing to errors committed by registrants in entering the information in notices submitted to the registry and allowing electronic payments for the registry services.
- (e) *Self-registration by a secured creditor which is a credit institution may improve efficient registration of secured interests*, subject to the debtor's ability to rectify any error in the registry.²¹

5.3.3 Scope of security interests

- (a) *There should be a rational system for security rights* covering the laws for security rights in movable assets and immovables, non-possessory rights in tangible and intangible assets such as deposit accounts, investment property, letter-of-credit rights, including transfer-of-title and retention-of-title arrangements, that exist under state statutes and common law;²²
- (b) *Security instruments should permit capturing future assets of the same type/on same land* within the relevant security instrument.²³ It is highly recommended

¹⁸ *Supra* note 7, UNCITRAL Legislative Guide, para.98 page 174.

¹⁹ *Supra* note 5, EBRD Core Principle 2, page 1.

²⁰ *Supra* note 9, UNCITRAL Model Law, Arts.1-33 pages 17-40.

²¹ *Supra* note 10, Guide to Enactment, Section D.

²² *Supra* note 12, UCC, Part 3 Subpart 1 sections 301-316.

²³ *Supra* note 7, UNCITRAL Legislative Guide, paras.51-56 pages 77-79; *Supra* note 8, UNCITRAL Guide,

to permit future acquired assets as one security agreement may cover a changing pool of assets that fit the description in the security agreement, which will help to avoid numerous amendments of security agreements.²⁴ Security over such future assets should have the same priority, regardless of when the encumbered assets come into existence or are acquired by the grantor.²⁵

- (c) *The legal framework should establish rules governing competing rights of persons holding security and other persons claiming rights in assets given as security.*²⁶ In particular priority between competing security rights should be determined: (i) vis-à-vis third parties by either order/ timing of registration of a notice in the registry or, for security rights which are effective against third parties other than by registration, by the order of third party effectiveness and priority competition between a security right that is made effective against third parties by registration of a notice in the registry and a security right that is made effective against third parties by another method shall be determined by whichever occurred first.²⁷

5.3.4 Realisation of security rights

- (a) *Enforcement systems should provide for prompt realisation of secured rights by efficient, cost-effective, transparent and reliable methods (including both expeditious judicial and, subject to appropriate safeguards, non-judicial proceedings) for enforcing a security right over movable and immovable assets, prompt realization of the rights obtained in secured assets, designed to enable recovery in a commercially reasonable manner, and the proceeds should be distributed according to the priority rules of the applicable substantive law. Furthermore enforcement should enable prompt realisation at market value.*²⁸
- (b) *Methods for enforcement of security should be designed to maximise the net amount from realisation of encumbered assets.*²⁹ In order to maximize flexibility in enforcement and thereby to obtain the highest possible price upon disposition, *the law should provide creditors with a right for an informal out-of-court enforcement process.*³⁰
- (c) *To make the enforcement process more efficient, consideration should be given to minimising prior intervention by public officials or authorities in the enforcement process i.e. removing the requirement for creditors to sue their debtors to obtain judgments prior to enforcement. Simplified processes can be more efficient and can maximise the amounts obtained from the encumbered assets.*³¹
- (d) *A creditor should be free to choose the type of enforcement procedure that it deems most appropriate. Furthermore, the choice of one type of enforcement*

Recommendation 28 page 90; *Supra* note 9, UNCITRAL Model Law, Art.6 (2) page 9.

²⁴ *Supra* note 7, UNCITRAL Legislative Guide, paras.51-56 pages 78-79.

²⁵ *Ibid*, para.97 page 233, para.143 page 223 and para.233 page 421.

²⁶ *Supra* note 5, EBRD Core Principles, Principle 4.

²⁷ *Supra* note 12, UCC, Part 3 Subpart 3 sections 317-339; See also *Supra* note 7, UNCITRAL Legislative Guide, Recommendations 76-109 pages 229-236.

²⁸ *Supra* note 6, WB Principles, A7, A8 page 16; *Supra* note 5, EBRD Core Principles, Principle 4 page 2.

²⁹ *Supra* note 7, UNCITRAL Legislative Guide, Recommendations 131-177 pages 310-318.

³⁰ *Supra* note 7, UNCITRAL Legislative Guide, preamble to Part VIII Enforcement of a security right page 53; and para.142 page 312; See also *Supra* note 6, WB Principles, B4 page 19.

³¹ *Supra* note 7, UNCITRAL Legislative Guide, paras.29-33 pages 283-284.

should not preclude the creditor from changing it to another, except to the extent that the exercise of one right has made the exercise of another right impossible.³²

5.3.5 Interaction between enforcement and insolvency

- (a) *There should be clear provisions with regards to the impact of insolvency/bankruptcy on secured creditor enforcement and recoveries* with the aim of reducing value leakage for secured creditors, so that the security right should continue to be effective and enforceable after the bankruptcy or insolvency of the person who has given it, subject to a limited exception for rules which permit a moratorium.³³
- (b) With the commencement of insolvency proceedings, *unauthorized disposal of the debtor's assets and actions by creditors to enforce their rights or remedies against the debtor or the debtor's assets should be prohibited*. The moratorium should be as wide and all-encompassing as possible, extending to an interest in assets used, occupied, or in the possession of the debtor.³⁴ At the time of the commencement of insolvency proceedings a security right that is effective against third parties should remain effective against third parties and retain the priority it had before the commencement of the insolvency proceedings, unless otherwise explicitly prescribed by law.³⁵
- (c) *Single creditors should be prevented from seeking to use insolvency proceedings as a substitute for debt enforcement*. For example, creditors with a small debt, or a debt representing only a fraction of the debtor's total indebtedness should be restricted from initiating insolvency proceedings against the debtor.³⁶

5.3.6 Court system

- (a) *There should be specialization within courts or specialised administrative agencies on commercial matters* to effectively enforce the rights of creditors in enforcement outside of insolvency.³⁷ Specialisation within the court system may, for instance, be achieved through the appointment of certain trained judges to enforcement cases.
- (b) *Unnecessary appeals, particularly where the debtor is a legal person, may be prevented by following the principle of due process* whereby parties have a right to be heard on and receive proper notice of matters which affect their rights: timely and proper notification to interested parties, disclosure of relevant information by the debtor, and retention of professional experts to investigate and act with integrity, impartiality and independence.³⁸
- (c) Procedures should be adopted to ensure the efficiency of the court. *The court should be organized so that all interested parties are dealt with fairly, in a*

³² *Ibid*, para.33 page 284 and Recommendation 143 page 312.

³³ *Supra* note 5, EBRD Core Principle 5 page 2; See also *Supra* note 9, UNCITRAL Model Law, Arts.35 pages 43-44, 94 page 72; *Supra* note 6, WB principles, C5.2 page 22; *Supra* note 9, UNCITRAL Model Law, Art.35 pages 43-44.

³⁴ *Supra* note 6, WB Principles, C5.2 page 22.

³⁵ *Supra* note 9, UNCITRAL Model Law, Art.35 pages 43-44.

³⁶ *Supra* note 11, UNCITRAL Insolvency Guide, Recommendations, para.41 page 52.

³⁷ *Supra* note 6, WB Principles, D1.5 page 29.

³⁸ *Ibid*, C2. page 20.

*timely manner, objectively, and as part of an efficient, transparent system. Implicit in that structure are firm and recognized lines of authority, clear allocation of tasks and responsibilities, and orderly operations in the courtroom and case management. An insolvency and creditor rights system should be based upon transparency and accountability. Rules should ensure ready access to relevant court records, court hearings, debtor and financial data, and other public information.*³⁹

5.3.7 Judges, bailiffs and registrars

- (a) *Adequate and objective criteria for appointment of judges is paramount to ensure that any court-led enforcement cases are handled effectively and that the rights of both secured and unsecured creditors outside of insolvency proceedings are enforced without undue delay.*⁴⁰
- (b) In addition to judges, bailiffs and other judicial officers play a visible role in enforcement proceedings with respect to the enforcement of court decisions and, in some limited cases, the realisation of collateral therefore *it is essential that bailiffs and other judicial officers have the requisite skills and training.*⁴¹
- (c) While not directly involved in enforcement, *competent registrars are essential for preserving the integrity of the registration of secured interests* which constitutes the basis of any enforcement action. Their duties must be determined accurately and their performance needs to be monitored and supervised constantly.⁴²
- (d) It is widely accepted that *any secured transactions regime must be properly understood and interpreted by all those who are called to put the law into action (including judges, bailiffs and registrars)* as such professionals will apply it. Beside the necessary training and education, there needs to be an effective system that allows for evaluation of court efficiency and for improvements to the administration of the process.⁴³

³⁹ *Supra* note 6, WB Principles D3, D4 page 29.

⁴⁰ *Supra* note 6, WB principles, D1.5, D2.1 page 29.

⁴¹ *Supra* note 7, UNCITRAL Legislative Guide, paras.5-8 page 34, para.40 page 175.

⁴² *Supra* note 8, UNCITRAL Guide, para.74, page 29.

⁴³ *Supra* note 7, UNCITRAL Legislative Guide, para.85 page 29; See also *Supra* note 6, WB Principles, D2.2 and D2.3 page 29.

B ALBANIA

1. EXECUTIVE SUMMARY

This study aims to review the current state of affairs with regard to the enforcement of creditor claims in Albania. The study was conducted by the law firm Tashko Pustina under the auspices of the European Bank for Reconstruction and Development and is a part of a wider research project conducted in five selected jurisdictions: Albania, Croatia, Cyprus, Greece and Ukraine.

The focus in this Report is on parameters that influence the effectiveness of the enforcement procedure. These parameters are simplicity, cost and overall predictability. The listed parameters represent the so-called "Key Determinants" of this Report. Key Determinants were assessed following the responses from market participants, including Ministry of Justice, Bank of Albania and Supreme Court of Albania. A full list of market participants is set out as an Annex hereto.

Whereas the law in Albania is formulated with a view to striking a balance between interests of debtors and creditors, market practice is characterized by a shift towards favouring the interest of creditors. In 2017, Albania introduced amendments to the Civil Code and the Law on Securing Charges and adopted a new Insolvency Law. A security interest can now be granted over any type of movable property and secured creditors are given absolute priority within insolvency proceedings. In addition, Albania has implemented new laws allowing for the general description of assets that can be used as collateral. Nevertheless, creditors still observe certain drawbacks and disadvantages in the practical application of the law relating to enforcement of claims and security.

Enforcement in Albania is entirely dependent on court proceedings and out of court enforcement is not permitted although the debtor and its creditor may come to a consensual agreement to expedite the court process. Enforcement proceedings are characterised by excessive length. Another issue is the lack of unified case law among the courts which leads to inconsistent application of the law, particularly in the areas of enforcement of contracts and enforceable deeds. However, since 2016 Albania has been in the process of the so-called Judicial System Reform⁴⁴, which promises to improve the overall performance of judicial institutions significantly. Although claims enforcement legislation has not been directly targeted in this reform, it will nevertheless be positively affected by the improved performance of the court system. The anticipated changes are welcomed by the large public, including investors, businesses and entrepreneurs in the Albanian market, as the Judicial System Reform is seen as a key instrument to fight corruption and lack of legal certainty.

The World Bank Report Doing Business 2018 annual report estimates that it takes approximately 525 days to enforce a contract in Albania. The costs in court fees, attorney fees (where the use of attorneys is mandatory or common) and enforcement fees expressed as a percentage of the claim value are estimated to account for 34.9% of the claim in Albania. In addition, the timeline for resolving insolvency is considered to take approximately two years with a cost of 10%

⁴⁴ The Judicial Reform was implemented through the amendment of the Albanian Constitution in 2016 by the Act of the Republic of Albania "On some changes and additions to the Act No. 8417, dated 21 October 1998", as amended, No. 76/2016, dated 22. July 2016 and through adoption of a number of acts by the Albanian Parliament amending existing acts and adoption of newly specific ones. For more details refer to the section on the Institutional Framework Review of the report for Albania.

to the insolvency estate.

As noted by market participants, with regard to the practical application of the law, claims enforcement in Albania is also affected by the inefficiency of auction procedures and lack of transparency. Except for financial collateral (which is directly enforceable by the holder of the collateral), all secured assets must be auctioned by bailiffs through public auction, although creditors can choose either state bailiffs or a private bailiff of their choice to conduct the auction. Improving the efficiency of auction procedures is seen as a key factor for creditors to increase their chance to collect debts and to increase the prospects of sale of auctioned assets. Another factor negatively affecting creditors' control and overall efficiency of the enforcement process is the inability of state or private bailiff agencies to gather adequate information about a debtor's assets and the lack of access of creditors to this information. Lack of adequate and summarized information about debtor's asset is a common issue in all countries in which this research is conducted. Furthermore, existing deficiencies in the property rights regime in Albania negatively affect enforcement of claims secured by immovable assets.

In the below table we highlight the main ongoing issues with respect to the security and enforcement framework identified in the report for discussion with the government authorities, based on our review of the legal framework and feedback from local stakeholders and market participants. A more detailed analysis of the issues and recommendations is found in the report, which is divided into Part (A) a Legislative Review contains an analysis of existing legislative provisions regulating claims enforcement and recommendations for improvement; Part (B) an Institutional Framework Review, which provides an analysis of the institutions involved in the enforcement process in Albania and, where applicable, suggestions for reform. The cut-off date for the legislative review was 30 November 2018.

No.	Title	Issue	Recommendations for reforms	Report reference
1.	Information on debtor's assets			
1.1.	Obtaining information on debtor's assets	As in Albania assets are registered in separate registries, the information on the assets of a debtor must be obtained from each registry individually which is time-consuming and inefficient. In addition, online (electronic) research for the identification of the debtor's assets is only possible for very few registries as most of the registries are not electronically available.	The identification of the debtor's assets - which should be done prior to initiating any enforcement proceedings - is critical for the success of the enforcement proceedings. Thus, the centralization and digitalization of public registries are highly recommended to establish the possibility of access through a sole research engine. This should enhance both success rates and efficiency and reduce the creditor's costs at the same time.	Sections A1.1, 6.1

No.	Title	Issue	Recommendations for reforms	Report reference
2.	Security Instruments: Mortgages			
2.1.	Mortgages over immovable assets	The registration of all current immovable assets in Albania as well as the digitalization of the immovable assets registry is not yet concluded. Both improvements when complete should enable creditors to verify the existence of any prior security and identify and target the debtor's assets for enforcing their claims, which at present are not always clearly verifiable.	Additional efforts as well as financial resources should be mobilised from the Albanian government to support the completion of the registration and digitalization processes in a timely manner.	Section 3.4
2.2.	Mortgages and pledges over business units	Albanian legislation is unclear on whether or not an existing mortgage can extend to assets attached/added to the already mortgaged assets after the date of the creation of the security. Albanian law does not recognize the legal concept of a business unit. Mortgages on business units are therefore created over separate registered property items which are a cumbersome and more costly process. It is unclear whether or not an existing mortgage extend to assets attached/added to the already mortgaged assets after the date of the creation of the security.	It would be advisable to add a new provision to Article 534 of the Civil Code providing for the registration of business units and the extension of mortgage and pledge automatically to any asset attached to such an existing business unit. The Albanian enforcement legal framework should also provide for mortgages or pledges over business units to be enforced through the court and public auctions conducted by the bailiff.	Section A1.1.1
2.3.	Pledges over movables	The Civil Code provides only for judicial enforcement of the pledge through a sale supervised by the court. In fact, claims against movable assets can only be enforced through public auctions that are supervised by a private/state bailiff.	In order to make the pledge over movables more attractive, it is our recommendation to amend Articles 554 and the relevant subsequent articles of the Civil Code in order to enable the creditor and the debtor to proceed with a voluntary enforcement of the pledge.	Section 3.5.1
2.4.	Securing Charge	Market participants have noted that access to the Securing Charge Registry needs to be improved in order to make the identification of pledged assets or other available assets of debtors more accurate. Correct identification of pledged assets would make it easier for creditors to enforce their claims and avoid overlapping of pledges	In addition to the improvement of the search modalities and access instruments in the Securing Charges Registry, a possible solution would be an online registration of pledges by market	Section 3.5.2

No.	Title	Issue	Recommendations for reforms	Report reference
		over the same asset.	participants through e-application This could be effected by amendments to the Securing Charge Act and adoption of a specific regulation by the entity which administers the Securing Charge Registry on concession basis.	
3.	Enforcement			
3.1.	Public auctions	Except for financial collateral (which is directly enforceable by the holder of the collateral), all secured assets must be auctioned through bailiff officers (public or private ones, at the choice of the creditor) by means of public auctions. Auctions in Albania are considered inefficient because the assets available for sale are not properly advertised to the public and the auctions lack transparency <i>per se</i> . This results in lower prices for creditors and lower prospects of sale. E-auctions are not available.	To increase the effectiveness of auctions, it would be advisable to amend the Public Auction Act in order to improve the current practice of auctions and increase of the transparency and publicity of auctions. It is recommended to set up a common legal framework for all auctions performed by both state and private bailiffs. The establishment of a centralized and electronic auction centre or different regional centres would increase transparency and make available information for any interested party to acquire assets put up for sale. Such improvements may help creditors to obtain higher prices prospects of sale for the auctioned assets.	Section 6.2
3.2.	Distribution of proceeds	Enforcement orders for monetary claims, which are issued by the court are supposed to be registered by the bailiff in a specific registry, from the moment the bailiff starts the enforcement procedure for the collection of the relevant debt. The creation of such central and public registry is provided by Article 516/a of the Civil Procedure Code to ensure the <i>pro rata</i> distribution of the amounts collected from the auction to all creditors registered with	In the opinion of market participants, the adoption of a specific regulation by the Ministry of Justice for the creation and functioning of the central registry provided already by Article 516/a of the Civil Procedure Code is necessary, because of existing delays in distribution	Section 6.2

No.	Title	Issue	Recommendations for reforms	Report reference
		the registry However, as of today, no such registry exists.	of proceeds due to the lack of a registry and the need to identify relevant creditors.	
3.3.	Duration of court procedures	Claims enforcement in Albania is a court driven process. The duration of the court procedures affects the efficiency of enforcement proceedings itself. Although Article 609 of the Civil Procedure Code provides that an appeal should be heard within 60 days, in practice it can take much longer (sometimes even more than one year) depending on the workload of the courts of appeal.	<p>Based on feedback from market participants and law professionals, we would propose:</p> <ul style="list-style-type: none"> • Specialisation within the court system i.e. creation of commercial courts or further specialisation of existing court divisions to handle commercial contracts, enforcement and insolvency; • Introducing the role of a single judge competent to hear all disputes for a given executive title/enforcement claim between the creditor and debtor in the Civil Procedure Code in order to ensure consistency for the resolution of the disputes between the same creditor and debtor for a specific claim and improve overall efficiency; • The overall duration of court proceedings may be further reduced by courts of appeal through the adoption of rules that allow for accelerated proceedings. Each court shall adopt specific rules for the acceleration and prioritization of enforcement disputes. • During insolvency proceedings claims enforcement outside the insolvency is 	Section 6.2

No.	Title	Issue	Recommendations for reforms	Report reference
			<p>suspended. Hence insolvency judges should receive specialized and appropriate training in order to develop and establish a consistent case law. Such training has to be in compliance with the newly adopted Insolvency Act in Albania;</p> <ul style="list-style-type: none"> • Improvement of the court infrastructure in order to reduce the workload for the judges; • Judges and judge candidates should receive specialized education and further training, especially in the field of business and insolvency law. 	
3.4.	Unlimited appeals	Judicial enforcement of claims is the preferred instrument of enforcement for Albanian market participants. Despite significant improvements to the Albanian Civil Procedure Code in recent years, current rules of civil procedure regulating enforcement process in Albania provide for a possibility for unlimited appeals. This procedural possibility is often used <i>by mala fide</i> debtors to prolong the enforcement process. Moreover, the case law is not yet consistent regarding such enforcement procedures.	<p>The opinion of the market participants, which is shared by the authors of this Report, is that unification of case law by the Supreme Court in this area would help to prevent unfair or abusive judgments and further consolidate the case law.</p> <p>In addition, the CPC should be further amended to specify that one judge shall be competent for all claims brought within enforcement proceedings.</p>	Section 7.1.2
3.5.	Enforcement costs	Enforcement costs in Albania consist of mainly legal and bailiff costs. Bailiff fees for services provided by private bailiff were increased in 2017. As of the date of this Report, this issue is still subject to discussion between the local stakeholders and the government, which has proposed the reduction of bailiff tariffs by 50%, meaning establishing the same level of bailiff tariffs that	As a solution it is suggested that bailiffs should be paid fixed tariffs which can differ for different thresholds, up to a reasonable cap. Indeed, regardless of the amount of the claim, bailiff procedures are standard and bailiffs should instead be	Section 6.6

No.	Title	Issue	Recommendations for reforms	Report reference
		<p>existed before the 2017 change. Bailiff tariffs are determined based on the value of the claim, in accordance with a sliding scale. In addition, to the reduction of the tariffs, market participants have proposed the introduction of fixed bailiff tariffs, which may be different for different thresholds.</p> <p>The Albanian government finally unified in August 2018 the state and private bailiff tariffs and reduced these to a sensible level. Currently, the new tariffs are suspended from effect through an interim injunction of the Tirana Administrative Court of Appeal until a final court ruling</p>	<p>compensated for extraordinary efforts in more complex cases through success fees. This solution could also incite bailiffs to be more efficient and cost-oriented. According to European Commission research on lawyer and bailiff fees in Europe, in most (70%) of the European states bailiffs are paid per act. It is common that bailiffs' fees are charged on the basis of a prescribed schedule and for the most part bailiffs' fees are determined according to the nature of the acts or procedure undertaken.⁴⁵</p> <p>Despite the suspension of the new bailiff tariffs, the Albanian government seems committed to keep the bailiff tariffs lower, responding positively to market participants' concerns. In the opinion of the authors of this Report, the introduction of more reasonable and more cost oriented bailiff tariffs is a matter of time.</p>	
3.6	Judicial enforcement	<p>The efficiency of enforcement of claims against any assets depends in general on the rule of law and law enforcement by courts. In Albania, enforcement of claims is a court-driven process and no voluntary, out-of-court, enforcement is possible. Even though first instance courts do have commercial divisions, the judges assigned to hear commercial cases deal with a great variety of commercial cases,</p>	<p>To increase the efficiency of enforcement of claims over any assets, market participants and the authors of this Report recommended further specialization and trainings for judges and prospective judges for the consolidation and</p>	Section 12

⁴⁵ https://e-justice.europa.eu/content_costs_of_proceedings-37-en.do

No.	Title	Issue	Recommendations for reforms	Report reference
		which does not allow for more expedited management of enforcement and insolvency cases.	unification of legal practice. Creation of separate commercial divisions for hearing commercial enforcement cases and insolvency cases may further improve the courts' efficiency.	
3.7.1	Claims priority	Recognition of variation of priority by agreement e.g. through an intercreditor agreement is legally unclear and open to interpretation. The Civil Code is silent on whether creditors can modify priority ranking, which is determined based on the origin (legal cause) of the claims. As a result variation of priority is not common for in current legal practice and it may take a long time for courts to establish the relevant case law or for the Albanian Supreme Court to unify the practice.	Our recommendation, supported by market participants, would be to amend Article 603 of the Civil Code and insert a provision specifically permitting the contractual assignment of priority ranking, meaning the ability of parties to agree contractually on ranking i.e. through an intercreditor agreement.	Section 4.3.3
3.7.2	Priority ranking and enforcement agencies	Priority of secured charges against ordinary mortgages and pledges is determined by the general ranking provided by the Civil Code, which is mandatory. Regardless of the type of security, higher ranking creditors have the right to enforce their claims before lower ranking creditors; i.e. claims originating from financial transactions secured by securing charges for the purchase price of a specific asset are ranked the highest. Nevertheless, market practice and case law differs in relation to enforcement of secured claims such as a mortgage competing with higher secured claims ranked higher by the Civil Code. Generally, enforcement agencies (such as bailiff or REROs) tend to give priority to the mortgage secured creditor which is first paid the proceeds from the auction sale of the asset, while the creditors entitled to employment claims are paid the remaining amounts from the auction proceeds.	It is recommended to adopt specific instructions/regulations addressed to enforcement agencies to ensure that their officers comply with the ranking provided by the Civil Code, or by unifying the case law through decisions of the Supreme Court, taking into consideration that despite the general ranking, courts tend to privilege secured claims over higher ranked claims, when hearing legal actions / appeals from the concerned higher ranked creditors.	Section 4.3
3.8.	Taking over by NPL purchaser of any existing enforcement	There is no specific provision in the current Albanian legal framework which enables an NPL purchase to take over any existing enforcement procedure attached to such NPL. Also, no consensus exists in legal practice. Some legal practitioners consider an existing	As a solution, we would advise clarifying the position by amending the Civil Code and the Civil Procedure Code to allow NPL purchasers to take over enforcement	Section 10

No.	Title	Issue	Recommendations for reforms	Report reference
	process	enforcement court order as an accessory to the main claim (i.e. loan), which should automatically be transferred with the loan. Other law professionals, however, consider that a new enforcement procedure should commence in case of the NPL transfer to third parties.	claims.	
3.9.	Out-of-court enforcement	Claims enforcement in Albania is a court-driven process and there is no specific regulation for out-of-court enforcement. Nevertheless if the debtor and creditor agree there are two main ways to expedite the process. First, the creditor and debtor may reach an agreement before or up to the preliminary hearing before a court and have this agreement ratified by the court hearing of the dispute for the issuance of the enforcement order. Second, a creditor may file a request with the competent court for the issuance of the writ of execution based on a notarial deed by which the debtor accepts the existence and payment of a debt/obligation to a creditor. This is a consolidated practice and quite efficient, providing the means for the creditor to obtain a writ of execution within few weeks. However, it is not clear whether any transferee creditor can benefit from the writ of execution which has been issued previously to the benefit of the first creditor, or if a new writ of execution must be issued reflecting the new creditor as the beneficiary of the claim. This is seen from market participants as an issue which may cause uncertainty in practice especially for the enforcement of NPLs.	Inserting a new provision in Article 510 of the Civil Procedure Code could address this issue given that a writ of execution for payment of monetary obligations constitutes a legal title creating rights transferrable to third parties, either on the basis of an agreement between the creditor and debtor or pursuant to the transfer of the claims to a new creditor. The new provision should clarify that a new creditor may benefit from any existing rights of the transferor, including pursuant to any agreement between the original creditor and the debtor and any writ of execution obtained by the original creditor.	Section 6.3
4	Impact of bankruptcy and pre-bankruptcy proceedings on enforcement			
4.1.	Impact of bankruptcy and pre-bankruptcy proceedings on enforcement	The new Insolvency Act entered into force in 2017. However, there is no new case law or established practice in the market in relation to the application of the legal provisions of the Act. The Insolvency Act provides first for the possibility of the debtor to be reorganized and continue to perform its activity in order to that the creditors may be paid their claims (pre-insolvency procedure), provided that reorganization is possible or can benefit the insolvent entity. Reorganization or the commencement of the insolvency procedure	Given the wide scope of powers of the insolvency administrator who are licensed by the Albanian National Insolvency Agency, it is very important for creditors to ensure that the capacity of the Agency and licensed insolvency administrators are improved through adequate training and understanding of the legal framework	Section 8

No.	Title	Issue	Recommendations for reforms	Report reference
		will result in a stay on any enforcement including any ongoing enforcement proceedings by secured creditors. This stay also applies to any other insolvency procedures. The insolvency administrator has wide powers to administer and decide on the secured assets including the power to decide, at his own discretion, to keep the asset for the benefit of the insolvency creditors even though the value of an asset is lower than the secured claim. While a secured creditor is entitled to request the separation of its collateral from the rest of the insolvency assets, resulting in the right of the creditor to sell or dispose of its collateral at his discretion, the administrator may prevent the secured creditor from exercising such right e.g. where he reasonably believes that the value of the asset may increase in the future and the auction selling price could be higher.	<p>established by the new Insolvency Act.</p> <p>We further recommend, supported by market participants, that transparent methodology procedures are established for the assessment of a secured asset value.</p> <p>Additionally, trainings, education and specialization of judges would increase efficiency and proper understanding of the newly adopted Insolvency Act.</p>	
5.	Registration system			
	Modernisation of the registration system	<p>In Albania different registries are provided for different types of asset. Thus there are a large number of registries: the Immovable property registry, the Commercial registry, the Securing Charge Registry, the Joint stock registry, the Albanian Civil Aircrafts Registry, and the Albanian Ship Registry. Generally, lack of a centralized, integrated and digitalized registry system is an issue. Furthermore, there is a lack of consistency by officials of the Commercial registry in relation to registration of bailiff's enforcement orders, as market participants have noted.</p> <p>There is no single registry to centralise information about a debtor's assets. According to market participants, inadequate information on the whereabouts of debtors and official addresses hinders all stages of enforcement, both the court related proceedings and enforcement proceedings conducted by bailiffs.</p>	<p>We recommend that the authorities consider future integration of the Securing Charge Registry, the Commercial Registry and the Joint Stock Registry to reduce the number of separate registries in line with international best practice. We also recommend improving the reliability of the information on the registry system and efficiency by amending the Companies Act and/or the Business Registration Act which cover the Commercial Registry and amending the Securing Charge Act which governs the Securing Charge Registry by introducing online registration of pledges by market participants through e-application.</p> <p>While it is acceptable to have special</p>	Sections 6.2, A1.1

No.	Title	Issue	Recommendations for reforms	Report reference
			<p>registries for special assets, it would be helpful to have a general registry for security rights over movable assets.</p> <p>To improve access of creditors to information about a debtor's assets we recommend to link all assets owned by a natural person or legal entity to their personal identification number, which would substantially simplify the creditor's position and reduce the creditor's costs before initiation of enforcement proceedings and (electronic) exchange of information between relevant registries where the debtor's assets are listed would also be helpful.</p> <p>Considering the inadequate information on debtors, a process of updating and correction of addresses should be conducted in the Registrar of Civil Status (where addresses of residents in Albania are registered with) in order that debtors are identified properly before or during the enforcement proceedings. Currently this process started in 2017 and is still ongoing.</p>	

2. GLOSSARY

ABA	Albanian Bank Association
ACAA	Albanian Civil Aviation Authority
Banks Act	The Act of the Republic of Albania "On Banks in the Republic of Albania", No. 9662, dated 18.02.2006, as amended
BoA	Bank of Albania
Business Registration Act	The Act of the Republic of Albania "On registration of the business" No. 9723, dated 03.05.2007
CC or Civil Code	Civil Code of the Republic of Albania, adopted by the Act of the Republic of Albania "The Civil Code", No. 7850, dated 29.07.1994, as amended
CM Instruction 1/2016	Instruction No. 1, dated 13.04.2016 of the Albanian Council of Ministers
Commercial Registry	Commercial Registry of the Republic of Albania, as established with the Business Registration Act
Companies Act	The Act of the Republic of Albania "On entrepreneurs and commercial companies" No. 9901, dated 14.04.2008
CPC or Civil Procedure Code	Code of Civil Procedure of the Republic of Albania, adopted by the Act of the Republic of Albania "Civil Procedure Code", No. 8116, dated 29.03.1996, as amended
EBRD	The European Bank for Reconstruction and Development
Former Insolvency Act	The Act of the Republic of Albania "On Insolvency", No. 8901, dated 23.05.2003, as amended
GDIP	General Directorate of Industrial Property
GMD	General Maritime Directory
Immovable Properties Registration Act	The Albanian Act "On registration of immovable properties", No. 33/2012, dated 21.03.2012, as amended
Industrial Property Act	The Act of the Republic of Albania "On Industrial Property", No. 9947, dated 07.07.2008, as amended
Insolvency Act	Act of the Republic of Albania "On Insolvency", No. 110/2016, dated 27.10.2016
IPR	Immovable Properties Registry of the Republic of Albania, as established with the Albanian Act "On registration of immovable properties", No. 33/2012, dated 21.03.2012, as amended
Joint Stock Registry	Joint Stock Registry, administered by the joint stock private company <i>Qendra e Regjistrimit te Aksioneve Sh.a.</i>
Key Determinants	Parameters influencing effectiveness of the procedure: speed, simplicity, cost and overall predictability of enforcement process
NBC	National Business Centre of the Republic of Albania
NIA	National Insolvency Agency of the Republic of Albania
NPL	Non-Performing Loan

Payments System Act	Act of the Republic of Albania "On payments system", No. 133/2013, dated 29.04.2013
Private Bailiff Act	The Act of the Republic of Albania "On the private judicial bailiff service" No. 10 031, dated 11.12.2008, as amended
Public Auction Act	Act of the Republic of Albania "On Public auction", No. 9874, dated 14.02.2008, as amended
Public Bailiff Act	According to the Act of the Republic of Albania "On the organization and functioning of the judicial bailiff service" No. 8730, dated 18.01.2001, as amended
RERO	Real Estate Registration Office
Sale-purchase Land Act	Act of the Republic of Albania "On sale-purchase of lands", No. 7980, dated 27.07.1995
Securing Charge Act	Act of the Republic of Albania "On securing charges", No. 8537, dated 18.10.1999, as amended
Securing Charge Registry	Securing Charge Registry of the Republic of Albania, as established with the Securing Charge Act
SHRC	Shares' Registration Centre Sh.a., a joint stock company established by the Decision of the Albanian Council of Ministers "For the establishment of the joint stock company " <i>Qendra e Regjistrimit te Aksioneve</i> "", No. 112, dated 19.02.1996

PART (A) LEGISLATIVE REVIEW

3. TYPE OF CLAIMS

3.1 Unsecured claims

Unsecured claims in Albania may be enforced only by means of obtaining 'an executive title'⁴⁶ issued by a competent court, after that the court has examined the merits of the case in the presence of the parties.⁴⁷ Creditors may register an executive title in a registry which holds the registration of the asset in question and therefore have such claims enforced in the same way as secured claims.⁴⁸

3.2 Secured claims

Under Albanian law claims can be secured by means of collateral (i.e. mortgage, pledge, etc. over the debtor's assets or any asset owned by a third party, such as guarantors) to guarantee fulfilment by a debtor of its obligations.

3.3 The types of security

The most common types of collateral are the following:

- (a) Mortgage over immovable assets⁴⁹
- (b) Pledge over movable assets⁵⁰
- (c) Securing charge over movable assets⁵¹
- (d) Financial collateral over the cash and other instruments of payment⁵²

A security can be created both over an entire asset or only part of it.

3.4 Immovable

Albanian Law categorizes as immovable the following types of properties: plots of land, buildings (including those under construction) and mineral resources (mines).

Mortgages are created by means of an agreement before a public notary, and registered with the local immovable properties registry ("**IPR**") administered by the respective Real Estate Registration Office ("**REERO**"). In addition, mortgages can also be created by registering a final court decision with the IPR.⁵³ To enforce a mortgage a creditor must obtain a court enforcement order, issued by a competent court in the event of a default of a debtor. A mortgage is enforced by bailiffs through a standard auction procedure. Mortgages over buildings are the most preferred and common means to secure claims in Albania, due to their effectiveness and presence of the established market practice and a developed legal framework regulating them.

⁴⁶ 'An executive title' is defined in Article 510 of the Civil Procedure Code, where the list of grounds to obtain such 'an executive title' is provided.

⁴⁷ In accordance with Articles 510 and subsequent of the Code of Civil Procedure of the Republic of Albania, adopted by the Act of the Republic of Albania No. 8116, dated 29 March 1996 (with subsequent amendments) ("**Civil Procedure Code**" or "**CPC**").

⁴⁸ Article 530 and subsequent of the Civil Code of the Republic of Albania, adopted by the Act of the Republic of Albania, No. 7850, dated 29 July 1994 (with subsequent amendments) ("**CC**" or "**Civil Code**").

⁴⁹ Article 560 CC and subsequent of the Civil Code.

⁵⁰ Article 546 and subsequent of the Civil Code.

⁵¹ Act of the Republic of Albania "On securing charges" No. 8537, dated 18 October 1999 ("**Securing Charge Act**").

⁵² Act of the Republic of Albania "On payments system" No. 133/2013, dated 29. April 2013 ("**Payments System Act**").

⁵³ Defined as Court Mortgage as per Article 565 CC.

Mortgages may only be registered if an immovable asset is already registered in the name of the respective person (individuals or legal entities) with the respective IPR. In case of more than one mortgage security over one asset, the registration order follows chronological rank of the respective applications. In case of two or more simultaneous applications for registration, all mortgages are registered under the same ranking number.⁵⁴

Currently approximately 4 million immovable properties exist in Albania, including all types of land (i.e. agricultural lands, plots of land) and buildings. Preliminary registration has been completed for about 3 million immovable properties.⁵⁵ A current digitalisation process is taking place to fill in a digital database for all REROs which had been completed for approximately 650.000 properties.

Identified issues:

A search in a digitalised database can be performed by anyone who has access to the system (available for persons with an established interest i.e. 'interested persons'). However, information related to immovable assets that are not yet included in a digital database is searched for manually by REROs' staff. Additionally, this manual search is only possible when a creditor can provide a special registered number assigned to this asset in the system, while digital search is possible by a name of an asset's owner.

Recommendations for reform:

Digitalisation of all immovable properties would make the search more effective and consequently make the enforcement process easier.⁵⁶ According to market participants, immovable properties digitalisation must be accelerated to obtain a better functioning registration system which is fundamental to the extension of secured credit and is recommended by the UNCITRAL Legislative Guide on the Implementation of Security Rights Registry.⁵⁷

In the opinion of the authors of this report, the Albanian government must take additional efforts and engage financial resources for the completion of registration and digitalization processes.

3.4.1 Mortgage on land plots

Albanian law recognises two main types of land: agricultural and construction land.

Identified issues:

Market participants observe that enforcement of collateral over agricultural land is often hindered by the specific situation in Albania in respect of the property rights over land plots and the zoning restraints. There is currently a restitution process taking place related to property nationalised by the communist regime which is not yet finalised.⁵⁸ As a consequence

⁵⁴ Article 575 CC and Article 37 of the Albanian Act No. 33/2012, dated 21 March 2012 "On registration of immovable properties", as amended ("**Immovable Properties Registration Act**").

⁵⁵ An immovable property is first registered with the respective IPR receiving an interim property number. Based on this preliminary (interim) registration procedure, immovable properties enter the market and can be disposed by their owners (sold, mortgaged, etc.). Albania is divided into cadastral zones and upon completion of the preliminary registration of the immovable properties for the respective cadastral zone, all properties are registered definitely. Currently, the preliminary registration has not been completed for 340 cadastral zones, mainly forests and pastures.

⁵⁶ *Supra* note 7, UNCITRAL Legislative Guide, para. 82 pages 31-33.

⁵⁷ *Ibid*, para. 91 page 35; see also *Supra* note 7, UNCITRAL Legislative Guide, Section IV, para. 39 page 158.

⁵⁸ During the communist regime, private properties were expropriated by the State. After the fall of the communist regime, in 1993, a large process of restitution of lands and buildings to the former owners was initiated. The process of the restitution and compensation of properties to the former owners has not been yet completed, for two major reasons:

(i) overlapping of claims over the same property, caused by the lack of proper registration of properties by the State during the communist regime;

(ii) legal uncertainty and abuse with the restitution of properties by the authorities and lack of consistency by the courts.

there is a problem to identify the owners of many land plots in Albania and land plots are often considered to be undesirable collateral. In addition, property rights over land plots can be acquired only by Albanian nationals (natural or legal persons), which limits the number of the potential buyers therefore rendering the market less liquid.⁵⁹ Disputed restituted properties represent a problem for both creditors and REROs as the legal certainty of the immovable assets market depends in great part from the final and regular registration of ownership over such assets as well.

Recommendations for reform:

In 2015, Albania adopted a new legal framework for the completion of the process of restitution of properties to former owners.⁶⁰ For this process to be transparent and efficient more efforts must be made for the identification of all public, free and undisputed properties and for the compensation of former owners.

3.4.2 Mortgage on premises and buildings, including buildings under construction

Buildings under construction can also be mortgaged (either over part of the units, or all the units to be constructed) after the registration of the sheet of the building with an interim section of the respective IPR for the property under development.⁶¹ Registration of the mortgage over building sheet may be performed only after:

- (a) registration with the IPR of the certificate on completion of skeleton works issued by the respective Municipality granting the construction permit; and
- (b) registration of the sheet with the respective interim section of the IPR for that property.

After registration of a sheet, a developer/constructor may typically register mortgage contracts for bank loans, etc. or the sale contracts for apartments/business units to the clients. After completion of the building, a developer/constructor would first obtain ownership rights over all the units and only after that property right is transferred to the respective owner. The mortgage is also registered in a specific section of a respective property. The completion of the registration under point (a) in the paragraph above depends on municipal authorities, which must send the respective file to RERO so the latter can register the sheet as per point (b). Costs of registration of the construction permit and the skeleton are afforded by a constructor.

Since 2018 the procedure has been carried out electronically and municipalities send the files through an electronic platform. This e-procedure has accelerated the process and has made it more efficient. According to the information provided by RERO it may take from 1-3 months to municipalities to send the respective file to REROs.⁶²

A mortgage over a building is extended also over the plot of land where the building is built and over all future additions to the building.

⁵⁹Article 5 of the Act of the Republic of Albania "On sale-purchase of lands" No. 7980, dated 27 July 1995 ("**Sale-purchase Land Act**"). In exception to this rule, foreigners may become owners of the land in case of investments of a value at least 3 times higher than the land value.

⁶⁰ The Parliament has adopted the Act of the Republic of Albania "On treatment of the property and completion of the process of properties compensation", No. 133/2015, dated 5 December 2015 repealing the former legal framework.

⁶¹ Instruction No. 1, dated 13 April 2016 of the Albanian Council of Ministers ("**CM Instruction 1/2016**").

⁶² The Municipality of Tirana (the capital of Albania) appears to be more efficient, as it generally takes less than 1 month to complete said procedure.

3.4.3 Mortgage on business unit (integral property complex)

Identified issues:

Albanian law does not recognize the legal concept of a business unit. Mortgages on business units are created over a separate registered property items. Therefore, no mortgage on an integral property complex is possible if such complex has not been registered as one immovable property asset with the respective IPR. For this reason, it is unclear whether or not an existing mortgage extendable to assets attached/added to the already mortgaged assets after the date of the creation of the security.

Recommendations for reform:

We recommend adding a new provision to Article 534 of the Civil Code providing for the registration of business units and extension of mortgage and pledge automatically to any asset attached to such an existing business unit.⁶³ This recommendation is supported by market participants.

3.5 Movables

3.5.1 Movable pledge

A movable pledge is created by a debtor or a third party, by way of temporarily transferring possession of an asset to another party.⁶⁴ A pledge can be imposed over movable assets, any real right or over usufructs' rights related to these properties or rights. A pledge agreement should be executed in a written or notary form and should specify at least the pledged asset, the secured obligations, and the forms of enforcement.

A pledge is typically used in respect of movable assets that are not registered with any specific registry. According to the general principle of transfer of possession for creation of a pledge, a pledged asset must be in physical possession of a pledgee. It is also possible to pledge all assets of an enterprise acting as an on-going concern; possession of such assets may be transferred to a third party which may manage them throughout the duration of the pledge.⁶⁵

Enforcement of a pledge over movable assets is possible if the court authorises a creditor to proceed with the sale of a pledged asset. If a pledged asset already has a market price established by an authorized person (i.e. organized markets), the asset can be sold by such authorized person. If there are several pledged assets, the court will limit the enforcement only to the assets necessary to cover secured obligations.

A sale is not applicable in cases when the pledged assets include cash or other payment instruments. When the pledge is created over cash or equivalent payment instruments, a creditor is entitled to bring a request within proceedings for retention of all sums necessary for the full discharge of the secured obligations.

Identified issues:

The pledge over movables is not common for the market and creditors prefer the securing charge over movables described in point 3.5.2 below.

Save for the particular provisions that govern specific movable pledges such as those created under the Securing Charge Act, there is no concept of a non-possessory pledge under the Civil

⁶³ *Supra* note 7, UNCITRAL Legislative Guide para. 64, pages 23-24.

⁶⁴ Articles 530 – 560 CC.

⁶⁵ Article 547 CC.

Code. The Civil Code provides only for material possession of pledged assets. Therefore, formally the Civil Code does not cover any possible scenarios when the pledgee executes control over the asset without holding it in material form.

Furthermore the Civil Code provides only for judicial enforcement of the pledge through a sale supervised by the Court, and there is no provision to entitle parties to proceed with a voluntary enforcement of the pledge. The current Albanian legal framework provides no possibility for voluntary enforcement of securities as to enforce claims against debtor's assets the creditor needs to obtain an executive order from the court, except for financial collateral under the Systems Payment Act.

For these reasons, a pledge over movable assets under the Civil Code is not commonly used in Albania. This is particularly problematic when the pledge is created over shares, as detailed in point 3.5.3 below.

Recommendations for reform:

We recommend, following consultations with market participants, that the Civil Code is amended in order to entitle parties to conclude an agreement with the effect that in the event of debtor's default, the pledge may be enforced by a direct transfer of a pledged asset to a creditor. These amendments should then also cover specific provisions for the determination of the price of pledged assets in case of contractual enforcement.

In order to make the pledge over movables more attractive, a possible solution would be the amendment of Article 554 and the relevant subsequent articles of the Civil Code and include provisions in the Civil Code and the Civil Procedure Code for submitting pledge enforcement to the general rules of enforcement proceedings, enabling also the creditor and the debtor to proceed to a voluntary enforcement of the pledge.

3.5.2 Securing Charge

The Securing Charge Act provides for a specific regime of movable pledges to secure financial transactions. A securing charge is a security created over movable assets which are registered with a specific securing charge registry ("**Securing Charge Registry**"). Any obligation secured by a securing charge must be capable of being valued in money. The asset may exist at the moment of execution of the securing charge agreement or may be created in the future. It may be located within or outside Albania and it includes also proceeds arising from the enforcement of the rights over the collateral. Various types of assets may constitute collateral, including tangible and intangible goods, security and financial instruments.

The Securing Charge Registry is currently administered by a private legal entity on concession basis.

Specifically, an account covers any monetary obligation that is not evidenced by an instrument or a security, whether or not the debtor has fulfilled the obligation ("receivables"). A securing charge can also be created by effect of law over sold goods, in favour of the seller of the goods to secure payment of the purchase price by the buyer (the "purchase price-securing charge").

The Act provides for conditions to be met before a securing charge becomes enforceable against the chargor and third parties, consisting mainly of: (i) execution of a written agreement between the owner of the asset and the creditor; (ii) registration of the securing charge with the Securing Charge Registry; and (iii) transfer of possession over the asset to the chargee or its agents.⁶⁶

⁶⁶ Articles 5 and 8 of the Securing Charges Act.

Priority between securing charges is determined based on the completeness of a charge and the registration order.

A securing agreement constitutes one of the ways to obtain an executive title to an asset. Thus, upon an event of default, the chargee may request an enforcement order from a competent court, to be subsequently executed by bailiff service, by way of seizing collateral and delivering it to a chargee or the person authorised by him. Following delivery of the collateral, the chargee may proceed with its sale.

Currently, securing charge is the most common and effective way to enforce claims over movable assets in Albania.

Recommendations for reform:

To make the Securing Charge Registry more efficient, we recommend, supported by market participants, amending the Securing Charges Act by introducing online registration of pledges by market participants through e-application.⁶⁷ This is in line with the World Bank Principles for Effective Insolvency and Creditor/Debtor Regimes⁶⁸ which emphasize the importance of a centralized and computerized registry system. In addition, digitalisation of the registry system is helpful for ensuring transparency and it also assists parties to ascertain the existence and priority of secured interests faster. It also helps to eliminate the risk of registry staff error. Together this results in more efficient access to registry services by users and greatly reduces the operational costs of the registry, translating into lower fees for registry users.⁶⁹

Registration may be effected by the secured party or its representative without the requirement of the debtor's involvement. If registration is made without the debtor's consent and it does not cover an existing security interest or is incorrect, the debtor can require that it be removed or corrected.

3.5.3 Pledge over shares

A pledge under the Civil Code can be created over: (i) capital parts (*quotas*) of limited liability companies, or (ii) shares of joint stock companies and must be registered in the share ledger of the Company to be valid.⁷⁰ Companies in Albania are registered with the commercial registry ("**Commercial Registry**") administered by the National Business Centre ("**NBC**").⁷¹ Registration of a pledge with the NBC is valid against third parties upon its publication in the Commercial Registry.

Pledges/Charges can be also created over shares based on the Securing Charge Act.⁷² In this case the securing charge (pledge) over shares is perfected only after being registered with the Registry of Securing Charges, meaning that it can be enforced against third parties only upon such perfection.⁷³ Additionally, a securing charge may also be registered with the NBC.

Identified issues:

It is usual, even though is not specifically required by any legal provision, to register a pledge

⁶⁷ *Supra* note 6, WB Principles A4.2, page 15

⁶⁸ *Supra* note 6, WB Principles A5.5, page 15

⁶⁹ *Supra* note 6, WB Principles, A5, page 15; *Supra* note 8, UNCITRAL Legislative Guide, pages 149-178; *Supra* note 8, UNCITRAL Guide, paras.135-150, page 53, para.150 page 57, paras.151-152 page 58, paras.39-43 pages 159-160; *Supra* note 10, Guide to Enactment, paras. 145 and 146 pages 49 and 50.

⁷⁰ Article 547 CC.

⁷¹ The Act of the Republic of Albania "On registration of the business" No. 9723, dated 3 May 2007 ("**Business Registration Act**").

⁷² Article 1 of the Securing Charge Act provides that any movable asset can serve as collateral to secure a claim.

⁷³ Article 8 of the Securing Charge Act.

over shares with the Commercial Registry; however, such registration is not mandatory either for the perfection or the validity of pledge, or for its enforceability. Registration merely serves for publication purposes to provide effective notice to third parties in order to prove their actual knowledge. In respect of joint stock company shares, the pledge should also be registered with the joint stock registry ("**Joint Stock Registry**") administered by the Shares' Registration Centre ("**SHRC**") ; this registration also envisages publication to notify third parties. The timing of the registration will determine the priority, making registration an important tool for creditors to secure their claims.

A shareholder may freely decide to create pledge over its shares, unless there is any agreement between the shareholders of the company providing for the consent of the other shareholders as well.

With respect to pledges over shares created under the Securing Charge Act, it is not possible to search in the Securing Charge Registry with a name of the company whose shares are pledged; a search is possible only against names of its shareholders. Furthermore, only tradable shares are considered as securities under the Securities Act. According to market participants there is no current practice in creating a pledge over such securities as there is no effective shares capital market in Albania.

Recommendations for reform:

In accordance with the World Bank Principles for Effective Insolvency and Creditor/Debtor Regimes, it is advisable for national registries to be integrated insofar as possible, therefore we would recommend the future integration of the Securing Charge Registry, the Commercial Registry and the Joint Stock Registry. A centralized approach is recommended in the UNCITRAL Model Law and Guide to Enactment. According UNCITRAL it is advisable that a single public registry relating to registration of notices with respect to security rights should exist.⁷⁴

The Securing Charge Registry serves as a public registry with the goal of being accessible to any interested party. Integration in a unique public authority may further increase the accountability and control from the public which may provide advantages in comparison to the current administration on concession basis. Additionally we recommend allowing a search against either the names of the company or its shareholders in such electronic registry.⁷⁵

To integrate the Securing Charge in one and unique registry with the Commercial Registry and Joint Stock Registry the government would first need to review and consider the annulment of the concession contract with the legal entity administering this Registry.

3.5.4 Pledge over corporate rights

Albanian law does not expressly prohibit the use of corporate rights (i.e. voting rights of shareholders) as collateral.⁷⁶ However, it is less than common for the current market practice.

3.5.5 Title retention

The pledged (movable) asset may also serve to secure performance of another obligation of the same debtor, which is not secured by this asset as part of the pledge agreement, but has arisen throughout the duration of the pledge agreement.⁷⁷

⁷⁴ *Supra* note 10, Guide to Enactment, Article 28, page 49.

⁷⁵ *Supra* note 6, WB Principles A4.2, page 15.

⁷⁶ Article 530 CC provides that the creditor may be rewarded by all existing and future wealth (meaning property in the modest sense possible) and an asset can be burdened by its owner for securing the payment of an obligation.

⁷⁷ Article 553 CC.

3.6 Rights

3.6.1 Receivables pledge

Receivables may be pledged:

- (a) under the Securing Charge Act if they qualify as an account. The securing charge created in accordance with the Securing Charge Act may extend to future receivables; or
- (b) under Articles 499 to 502 of the Civil Code on assignment of rights for guarantee purposes.

3.6.2 Pledge over bank account

A bank account may be pledged in accordance with Articles 499 to 502 of the Civil Code on assignment of rights for guarantee purposes.

Cash contained in the bank account may be pledged in accordance with provisions on the movable pledge under the Civil Code.

Also a notion of intangible property under the Securing Charges Act includes accounts composed of unsecured monetary obligations (both fulfilled and unfulfilled). The Securing Charges Act provides that accounts may constitute collateral, and thus a bank account may be pledged with a securing charge. In such a case, it is considered that the pledge covers the right to be repaid the money by the bank. Cash credited in a bank account, such as in a deposit, may also be subject to a financial collateral arrangement (as explained below).

3.6.3 Pledges over IP rights

The Industrial Property Act provides that a pledge may be constituted:⁷⁸

- (a) over a patent (Article 36/a);
- (b) over an industrial design (Article 129/a); and
- (c) over a trademark (Article 163/a).

Any pledge under the Industrial Property Act has to be registered with a relevant register held by the General Directorate of Industrial Property ("GDIP"), and published in the bulletin. Registration is not a pre-condition for the validity of the pledge agreement but it serves for publication purposes against third parties, unless knowledge of such third party can be proved irrespective of said registration. Where no specific provisions are contained in the Industrial Property Act, the CC general provisions apply.

Additionally, intangible property under the Securing Charges Act includes also intellectual property rights, which may thus be constituted as collateral of a securing charge, and be registered with the Securing Charge Registry. Moreover, if IP rights subject to the securing charge are registered with the respective register of GDIP, then the securing charge should be registered in the same register as well.

The ability to pledge an IP right as collateral has been made possible only recently, therefore

⁷⁸ The Act of the Republic of Albania "On industrial property" No. 9947, dated 7 July 2008 ("**Industrial Property Act**").

such practice has not yet been developed as reported by market participants in Albania.⁷⁹

3.7 Claims under financial collateral regulations

Financial collateral arrangements are regulated by the Payments System Act, which transposes within the Albanian legislative framework the requirements of the Directive 98/26/EC of the European Parliament and of the Council of 19 May 1998 "On settlement finality in payment and securities settlement systems", as amended, and the Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 "On financial collateral arrangements", as amended.

Identified issues:

According to observations made by market participants, the legal provisions of the Payments System Act are not harmonized with the Securities Act and the Companies Act.⁸⁰ Also, there is no active public capital market of shares in Albania. Furthermore, although the Act on Securities and the Payments System Act provide for a broad definition of financial instrument, there are no practical instructions on implementation of book entries of securities, or account of securities. The NBC is not capable of registering securities or book entries of securities in accounts; there is no accurate procedure on how a title is evidenced by entries in a register or account maintained by or on behalf of an intermediary or how to make book entries of securities.

Therefore, the role of the NBC remains legally uncertain. Thus, a financial collateral agreement over shares may not be perfected and is unenforceable in Albania.

Recommendations for reform:

As observed by market participants, further legislative provisions ought to be adopted in the Securities Act in order to clarify under the Albanian law the meaning of negotiable share, account of securities, book entry of securities, dematerialized titles, and provide practical measures for the dematerialization and negotiability in organized market of shares and securities.⁸¹ In any case, any such legislative reform must reflect the current state of affairs as there is no active public capital market of shares in Albania.

3.7.1 Covered arrangements

The Payments System Act provides for:

- (a) title transfer financial collateral arrangement which means an arrangement, including repurchase agreements, under which a collateral provider transfers full ownership of financial collateral to a collateral taker for the purpose of securing or otherwise covering the performance of relevant financial obligations;
- (b) security financial collateral arrangement, which means an *arrangement* under which a collateral provider provides financial collateral by way of security in favour of, or to, a collateral taker, and where the full ownership of financial collateral remains with a collateral provider when a security right is established;

⁷⁹ The Act of the Republic of Albania "On some amendments and additions to the Law No. 9947, dated 7 July 2008 "On Industrial Property", as amended, No. 17/2017, dated 16 February 2017, entered into force by March 2017.

⁸⁰ The Act of the Republic of Albania "On entrepreneurs and commercial companies" No. 9901, dated 14 April 2008 ("Companies Act").

⁸¹ UCC §§ 8-102(a)(4) (defining 'certificated security'), (18) (defining 'uncertificated security'), (15) (defining 'security'), (9) (defining 'financial asset' as including a security); UCC § 8-501(a) (defining 'securities account' to mean 'an account to which a financial asset may be credited'); See also *Randall D Guynn*, Modernizing Securities Ownership, Transfer and Pledging Laws (1996) page 33 (<https://www.davispolk.com/files/files/Publication/0da3a245-26b8-436b-b935-0c8ea6de773f/Preview/PublicationAttachment/b6f7e950-a5a4-4462-91bd-12a49ed316ab/modernizing%20securities%20ownership.pdf>).

Pursuant to the Payments System Act, financial collateral to be provided shall consist of *cash* or *financial instruments*, which have the following meaning:

- (a) cash refers to money credited to an account in any currency, or similar claims for the repayment of money, such as money market deposits;
- (b) 'financial instruments' refers to shares in companies and other securities equivalent to shares in companies and bonds and other forms of debt instruments if these are negotiable on the capital markets, and any other securities which are normally dealt in and which give the right to acquire any such shares, bonds or other securities by subscription, purchase or exchange or which give rise to a cash settlement (excluding instruments of payment), including units in collective investment undertakings, money market instruments and claims relating to or rights in or in respect of any of the foregoing.

Identified issues:

Legal uncertainty persists with regard to interpretation of financial collateral definitions due to lack of case law. There is no common accord among professionals on whether the definition of cash as financial collateral covers only money credited in an account for securities settlement, such as ordinary deposit accounts, etc.

Recommendations for reform:

In the opinion of market participants, any cash credited to any account may be subject to a financial arrangement under the Payments System Act; however, this issue has to be expressly addressed by legislative amendments in the Payments System Act, by inserting a provision in Article 5 of the Payments System Act. In addition, current collateral regulations do not cover an alternative of providing financial collateral in a form of credit claims or receivables.

Market participants suggest that this issue must be addressed by legislative amendments as well as market participants frequently need to charge receivables and/or credit claims by way of flexible security.⁸²

To solve this issue certain Member State countries, e.g. UK, implemented the EU Financial Collateral Directive broadly to cover this scenario through an expanded definition of cash. In this legislative "cash" means money in any currency, credited to an account or a similar claim for repayment of money and includes money market deposits and sums due or payable to, or received between the parties in connection with the operation of a financial collateral arrangement or a close-out netting provision.

3.7.2 Covered market participants

Any collateral arrangement may be entered into only where both a collateral taker and a collateral provider are legal persons, one of which must also belong to one of the following categories: the Republic of Albania, Central Bank of Albania, a foreign central bank, a bank, a financial institution, any other entity performing functions of a bank or a financial institution, a payment platform operator, a public operator be it national or international.

⁸² *Supra* note 6, WB Principles, A3 pages 11-12; See also *Supra* note 7, UNCITRAL Legislative Guide paras. 94-98, page 305; *Supra* note 9, UNCITRAL Model Law, Arts. 61-67, pages 119-125.

4. RANKING AND PRIORITY OF CLAIMS

4.1 Suretyship⁸³

A personal guarantee secures performance of an obligation of a principal debtor.⁸⁴ A personal guarantee is an accessory obligation, validity and existence of which depend on a principal obligation.⁸⁵ A guarantee might also be granted to ensure performance of a future or conditional obligation. A personal guarantee's obligations are covered by overall estate of a personal guarantor. As a rule, a personal guarantee expires after 6 months upon the expiration of the term of a principal obligation and in case the parties have not stipulated in writing the term of the enforcement of the principal obligation, the guarantee shall expire after 1 year from the signing date of the guarantee.⁸⁶

The Civil Code does not provide any specific term, taking into account that the guarantee is an accessory obligation to the principal obligation and any term of the latter shall apply automatically to the guarantee as well, unless the parties agree differently in written.

Therefore, the guarantee can be limited by the parties at their discretion or terminated by mutual agreement.

Personal guarantees cannot be enforced against assets of a guarantor that are pledged or mortgaged to third parties. For this reason and as observed also by market participants, personal guarantees serve only as additional security instruments for banks.

Identified issues:

According to market participants, case-law varies on whether: (i) a personal guarantor has joint responsibility with a principal debtor towards a creditor, and (ii) whether courts are authorised to establish the 6-months expiration term on their own initiative (*ex officio*).⁸⁷

The joint responsibility issue means that it is unclear whether the creditors can enforce the guarantee without first seeking to enforce against the debtor.

Recommendations for reform:

A unification judgment of the Supreme Court would clarify both issues and bring more certainty into current practice. As of today, the civil panel of the Supreme Court has already submitted this issue to the Joint College of the Supreme Court for the unification of case law.⁸⁸

4.1.1 Assets not capable of being pledged

Assets not capable of being pledged include assets which may not be seized for enforcement purposes (due to their requirements for basic existence, such as normal quantity of food and fuel needs up to three months, personal possessions and those required for work, assets used for artistic activities, social pensions, etc.).⁸⁹ In addition, public assets and historic and cultural

⁸³ Personal guarantees are governed by Articles 585-600 CC.

⁸⁴ Article 585 CC and subsequent.

⁸⁵ *Supra note 7*, UNCITRAL Legislative Guide paras. 128-131, pages 135-136.

⁸⁶ Article 600 CC.

⁸⁷ Market participants share two opinions on this matter: part of them hold that the 6 monthly term is a preclusive term, meaning that courts can assess the expiration of such term *ex officio*; others are of the opinion that courts cannot establish such fact *ex officio* and it should be up to the debtor to claim such fact before the court (prescription term or referred to also as limitation period under common law).

⁸⁸ The Plenary Session (Joint Colleges) of the Supreme Court has the right to unify the case law for specific legal matters in relation to which lower courts have ruled in different ways. The Supreme Court is composed of 17 judges and currently only 10 judges are in office while the other seats are vacant for various motives. The Plenary Session must be attended by at least 12 judges in order the Supreme Court may unify the case law.

⁸⁹ Listed in Article 529 of the Civil Procedure Code.

monuments cannot be pledged, as transfer of property or other personal or other inalienable rights is not permitted in respect of these objects.

4.1.2 Bank guarantee

Albanian law does not provide for any specific tools or provisions for financial or bank guarantees. However, this matter has been regulated on contractual basis by the parties, which usually enter into such financial guarantees, as *sui generis* contracts, in accordance with general provisions of the Civil Code.

Parties generally agree that payment of such financial guarantees should follow upon the first request of beneficiaries, after presentation of a duly executed written request and usually certain pre-determined documents. Usually, a provider of such financial guarantee irrevocably and unconditionally, irrespective of the validity and effects of the underlying contract, waives all rights of objection and defence arising therefrom. Mostly, banks or financial institutions serve as providers of such financial guarantees.

There is a present practice in the market for parties to accept the Uniform Rules for Demand Guarantees 758 (URDG 758) or other instruments of the International Chamber of Commerce, as binding provisions among them. Upon payment of the financial guarantee, provider is entitled to make recourse for repayment against the applicant.

The Civil Code provides that contracts are binding for the parties (Article 420) and have the force of the law for the parties (Article 690). Such legal basis, in connection with the current practice in the market, according to which bank guarantees refer to URDG, seem to provide satisfying support to market participants, who have not raised specific concerns in this regard.

4.2 Unsecured claims

Enforcement of secured claims has priority above enforcement of unsecured claims.

4.3 Secured claims

Secured claims compete between each other according to the general priority order provided by the Civil Code.⁹⁰ Secured claims over the same asset compete based on the timing of registration (the earlier registration has priority over the subsequent registration).

4.3.1 The highest ranking security interest

Higher ranking creditors have the right to enforce their claims before lower ranking creditors; i.e. claims originating from financial transactions secured by securing charges for the purchase price of a specific asset are ranked the highest.⁹¹ The ranking established by Article 605 CC is mandatory and its scope is to protect the rights of the most vulnerable creditors as the ranking suggests. Article 605 CC provides for the following general claims' ranking order:

- (a) claims originating from financial transactions secured by securing charges for the purchase price of a specific asset;
- (b) claims originating from salaries in employment or service relations and alimonies, however, for a period of no longer than 12 months;
- (c) social insurance claims on unpaid contributions along with the interests, as well

⁹⁰ Article 605 CC.

⁹¹ Paragraph a) of Article 605 CC.

as claims of employees for indemnification related to unpaid due contributions by the employer;

- (d) claims for indemnification for death or health impairment;
- (e) copyright claims of authors or their heirs on full or partial alienation of their rights for payment of obligations for the last two years;
- (f) claims by the state authorities on obligations to the state budget and the state insurance institute for the mandatory insurance, set out by law;
- (g) claims originating from financial transactions, secured by securing charge, under the criteria set out by law;
- (h) labour claims for payment of salaries or service fees, as well as alimonies beyond the limit set out in letter "b" of this Article;
- (i) claims deriving from the agent/mediation contract limited to the last year's remuneration;
- (j) claims secured by mortgage or pledge;
- (k) claims on payment of court expenses for preserving the asset and actions for the joint benefit of creditors;
- (l) bank loans claims, not falling under paragraph 'e' and voluntary social contributions claims; and
- (m) claims on amounts used for the supply of seeds, fertilizers, insecticides, water for irrigation and for the works for cultivating and harvesting agricultural products, on the annual agricultural products (yields).

Identified issues:

Both the market practice and case law differ in relation to enforcement of secured claims such as a mortgage competing with higher secured claims which is ranked higher by Article 605 CC, i.e. claims originating from employment contracts. Generally, enforcement agencies (such as bailiff or REROs) tend to give priority to the mortgage secured creditor who is first paid the proceeds from the auction sale of the asset, while the creditors entitled to employment claims are paid the remaining amounts from the auction proceeds.

In addition, the security interest stipulated by Article 605(a) CC is subject to debates among law professionals. Market participants are of the opinion that Article 605(a) refers in general to any transaction and not only to financial transactions claims secured through a securing charge (the latter being stipulated explicitly by letter (g) above).

We are of the opinion that this is a matter of poor or inappropriate wording during the drafting of the Civil Code and this security refers to the contract for the sale of an asset, which ownership is transferred to the buyer while the latter has not paid the full price to the seller. For this reason, the seller has the priority over all creditors of the buyer for the outstanding part of the purchase prices.

Recommendations for reform:

According to market participants this issue must be addressed by specific instructions/regulations to be adopted by the government for REROs to comply with the ranking provided by Article 605 CC, or by unifying the case law through decisions of the

Supreme Court.⁹²

The authors of this Report propose that the scope of the security interest provided under letter (a) of Article 605 CC be further clarified through an amendment of this provision which should specify that claims originating from financial transactions secured by securing charges for the purchase price of a specific asset refer to the contract for the sale of an asset, with which ownership is transferred to the buyer notwithstanding that the latter has not paid the full price to the seller.

4.3.2 The security interest with subsequent ranking

Subsequent ranked creditors' claims are subordinated to claims of the higher ranked creditor. This means that such subordinated claims may be enforced only after the full satisfaction of the higher ranked creditor's claims. It is possible to create a subsequent ranking interest over assets already mortgaged/pledged, provided that the holder of the higher ranking interest gave its consent. Prior written approval clauses in security agreements in favour of banks or other lenders are common for the market practice.

4.3.3 Possibility of contractual assignment of a priority ranking

Creditors can transfer their rights under a security agreement to a third party, provided that an underlying obligation is transferred as well. Such transfer would include also assignment of the priority ranking. Priority ranking is related to the security itself, which in its turn is an accessory to the rights secured (i.e. creditors' rights). In an event of transfer or rearrangement of the secured creditors' rights or claims, security interest shall follow such transfer or rearrangement.

In any case, in the opinion of the authors of this report, such assignment may not be enforced in case of insolvency of the debtor, provided that the asset subject of the assignment has a greater value than the respective secured obligation. As we have explained in section 8 below, the insolvency administrator has the right to keep the asset for the benefit of the insolvency creditors under the above-cited conditions, preventing therefore the secured creditor from exercising the right to separate the respective collateral from the rest of the insolvency assets and to enforce those assets outside of the insolvency procedure.

Identified issue:

The Civil Code is silent regarding the possibility of creditors to modify the priority ranking. Priority ranking is determined by law based on the origin (legal cause) of the claims.⁹³ We believe that the ranking has been set based on general social and economic interests, i.e. to protect the most vulnerable persons, which makes the priority ranking provided by law mandatory. On the other hand, some market participants are of the opinion that such assignment is possible provided that it does not affect the interests of third parties.

Recommendations for reform:

Indeed, it is not common for Albanian legal practice to change a claims enforcement priority order by an agreement and it may take long for courts to establish case law or for the Supreme Court to unify the practice.

Market participants observe that this issue could be addressed by amending Article 603 and inserting a provision specifically allowing parties to agree contractually on ranking i.e.

⁹² *Supra* note 7, UNCITRAL Legislative Guide, para.55 page 21; See also *Supra* note 6, WB Principles, C10, page 18;

⁹³ Article 603 CC.

through an intercreditor agreement, in order to limit the interference of insolvency regime with the existing contractual rights.⁹⁴

4.3.4 Priority between public and private encumbrances (court rulings, tax pledge effect on a security instrument)

The ranking order provided by law is valid in respect of public and private encumbrances. However, priority between state claims and securing charge claims depends on which claim has been registered earlier with the securing charge registry. Therefore, in principle state/public claims rank junior than secured claims as per Article 605 CC cited above.

4.3.5 General priority of satisfaction of claims in insolvency and winding-up

The general ranking order as provided in the Civil Code is not applicable in the case of insolvency.⁹⁵ This means that in case of commencement of insolvency procedures all pending enforcement procedures against the entity subject of the insolvency proceedings must be suspended.

The Insolvency Act establishes the following priority of claims within insolvency proceedings, which we have summarized in a general priority order as follows:⁹⁶

1. Insolvency proceedings' costs and fees – first priority order;
2. Insolvency creditors – second priority order.

Insolvency creditors are ranked as follows:

- (a) secured creditors up to the value of the secured asset – second priority order (for the priority issue we refer to the section 4.3.1);
- (b) preferential creditors – third priority order;
- (c) unsecured creditors – fourth priority order;
- (d) subordinated creditors – fifth priority order and
- (e) equity holders – sixth priority order.

Ranking within the category of preferential creditors:

- (a) claims arising from the termination of the employment up to three months before the filing for bankruptcy, including wages and annual health permits, and maternity leave payment, not exceeding ALL 500,000 in total;
- (b) claims for alimony and maintenance arising prior to the commencement of the bankruptcy when the debtor is an individual;
- (c) employees claims for personal injury incurred while working in the debtor enterprise;

⁹⁴ EBRD, Core Principles on Insolvency Regime, para.5 (2011) (<http://www.ebrd.com/documents/legal-reform/core-principles-for-an-insolvency-law-regime.pdf>).

⁹⁵ Last paragraph of Article 605 CC.

⁹⁶ Article 34 and subsequent of the Act of the Republic of Albania No. 110/2016, dated 27 October 2016 "On insolvency" ("Insolvency Act").

- (d) tort claims arising as a consequence of damage caused by the debtor before the commencement of bankruptcy proceedings;
- (e) claims for unpaid taxes arising in the one year leading up to the filing of the request;⁹⁷
- (f) claims ranking within the category of subordinated creditors;
- (g) penalties for late payment accruing on the claims of the bankruptcy creditors before the commencement of the bankruptcy proceedings;
- (h) fines under the Civil Code, administrative legislation and Criminal Code which are binding on the debtor;
- (i) claims for repayment of loans by persons related to the debtor, if the lender or credit provider was a family member of the debtor at the moment of the transaction;
- (j) claims which the creditor and the debtor have agreed to be subordinated.

Claims of the insolvency proceedings creditors being first ranked are considered by the market participants as superior claims. Such creditors would be typically the insolvency administrator and the lawyers and experts assisting the administrator in the preliminary stage of the insolvency proceedings before the competent court (as explained below in section 8).

4.3.6 Subordinated claims

Enforcement of subordinated claims is performed in accordance with the general ranking order established by law.⁹⁸ Secured claims have priority above the subordinated claims.

According to market participants, a ranking order of creditors' claims in the insolvency proceedings is mandatory and cannot be changed by an agreement.

Shareholders of a debtor are ranked in the last category of insolvency creditors. According to market participants, a court might rule to postpone payment to equity holders until those creditors turn all amounts or assets which the court considers they have taken from the debtor right before the insolvency claim is filed.

5. REGISTRATION AND PERFECTION WITH REGISTRY SYSTEM

5.1 Form

All contracts creating rights over immovable assets must be executed before a notary.⁹⁹ Contracts imposing rights over immovable assets (i.e. mortgage contract) not in notarial form are null and void (absolute invalidity).¹⁰⁰

Market participants have not demonstrated any specific concern on notary fees.

The form of the contract is provided explicitly in a law governing that contract.

⁹⁷ According to the Insolvency Act, state/public claims rank junior than some secured claims (Same as the ranking provided by Article 605 CC).

⁹⁸ Article 605 CC or Article 34 of the Insolvency Act.

⁹⁹ First paragraph of Article 83 CC.

¹⁰⁰ Second paragraph of Article 83 CC.

5.2 Form for specific types of contracts

5.2.1 Securing Charge

Securing charge contracts must be executed in written form.¹⁰¹ However, the execution of this type of contract before a notary is mostly encountered in practice.

5.2.2 Financial collateral

Financial collateral agreements may be executed in written or electronic form.¹⁰²

5.3 Notarial deed

5.3.1 Mortgage

Mortgage agreements must be executed as notarial deeds and subsequently registered with the IPR.¹⁰³

5.3.2 Pledge

Pledge agreements may be executed either in writing or as notarial deeds and this remains at the discretion of the parties.¹⁰⁴

5.4 Registration

Contracts creating security require registration with a relevant registry. Registration of security with a registry makes the existence of the security public and guarantees certainty for a future creditor. Additionally, registration act determines the ranking order for enforcement purposes.

5.4.1 Registration with a public authority

Each specific registry is administered by a respective public authority competent for a relevant industry, other than the Joint Stock Registry which is administered by a private company and the Securing Charge Registry which is administered by a private company on concession basis. All other registries are administered by the relevant state agency. However, both the Joint Stock Registry and the Securing Charge Registry are public registries open to public and are regulated by law.

(a) Land Registry

The territory of Albania is divided into several districts – each attributed with a local RERO, responsible for the registration of immovable assets within its jurisdiction.

(b) Pledge Registry

There is no unified or central pledge registry in Albania. For the importance of centralized and unified registries we refer to section 3.5 above.

Registration of a pledge is conducted at the respective agency which holds registration of an asset itself. The following registration agencies exist in Albania:

¹⁰¹ Article 5, letter "a" of the Securing Charge Act

¹⁰² Article 25, letter "a" of the Payments System Act.

¹⁰³ Article 83 CC.

¹⁰⁴ Article 83 CC.

- (i) IPR with the respective REROs;
- (ii) Commercial Registry with NBC;
- (iii) Joint Stock Registry with SHRC;
- (iv) Securing Charge Registry, where creditors register securing charges on:
 - vehicles;
 - civilian aircrafts;
 - civilian ships and other watercrafts
- (v) Patents, designs and trademarks are registered with GDIP.

5.4.2 Consequences of absence of registration with the public authority

The purpose of registering security with the relevant registry is to provide publicity and inform third parties of security. If there are several claims with the same priority status, the moment of registration of security should define the claim's enforcement order. Therefore, an absence of registration does not make the legal title invalid but in practice it makes impossible for a creditor to enforce claims against third parties which were not aware of the existence of a pledge.

5.5 Possession principle

The possession principle is applicable to a classical pledge of movable assets or goods, which are not registered with a special registry (see section 3.5 above). In order for a pledge to be created, physical possession of a pledged asset must be obtained by a creditor or by a third party (if agreed by the parties).¹⁰⁵

Articles 546 and subsequent of the Civil Code are not applicable to pledges/securing charges/financial collateral, which are governed by special laws, such as, respectively, the Securing Charges Act, the Industrial Property Act, the Payments Systems Act, etc. However, possession of financial collateral is a condition for the validity of the title.¹⁰⁶

5.6 Exemptions from perfection requirements for financial collateral

Financial collateral agreements shall be valid, perfected and enforceable against third parties, including a liquidator, and can be enforced, provided that:

- (a) an agreement is done in writing or electronically, or in any other legally equivalent manner;
- (b) possession of financial instruments subject to a financial collateral agreement, is transferred to a collateral taker; this condition is met if the financial instruments:
 - are physically delivered to the collateral taker or a person acting on its behalf;
 - are held, transferred or subject to any measure in such a manner that the collateral taker or a person acting on its behalf has the possession or the control of the financial instruments. This transfer of the possession of financial instruments may also be

¹⁰⁵ Article 546 CC.

¹⁰⁶ Article 25 of the Payments System Act.

achieved by means of them being credited to a special book entry account opened in the name of the collateral provider, the collateral taker or a third party, acting as depositor; and/or

- possession of cash, subject to financial collateral agreement, is transferred to the collateral taker; this condition is met if cash is transferred to a separate account, is held, transferred or subject to any measure in such a manner that the collateral taker or a person acting on its behalf has the possession or the control of the cash. Transfer of possession of cash may be achieved by means of a notification by the collateral taker to the debtor of the claim giving rise to the cash or by the express acknowledgement by such debtor of the existence of the financial collateral agreement.

6. ENFORCEMENT PROCEEDINGS

6.1 Obtaining of information on a debtor's asset

A creditor can request information from banks, REROs and all other public registries only after providing a proof of legal interest. In addition, access is available for all interested persons online at the Commercial Registry and other public registries such as the Joint Stock Registry and the Securing Charge Registry.

The Register of Loans administered by the Bank of Albania ("**BoA**") contains data on loans advanced to legal entities and individuals by Albanian banks, financial institutions and other non-banking financial institutions. Mostly, information is requested through the notaries and bailiff officers who have access to IPRs, Securing Charge Registry, etc. Information from banks for a specific debtor can be collected by a bailiff officer authorised by an enforcement order only.

6.2 Judicial enforcement

6.2.1 Court driven process (state courts, arbitration)

After a court judgment on merits of the case becomes final, such judgment obtains a power of an executive title enforceable against the debtor.¹⁰⁷ The same principle is applicable to local or international arbitration judgments enforceable in Albania.

The enforcement market in Albania is open and enforcement of claims can be performed either by state¹⁰⁸ or private bailiff agencies¹⁰⁹, based on the choice of the creditor. Bailiff officers have *quasi*-judicial authority and the orders that they issue during the enforcement procedures are obligatory to all receiving parties.

Public bailiff officers are considered as public officials and their recruitment is subject to the same rules for entering the public administration, while private bailiff is a regulated profession as such services may be carried out only by individuals holding a valid law degree who have passed the respective exam for private bailiff, as explained in more details in section 12.1.2 of this report.

Upon commencement of enforcement procedures, bailiff officers must register all creditors' claims with the central registry of the Ministry of Justice. If several claims are registered by

¹⁰⁷ Article 510 and subsequent CPC.

¹⁰⁸ According to the Act of the Republic of Albania "On the organization and functioning of the judicial bailiff service" No. 8730, dated 18 January 2001, as amended ("**Public Bailiff Act**").

¹⁰⁹ The Act of the Republic of Albania "On the private judicial bailiff service" No. 10 031, dated 11 December 2008, as amended ("**Private Bailiff Act**").

other creditors against the same debtor for payment of monetary obligations, a bailiff officer must suspend enforcement proceedings and re-address a creditor to a bailiff officer who registered an earlier request for enforcement. Therefore, a bailiff who started the first enforcement proceedings should proceed with the enforcement of all claims and distribute obtained money on a *pro rata basis* to the value of each creditor's claim.¹¹⁰

Creditors may enforce their claims against pledged assets (movable or immovable) by means of an auction, which is organized and administered by a bailiff officer authorised by a court enforcement order. If a creditor and a debtor do not agree on the price of an asset put up for auction, bailiff officers have the right to determine the price by themselves or by appointing independent licensed experts.¹¹¹ Such price is determined based on the methodology approved by the Albanian Council of Ministers.

Identified issues:

A methodology for assessing the price of auctioned assets has not been yet approved by the Council of Ministers as at the date of this Report. This issue must be addressed through a specific decision of the Council of Ministers as soon as possible.

In addition, a major issue raised by several market participants concerns assets which do not sell during auctions and which creditors (mainly banks) must acquire for price of the due obligation of the debtor. According to market participants auctions are not efficient due to the lack of publicity. Both private and state bailiffs reportedly often deliberately fail to notify the public of an auction as a favour for a debtor, or creditors which would like to purchase the auctioned asset.

Furthermore, market participants observe that the lack of the central registry of the Ministry of Justice for the registration of monetary claims affects the efficiency of claims enforcement. The purpose of such registry is to register all monetary claims of all creditors in order proceeds from auctions/enforcement proceedings are distributed to all creditors *pro rata* their claims and in respect of the ranking priority of each claim, by the bailiff who has first registered a claim against the same debtor with the registry. Therefore, there are cases when enforcement proceedings overlap and the bailiff who has started the proceedings in the first place, or the bailiff who succeeds him, distributes all the proceeds to one creditor, while the proceeds should have been distributed *pro rata* to all the registered creditors in compliance with the claims priority ranking.

Recommendations for reform:

A possible solution for the near term, which is also envisaged by market participants, would be to organize auctions in already determined premises, such as local bailiff's chambers (for private bailiffs) and public/state premises for auctions organized by a state bailiff. In addition, online periodical publications could properly inform the public about auctions. Additionally, the monitoring activities as well as distributing public information in relation to auctions has been proposed. In the mid to long term consideration should be given to establishing an e-auction system for sale of enforcement assets.

Cooperation between the State Bailiff and the Private Bailiff Chamber and the Ministry of Justice is required for effective performance of the central registry of the Ministry of Justice. The registration of claims which bailiffs have started the enforcement procedures with the registry before commencement of the enforcement proceedings would secure transparency in enforcement proceedings and help to avoid unlawful actions by Bailiff officers such as

¹¹⁰ Article 516/a CPC.

¹¹¹ Article 564 CPC, as amended recently by the Act of the Republic of Albania "On some changes and additions to the Civil Procedure Code", No. 114/2016, dated 3 November 2016.

enforcement of claims not in compliance with the claims priority ranking or distribution of the proceeds not to all the creditors pro rata their claims, but just to one or a few of them.

In accordance with UNCITRAL Guide on Secured Transactions, there are two approaches of extrajudicial enforcement of the rights of the secured creditor. In the first case, when a government has quite clear provisions in the Civil Code, authorities (such as bailiffs, sheriffs, notaries or the police) will take possession of the encumbered assets and sell them in a public auction. In the second case, even after a secured creditor has obtained a judgment, it may exercise its extrajudicial right to take possession of the encumbered assets and proceed to dispose of the assets extra judicially e.g. by private sale.¹¹²

Additionally, in accordance with the Uniform Commercial Code, in order not to fail to account for the auction price, to avoid delays the sale and further devaluation of the assets it is recommended to allow the creditor the option of private sale.¹¹³

There are different types of judicial auctions in the EU countries, whose national law provide for the relevant legal framework. In some EU countries a judicial auction can be held on line, thus avoiding participants appearing personally before the judge or in the court or in other public or private entities.

The authors of this report propose the following actions for addressing the issues raised herein above:

- Amendment of the Act of Albania "On Public auction"¹¹⁴ through introducing common rules for auctions performed by both state and private bailiffs. The establishment of a centralized auction centre or different regional centres would increase the transparency and make available information for any interested party to acquire assets put up for sale.
- E-auction could be a long term recommendations, taking into consideration that auctions lack efficiency and need to become first a reliable instrument to market participants and stakeholders in general.
- Adoption of the relevant regulation by the Ministry of Justice for the creation and functioning of the central registry provided already by Article 516/a of the Civil Procedure Code¹¹⁵ in order to fully implement a central registry for the registration of monetary claims.
- Adoption of the methodology for assessing price of auctioned assets, which has not been yet approved by the Council of Ministers, in order that the value of the auctioned assets is not disputed by the debtors during the enforcement proceedings.

¹¹² *Supra* note 7, UNCITRAL Legislative Guide, para. 49 pages 290-291.

¹¹³ *Supra* note 9, UNCITRAL Model Law, Art. 9; See "A Primer On UCC Article 9 Sales", pages 7-8 (2014) (https://www.hodgsonruss.com/media/publication/84_A%20Primer%20on%20UCC%20Article%209%20Sales.pdf):

"Article 9 does not expressly define what constitutes a "commercially reasonable" sale. Rather, Article 9 demands that a secured creditor's sale must be reasonable in every aspect, including time, manner, place and any other terms <...> Art. 9 provides a secured creditor with an incredible amount of freedom in determining how to dispose of collateral".

¹¹⁴ Act of the Republic of Albania "On public auction" No. 9874, dated 14 February 2008, as amended ("**Public Auction Act**").

¹¹⁵ The Albanian Council of Ministers has adopted the Decision No. 443, dated 16. June 2011 "On the creation, registration, manner of functioning, of administration and interaction and for the security of the judicial bailiff cases electronic system management (Albis)", for the implementation of the Public Bailiff Act and Private Bailiff Act. Nevertheless, this decision of the Council of Ministers does not refer to the scope of central registry provided by Article 516/a of the Civil Procedure Code.

6.2.2 Features of judicial enforcement inherent to Albania

The same court which has ruled on merits of the case issues a writ of execution after the judgment has become final. The order then becomes available for enforcement against a debtor by means of bailiff services. The writ of execution for arbitration rulings is issued by the Tirana Court of Appeals. Judicial enforcement is the predominant means of claims enforcement in Albania and common for all types of securities apart from financial collateral.

Identified issues:

Lack of correct addresses/registration of population constitutes a major problem for state agencies originating in the massive population emigration and immigration of Albanians following the fall of the communist regime in 1991. According to the observations made by market participants, inadequate information on the whereabouts of debtors and official addresses hinders all stages of enforcement, both the court related proceedings and enforcement proceedings conducted by bailiffs.

Recommendations for reform:

A process of updating and correction of addresses is underway in Albania.¹¹⁶ In order to make this process more efficient and accurate, it should include the registration of amendment and cancellation notices in order to record up-to-date details governing debtors' addresses.¹¹⁷

6.3 **Extrajudicial (out-of-court) enforcement**

6.3.1 Enforcement of unsecured claims (voluntary enforcement)

A creditor and a debtor may reach an agreement before or up to the preliminary hearing before a court and have this agreement ratified by the court hearing the dispute (Article 158/ç CPC). The purpose of the preliminary hearing is for a court to examine if there is any possibility for parties to reach a friendly/settlement agreement on a dispute. If parties have reached such an agreement, by its decision on merits of the case, court refers to the settlement agreement and the court judgment becomes a "ratifying court decision".

A writ of execution, issued based on a final court ruling "ratifying" parties' agreement, has the same binding force and is enforceable as a standard/ordinary writ of executions.

6.3.2 Enforcement of secured claims (depending on type of security)

(a) Enforcement by way of notary enforcement writ

A creditor may file a request with the competent court for the issuance of the writ of execution based on a notarial deed by which the debtor accepts the existence and payment of a debt/obligation to a creditor.¹¹⁸ This is a consolidated practice and quite efficient, providing the means to the creditor to obtain a writ of execution within few weeks. This explains also why many forms of security are executed before a notary, other than immovable which need to be executed before a notary.

(b) Enforcement by way of taking on legal title with registry

Based on a final court ruling, a creditor may register a writ of execution with the

¹¹⁶ Act of the Republic of Albania No. 134/2016, dated 22 December 2016 "On some additions and amendments to the Act No. 10129, dated 11 May 2009 "On the Civil Status", as amended.

¹¹⁷ *Supra* note 8, UNCITRAL Guide, Section V.

¹¹⁸ According to Article 510 CPC.

relevant registry and take the legal title over the asset. Such enforcement procedure is possible as the result of an out-of-court procedure.

(c) Enforcement by way of security assignment

According to the current bank practice, banks have often assigned or been assigned securities to enforce claims against debtors based on the same writ of execution, without requesting issuance of a new writ of execution despite of replacement of creditors (acquisition of NPLs by another bank or financial institution).

Identified issues:

Neither the Civil Code, nor the Civil Procedure Code contain provisions which would clarify whether after assigning security to another creditor a new creditor must obtain a new writ of execution or not. Case law differs in respect of this issue.

Recommendations for reform:

A new provision should be inserted in Article 510 of the Civil Procedure Code to address this issue and clarify that a the transferee creditor may rely on the existing writ of execution, bearing in mind that a writ of execution for payment of monetary obligations constitutes a legal title creating rights which are transferrable to third parties.

6.3.3 Enforcement of the surety

Sureties are enforced by the same way as securities according to the same rules as explained above. In case of a default by the debtor in paying its obligations, a creditor may address all legal actions against a guarantor who/which is obliged to fulfil all the debtor's obligations, so replacing the debtor in relation to the creditor.

6.4 Exemption for enforcement requirements for financial collateral

The Securing Charge Act provides that when collateral constitutes an account, instrument, or a security title, a chargee may notify an account debtor or a person obliged under an instrument or security to pay to the chargee amount owned on the account or under the instrument or security and may apply any money received for the satisfaction of the secured obligation after deducting the reasonable expenses of collection.

The Payments System Act provides that upon the occurrence of an event of default or any similar event as agreed between the parties under the terms of a financial collateral arrangement or by operation of law, the collateral taker is entitled to realize the appropriate financial collateral or a close-out netting provision comes into effect.

Parties may include a close-out netting provision in the financial collateral arrangement, by which in the event of enforcement, whether by means of an operation of netting or set-off or otherwise:

- (a) the obligations of parties are accelerated so as to become immediately due and expressed as an obligation to pay an amount representing their estimated current value, or are terminated and replaced by an obligation to pay such an amount; and/or
- (b) an account is taken of what is due from each party to the other in respect of such obligations, and a net sum equal to the balance of the account is payable by the party from whom the larger amount is due to the other party.

Despite commencement of the insolvency process, a pledgee has a right to immediately and without a prior notice or any court's permission to dispose of financial collateral where the financial collateral concerns:

- (a) a financial instrument, which is realized by sale and subsequently setting off their value against or applying its value in discharge of the guaranteed obligations;
- (b) cash, which is realized by setting off the amount against or applying it in discharge of the guaranteed obligations.

Appropriation is possible only if this has been agreed by the parties in the security financial collateral arrangement; and the parties have agreed in the security financial collateral arrangement on the valuation of the financial instruments.

The realization or valuation of financial collateral and the calculation of relevant financial obligations must be conducted in a commercially reasonable manner; however, the law does not provide for the intervention of any public institution or third party for the assessment of the commercially reasonable manner.

A financial collateral arrangement can take effect in accordance with its terms notwithstanding the commencement or continuation of insolvency or reorganization proceedings in respect of the collateral provider or collateral taker.

6.5 Enforcement of financial guarantee

Financial guarantees are *sui generis* instruments and are not regulated specifically by the Albanian legislation. Therefore, they are enforced the same way as unsecured claims.

6.6 Enforcement costs

Bailiff fees for services provided by private bailiff have increased recently, by a joint instruction of the Minister of Justice and Minister of Finances, namely Instruction No. 385/7, dated 28 June 2017.

Bailiff tariffs are calculated based on the amount of the claim, starting from the basic fee of ALL 15,000 (approx. EUR 115) up to 10% for claims up to ALL 2,000,000 (approx. EUR 14,800).

For claims amounting from ALL 2,000,000 (approx. EUR 14,800) up to ALL 90,000,000 (approx. EUR 666,000), the bailiff fee descends to 4% of the value of the claim.

For claims with value more than ALL 90,000,000 (approx. EUR 666,000) the tariff is 3% but not more than ALL 15,000,000 (approx. EUR 111,000).

VAT of 20% is applied to bailiff tariffs.

A creditor must prepay a basic fee of ALL 15,000 (approx. EUR 115) before a bailiff officer begins enforcement procedures. The bailiff first invites the debtor to pay the due amount voluntarily and in case the debtor does not proceed accordingly within a deadline of 5-10 days, the bailiff continues with the mandatory enforcement procedures. A remaining part of the fee must be paid by a creditor upon commencement of compulsory enforcement.

In the event of successful enforcement, bailiff tariff and all expenses paid during the proceedings (such as auction costs, etc.) shall be deducted from a debtor's collected amounts and reimbursed to the creditor. In case of unsuccessful procedures, the creditor shall not be reimbursed. To avoid prepayment of bailiff costs without knowing the outcome of the enforcement procedures, creditors and bailiffs agree on payment of the fee in instalments or full payment only at the end of the successful enforcement.

Private and state bailiff tariffs have been unified recently by joint instructions of the Minister of Justice and Minister of Finances and Economy.¹¹⁹

The new bailiff tariffs are as follows:

¹¹⁹ Instruction No. 30, dated 30 August 2018 for the private bailiff tariffs (amending the disputed Instruction No. 385/7, dated 28. June 2017) and Instruction No. 32, dated 30 August 2018 for the State bailiff tariffs.

- a) For tariffs up to ALL 500,000 (approx. EUR 4,000) a fix tariff of ALL 30,000 (approx. EUR 240) is applied;
- b) For tariffs higher than ALL 500,000 (approx. EUR 4,000), a fix tariff is applied as follows:

Amount of the claim in ALL from to ...	Fix tariff (in percentage on the amount of the claim)
500,001 – 2,000,000	5.5%
2,000,001 – 5,000,000	3.85%
5,000,001 – 10,000,000	2.75%
10,000,001 – 30,000,000	2.2%
30,000,001 – 90,000,000	1.65%
Over 90,000,000	1.1%
	Minimum tariff 1,485,000 ALL
	Maximum tariff 2,500,000 ALL

Nevertheless, the new tariffs have been suspended by the Tirana Administrative Court of Appeal through an interim injunction following claims lodged by the National Private Bailiff Chamber ("NPBC").¹²⁰ The claims of the NPBC are grounded mainly on procedural shortcoming claimed by the plaintiff and other general claims on the consequences of the implementation of the new tariffs without going first through a transition period.

Identified issues:

As explained above banks have opposed the 2017 increase of the private bailiff tariffs in light of their exposure to enforcement costs during the enforcement process and due to the greater share of private bailiffs in the bailiff enforcement market.

This is an issue of a real concern for Albanian banks, which are the most affected from such tariff changes and the government is currently discussing with the market participants, notably banks and bailiffs, a sensible reduction of the tariffs.

Recommendations for reform:

According to the information provided by the Albanian Banks Association ("ABA") the current proposal of the government consists of reducing the bailiff tariffs by 50%, while tariffs are still determined based on the value of the claim: tariffs are expressed in percentage for a specific threshold. The same principle would apply, according to which the higher the value of the claim is, the lower the percentage of the tariff becomes.

Nevertheless, for the banks (as confirmed by ABA) and creditors in general the best option would be the introduction of fixed bailiff tariffs, which may be different for different thresholds. This would also comply with the international best practice.¹²¹

In the opinion of the authors of this report, the bailiff should be paid fixed tariffs which can be different for different thresholds, up to a reasonable cap. Indeed, regardless of the amount of the claim, bailiff procedures are standard and bailiffs may be compensated for extraordinary efforts in more complex cases through success fees. This solution could also incite bailiffs to be more efficient and cost oriented. According to European Commission research on lawyer and bailiff fees in Europe, in most (70%) of the European states, bailiffs are paid per act. It is common that bailiffs' fees are

¹²⁰ Decision Act No. 363, dated 26 September 2018 of the Tirana Administrative Court of Appeal, which is still effective until the final court ruling. The case is still pending before the court as at the date of the Report.

¹²¹ According to information by the Secretary General of ABA, bailiff tariffs in EU countries may go up to EUR 2,500, regardless of the amount of the claim or complexity of the case.

charged on the basis of a prescribed schedule and are determined according to the nature of the acts or procedure undertaken.¹²²

The new bailiff tariffs which are still suspended until the final court ruling, have been reduced sensibly and despite the court outcome, the Albanian government seems committed to keep the bailiff tariffs lower, responding positively to market participants' concerns.

7. PROCEDURAL APPEAL

7.1 Appeal in judicial enforcement of secured claims

Several amendments to the CPC during the last decade have balanced the interests of creditors and debtors with a view to prevent debtors from using abusive procedural means to delay enforcement procedures by lodging spurious claims or appeals before court.

Pursuant to Article 609 and subsequent of the CPC, a debtor may challenge before a competent court enforcement proceeding on the following grounds:

- (a) An executive title (the final court ruling on the merits of the case) is null and void;
- (b) A debtor has fulfilled all due obligations;
- (c) An outstanding debt is lower than the amount determined in the writ of execution; or
- (d) A bailiff officer has issued orders in the framework of the enforcement procedures in breach of the provisions of the CPC (i.e. the writ of execution provides for a due amount lower than the one the bailiff has ordered the debtor to pay).

Appeals filed with the first instance court and/or appeals to the Court of Appeal do not suspend the enforcement process, except for court suspension orders (interim injunction order) issued as explained below.

7.1.1 Matters under (a), (b) and (c) above

A debtor may request the court to suspend enforcement process for reasons listed under (a) and (b) above only. A debtor may be requested, at the discretion of the court, to submit proportionate monetary guarantees. Generally, courts do request debtors to submit such guarantees. In addition, in relation to bank loans suspension of the enforcement may be ordered by the court only if a debtor presents a monetary guarantee and that suspension is effective for 3 months only.¹²³

Any party may challenge the court ruling before the competent Court of Appeal. In principle court rulings of the first instance court on suspension must be heard by the Court of Appeal within 30 days, while appeals on the merits of the case must be heard within 60 days. Despite the abovementioned deadlines, in practice the time it takes to the second instance courts to hear these cases oscillates between 3-9 months or even longer.

7.1.2 Matters under (d) above

In relation to actions of bailiff officers challenged before the court, the same rules are applied as well, with the difference that Article 610 of the CPC provides shorter deadlines. The court suspension order is effective for 20 days only and the Court of Appeal is supposed to hear the

¹²² https://e-justice.europa.eu/content_costs_of_proceedings-37-en.do

¹²³ Third paragraph of Article 609 of the CPC.

case within 30 days.

Identified issues:

Despite continuous legislative improvements, market participants have raised the issue of lack of unified case law in relation to precise standards based on which courts hear suspension requests and pointed out that in the absence of unified court practice every court decides cases on a case by case basis.

In addition, according to market participants, debtors abuse their rights to challenge all actions of a bailiff officer during enforcement process.

Recommendations for reform:

Better monitoring of courts and unified case law by the Supreme Court have been mentioned as possible solutions by market participants, with regard especially to the circumstances when the suspension is granted and monetary guarantees need to be provided by the requesting party. Given the great number of appeals debtors may file against actions of a bailiff officer within the enforcement process, we recommend to further amend the CPC by introducing a figure of a judge competent for all claims brought within enforcement proceedings, a recommendation which is supported by market participants. Having one judge responsible for entire enforcement proceedings within one case would make administration of the judicial proceedings more effective.

Another recommendation for reform, supported by market participants, is to amend the CPC in relation to the cases returned by the appeal court for new proceedings to the first instance court. The ability of the appeal courts to return cases to the first instance should be limited and courts of appeal may hear such appeals as first instance courts without the need to send back cases to be reheard by the first instance courts.

Situations where the cases are returned to the first instance court to commence new proceedings are not just happening in Albania, but in other European civil law jurisdictions. An example is Croatia where the appeal court is returning cases to the first instance court for new proceedings on the grounds of non-compliance with procedural rules.

In these situations is advisable to have concrete legislation and prescribed requirements which have to be fulfilled for returning the case for the new proceedings.

The authors of this Report propose that the length of court proceedings may be further shortened by courts of appeal through the adoption by each court of specific rules for the timeframe of hearing enforcement cases and giving further priority to claims enforcement disputes.

7.2 Appeal in out-of-court enforcement of secured claims

The same legal framework and practice as per section 7.1 above is applicable.

7.3 Appeal in insolvency and winding-up proceedings

The CPC provisions are applicable to insolvency proceedings and winding-up proceedings provided that its provisions do not conflict with specific provisions of the Insolvency Act.¹²⁴

As a general rule, filing lawsuits and/or appeals against court decisions in the ambit of insolvency and winding-up proceedings does not suspend the enforcement procedures.¹²⁵ The parties entitled to file

¹²⁴ Article 4, paragraph 2 of the Insolvency Act.

¹²⁵ Article 10, paragraph 1 of the Insolvency Act. Indeed, the only cases when the Insolvency Act provides for the possibility of suspension of a court ruling regards the reorganization procedure (Article 114, paragraph 2 and Article 124, paragraph 3), when the Court of Appeal may suspend the first instance court decision on approval or rejection of the standard procedure

appeals in insolvency proceedings are the creditors, the debtor and the insolvency administrator. In addition, any person that claims being a creditor has the right to appeal court decisions in case the request to be included in the creditors list has been rejected.

The range of decisions courts may take under the Insolvency Act is not exhaustive; thus courts are given the capacity to rule based on the requests of the insolvency procedures parties. In principle, the same rules regulating appeal proceedings are also applicable to the insolvency procedures, except for interim measures (see below Section 8.2).

According to market participants most cases of appeal concern requests of third parties to be accepted into the proceedings with a status of an insolvency creditors or claims in relation to the value of insolvency assets. Creditors must file their request with an insolvency administrator within 30 days from publication of a notice on the commencement of insolvency process.

Identified issues:

Market participants reported that courts have previously ruled that a person denied being included in a list of creditors by an insolvency administrator or by the court, can challenge such denial by filing a separate claim to the relevant court. Thus it is for a court to determine whether the claimant does have a claim against a debtor. Only after the ruling on this matter by the relevant court in favour of the claimant can a request to an insolvency court to be included into the insolvency creditors' list be submitted.

This position of courts is controversial since it is the insolvency court which is supposed to hear all claims in relation to the debtor within a reasonable time to ensure the creditors or may enforce their rights before the insolvency procedure is completed and the debtor's assets are distributed between creditors.

Recommendations for reform:

The Insolvency Act is silent on this issue (as well as the Former Insolvency Act) and for market participants this issue needs to be addressed either by means of legislative amendments to the Insolvency Act or by means of unification of the case law by the Supreme Court.¹²⁶ We would recommend for example that the same insolvency court hears all challenges from creditors with respect to the list of creditors prepared by the insolvency administrator.

8. IMPACT OF INSOLVENCY AND WINDING-UP PROCEEDINGS ON ENFORCEMENT

The Insolvency Act entered into force in May 2017 and current practice and case law is still remaining based on the previously binding legislation. According to the legal certainty constitutional principle, the Insolvency Act has no retroactive effect and it will not apply to insolvency proceedings that were commenced prior to its entry into force; therefore, the current case law and problems arising in this respect are related to the previous legal framework.¹²⁷

For this reason, there is no established practice in the market in relation to the application of the legal provisions of the Insolvency Act.

Issues raised by market participants that we shall consider in the following paragraphs are related to the enforcement practice based on the Former Insolvency Act. In addition, these issues shall be assessed in the light of the recent amendments introduced by the recently adopted Insolvency Act.

reorganization (Article 114) or expedite reorganization (Article 124).

¹²⁶ *Supra* note 7, UNCITRAL Legislative Guide, para. 138 page 449.

¹²⁷ The Act of the Republic of Albania "On Insolvency" No. 8901 dated 23 May 2003 ("Former Insolvency Act").

8.1 Limited exemptions to security enforcement from insolvency

In principle, pursuant to Articles 34 and 35 of the Former Insolvency Act assets on which creditors have a secured interest are not subject of the insolvency procedures. This means that secured creditors under any cases initiated prior to the 2017 Insolvency Act ("**Old Insolvency Cases**") were not part of the insolvency proceedings and security enforcement was allowed to take place out of the insolvency procedures.

As an exemption to this rule, the insolvency administrator appointed under an Old Insolvency Case was allowed to dispose/administer secured assets under possession of the debtor in the ambit of insolvency proceedings provided that the net value of such asset is higher than the aggregate amount of the secured claim and the expenses for the enforcement of the respective claims (Article 133 of the Former Insolvency Act).

Coming to the new legislative framework, it needs to be emphasized that the Insolvency Act provides some changes to the general principle, as there is no reference to the exemption principle for secured assets anymore, but the rule according to which secured assets can be the subject of the insolvency proceedings under the conditions of Article 133 of the Former Insolvency Act still remains.

More specifically, Article 141 of the Insolvency Act provides that the insolvency administrator at his/her own discretion may decide whether or not to exempt the secured asset from the insolvency procedure if its value does not cover the secured claim value and the expenses for its enforcement.

If the administrator keeps the secured assets for the insolvency procedure, the secured creditor is also prevented from enforcing its security.

The wording of this provision and the abrogation by the Insolvency Act of the exemption principle for secured assets, suggests that the powers of the insolvency administrator have been extended and it will be the latter who shall freely decide based on the best interest of the insolvency creditor.¹²⁸ This means that the insolvency administrator has the right to keep the asset for the benefit of the insolvency creditors in case that the value of an asset is higher than the secured claim, preventing therefore the secured creditor from exercising the right to separate the respective collateral from the rest of the insolvency assets.

Identified issues:

According to the current case law, courts have established different practices with regard to the exemption of secured assets from the insolvency proceedings. Indeed, there have been cases when courts have treated secured assets as part of the insolvency mass of properties/assets, resulting in the secured creditors becoming insolvency creditors as well. In other cases, courts have ruled in compliance with the provisions of Articles 34 and 35 of the Former Insolvency Act and have exempted secured assets from the insolvency procedure.

The Insolvency Act provides first for the possibility of the debtor to be reorganized. Reorganization is an alternative to the start of the insolvency procedure. Reorganization or the commencement of the insolvency procedure will result in a stay on any enforcement including any on-going enforcement proceedings by secured creditors. This stay also applies to any other insolvency procedures. The insolvency administrator large powers to administer and decide on the secured assets including the power to decide, at his own discretion, to keep the asset for the benefit of the insolvency creditors even though the value of an asset is lower than the secured claim. While a secured creditor is entitled to request the separation of its collateral from the rest of the insolvency assets, resulting in the right of the creditor to sell or dispose of its collateral at his discretion, the administrator may prevent the secured creditor from exercising such right e.g. where he reasonably believes that the value of the

¹²⁸ For example, regardless of the value of the asset which may not cover the value of the secured claim, the insolvency administrator may still decide to keep the asset for the insolvency creditors in case the administrator reasonably believes that the value of the asset may increase in the future and the auction selling price could be higher.

asset may increase in the future and the auction selling price could be higher.

Recommendations for reform:

We recommend, supported by market participants, that transparent methodology procedures are established for assessment of a secured asset value, which linked to the proposals for more efficient auction procedures shall increase in general the claims enforcement success rate. The rationale for the right of the insolvency practitioner to prevent enforcement by the secured creditor is that secured assets which have a marketable value may serve for covering the claims of other creditors in addition to the secured creditor. Hence, this explains the reason why the Insolvency Act gives discretionary powers to the insolvency administrator.

In addition, trainings and specialization of judges and insolvency administrators would increase the efficiency and proper understanding of the newly adopted Insolvency Act.¹²⁹ Also, it would have a positive impact on the efficiency of insolvency procedures, to have in place commercial courts divisions dealing with insolvency and enforcement within the first instance court system or commercial courts ensuring that these matters are handled by specialised judges

8.2 Moratorium

The competent court for the insolvency proceedings may, according to Article 22 of the Insolvency Act, issue interim injunction orders effective for a period no longer than 60 days to safeguard the interests of the secured creditors.

Secured assets may not be object of interim injunction orders if the court assessed previously that such asset is excluded from the insolvency proceedings as provided under Article 141 above.

The purpose of interim injunction orders is to safeguard the assets owned by or in possession of the debtor serving for the repayment of the insolvency creditors, from the moment of filing for insolvency until the court decides to put the debtor under insolvency proceedings.

Upon the commencement of insolvency and reorganization proceedings, all legal actions which aim to execute or enforce an obligation against a debtor must be suspended, including suspension of enforcement of claims of secured creditors for a period of 6 months or till approval of a reorganization plan, whichever event takes place first.¹³⁰

Identified issues:

The Insolvency Act aims, as did the former legislation, to provide for well determined deadlines, but according to market participants the courts proceedings are still excessively lengthy with the effect that the provisions providing strict deadlines remain ineffective. There are cases when it takes more than 60 days for the court to take a decision on the commencement of the insolvency procedure.

Recommendations for reform:

Streamlining court system to have specific commercial division dealing with enforcement and insolvency cases and, in longer term, considering whether a separate commercial court system may be needed.

¹²⁹ The World Bank, which recognizes the importance of strong institutions to sustainable development, supports client countries in their efforts to strengthen institutional capacity through a wide range of lending, assessment, technical assistance and knowledge products; and the International Monetary Fund, which provides expert training, workshops and seminars for the authorities of member countries to help strengthen their legal infrastructure and institutional performance of the judiciary, where such issues are macro-economically relevant.

¹³⁰ Article 69 of the Insolvency Act.

8.3 Pre-insolvency proceedings

The Former Insolvency Act was silent on the possibility of any type of pre-insolvent procedure or settlement, as a means of out-of-court restructuring. The Former Insolvency Act provided the possibility for a debtor to request only reorganization during the insolvency procedure. The Insolvency Act currently in force provides for the possibility of the debtor to file directly for reorganization as a specific and separate procedure, without going through general insolvency proceedings. The Insolvency Act refers to this procedure as an expedited reorganization procedure. Within the expedited procedure, a debtor and its creditors may reach an agreement out of court and submit it to the insolvency court for approval (Article 122 and subsequent of the Insolvency Act). The debtor files a request for reorganization with the court and all claims or enforcement proceedings against the debtor must be suspended until the court rules on the request.

The aim of this procedure is to overcome a situation of imminent insolvency.

According to market participants, there is still no practice formed within the market in relation to out-of-court restructuring which may create obstacles to using the new expedited reorganization procedure. The Insolvency Act has not been yet tested in practice and in general restructuring is not common in respect of insolvency cases.

8.4 Insolvency proceedings

Insolvency proceedings in Albania are lengthy, lack efficiency and as a result a number of requests filed to the court remain quite low. Based on *Doing Business* for the year 2018 issue,¹³¹ the average duration of insolvency proceedings is 2 (two) years, while related costs are estimated around 10% of a debtor's estate, with the recovery rate of 44% on a US Dollar. These statistics reflect upon the market practice formed when the Former Insolvency Act was still in force, and are in line with the data from the previous report, with a slight improvement regarding the recovery rate.¹³²

According to statistics provided by the National Insolvency Agency for the year 2016, there were 22 pending insolvency procedures in 2015 and 53 new insolvency requests were filed with only 1 request for reorganization filed in 2016. Data for the years 2017 and 2018 are still being processed.

Insolvency proceedings may be started by a debtor or any of the creditors. It is to be noted that administrators/directors/executives of insolvent entities are obliged to file for bankruptcy within 60 days following the date the entity became insolvent (Article 15 of the Insolvency Act). Creditors must prove to the court that (i) the debtor failed to fulfil a due obligation against the creditor and (ii) the debtor is insolvent, while insolvency of the debtor is presumed if the debtor failed to pay any obligation based on an enforcement order.¹³³

Following the appointment of an interim insolvency administrator the court starts the assessment of the insolvency of a debtor based on the evidence submitted by the claimant. Therefore, the court declares the opening of the insolvency procedures if assets of the debtor cover costs of the insolvency proceedings. Otherwise, the court dismisses the request and decides to terminate insolvency proceedings.¹³⁴ Creditors have 60 days to register their claims upon a publication by the court of an invitation to file the claims.¹³⁵

Secured creditors or other creditors of the debtor recognized by the final court (arbitration) judgments or official certificates/attestations issued by the public authorities are registered by the insolvency administrator *ex officio*. Other creditors must submit their request to the administrator and the

¹³¹ http://www.doingbusiness.org/en/data/exploreeconomies/albania#DB_ri.

¹³² Doing business for the year 2016: <http://www.doingbusiness.org/data/exploreeconomies/albania#resolving-insolvency>. Recovery rate for the year 2016 when the first report was drafted was 42,3%.

¹³³ Article 16 of the Insolvency Act.

¹³⁴ In this case the debtor is then deregistered from the commercial registry, according to the provisions of the Companies Act and the Business Registration Act.

¹³⁵ Article 20 of the Insolvency Act.

evidence on the origin and existence of its claims (Article 86 of the Insolvency Act). The Insolvency Act does not provide any specific deadline for such creditors to present their claims,¹³⁶ but it appears from the wording of Article 86 of the Insolvency Act that such deadline is determined by the court in the decision on the commencement of the insolvency proceedings.

The insolvency administrator submits the definite list of the creditors to the court. All persons which were not accepted by the administrator as creditors have a right to challenge this decision in front of the court.

Identified issues:

According to market participants, it is not clear whether creditors which submitted their claims in the first phase of the insolvency proceedings, need to formally submit again their claims within the deadline determined by the court in the decision on the commencement of the insolvency proceedings, as mentioned above.

In addition, the Insolvency Act does not define clearly the priority status of the claims of creditors which did not present their claims to the insolvency administrator within the respective deadline (referred to as "late claims").¹³⁷ These creditors would not benefit from the distribution of proceeds that have taken place under the insolvency proceedings before they have submitted their claims. For market participants it remains unclear whether these 'late claim' creditors shall be ranked at the bottom of the insolvency priority or whether their claims shall compete with those of the creditors of other ranks.

Both issues need to be further addressed by future amendments to the Insolvency Act. It is, furthermore, questionable which date is the applicable date by which all claims should be registered. The date is questionable because the Insolvency Act does not provide any specific deadline for such creditors to present their claims. However as explained above, it appears from the wording of Article 86 of the Insolvency Act that such deadline is determined by the court in the decision on the commencement of the insolvency proceedings. This is an issue which needs to be specifically addressed as the opening of the insolvency proceedings empowers the insolvency administrator to suspend the enforcement of collaterals by secured or unsecured creditors (as explained above). This may result in the loss of the rights of the "late claims" creditors to receive the respective proceeds from the liquidation of the insolvency assets.

Another issue observed by market participants is how to determine the competent judge to hear the claims of the persons left out from the insolvency creditors' list. Both the Former and the current Insolvency Act are silent in this respect.

Recommendations for reform:

It is not clear why there is an uncertainty over which court is competent to hear the claims of persons left out from the list is given that the insolvency court is supposed to hear all claims in relation to the debtor within a reasonable time. The insolvency judge must also hear the claims of persons left out from the insolvency creditors' lists. These claims are related to the insolvency procedure and must be addressed before the closing of the proceedings.¹³⁸

We recommend, following discussions with market participants, that this issue is clarified by legislative amendments to the Insolvency Act or by means of unification of the case law by the Supreme Court.

¹³⁶ The Former Insolvency Act provided for a 30 days term.

¹³⁷ Article 92 of the Insolvency Act.

¹³⁸ *Supra* note 6, WB Principles C1 (vi), page 20.

8.4.1 Asset administration

In principle, the insolvency administrator has wide competencies, subject to the control of the creditors and the courts. The administrator is also entitled to conduct preliminary verification of the possibility of liquidation of the debtor's assets, with the aim to protect its commercial activity. The insolvency administrator is responsible for asset administration and liquidation. The insolvency administrator, under the authority and supervision of the court is entitled to take any action for the liquidation of the insolvency assets and distribute to the creditors all collected amounts, without being obliged to engage the services of either the state or a private bailiff.

Later on, if court decides to continue the insolvency procedures, it appoints the insolvency administrator (often the same person appointed as the interim administrator during the first phase).

Since 2012 insolvency administrators have been licensed by the NIA. His or her role is to monitor and assist the insolvency administrators in performing their duties in compliance with the code of ethics and professional standards.

Article 141 of the Insolvency Act, granting to the insolvency administrator discretionary powers, will be developed by future case law in respect of the standards the court will set in relation to the powers of the administrators.

8.4.2 Rehabilitation procedure

The rehabilitation process pursuant to Article 96 and subsequent of the Insolvency Act includes an expedited reorganization, by means of an out-of-court agreement between a creditor and a debtor (as defined in Article 122). The aim of this process is to overcome a situation of imminent insolvency.

The rehabilitation must be approved by the court. In the event that the court rejects the rehabilitation plan, it must declare the commencement of an ordinary insolvency plan.

8.4.3 Solvency renewal administration (restructuring/investor step-in)

The solvency renewal process referred to under the Insolvency Act as a restructuring plan is one of the stages of the insolvency proceedings pursuant to Article 93 and subsequent of the Insolvency Act. Restructuring is possible if the court approves an organization plan proposed by the creditors.

The expedited reorganization/rehabilitation has the same scope, with the difference being that the expedited process consists of an-out-court agreement ratified by the court before the commencement of insolvency proceedings.

8.5 **Winding-up proceedings**

Winding-up (used for the voluntary termination as per the note to the local experts on the terminology) is governed by the Companies Act as this process consists of the voluntary liquidation of a solvent entity.

The Companies Act addresses the consequences arising from winding-up, which include deregistration of a liquidated entity, given that the entity may not continue its activity, as it is liquidated and the proceeds of the assets are distributed.¹³⁹

¹³⁹ Article 202 of the Companies Act.

8.6 Financial collateral: close-out netting and treatment in insolvency procedure

In principle, financial collateral can be enforced notwithstanding the commencement or continuation of insolvency or reorganization proceedings in respect of the collateral provider or collateral taker (Article 26, letter "a" and Article 28, paragraph 1 of the Payments System Act).

However, according to Article 74 of the Insolvency Act, if the financial collateral cannot be enforced because of commencement of an insolvency process, the secured party or financial collateral taker can claim payment of damages arising from non-execution of the collateral.

9. FINANCIAL (CONSENSUAL) RESTRUCTURING AND OTHER WORK-OUTS

9.1 Standstill

There is no specific legislative act regulating workouts or wholly out-of-court restructuring situations in Albania. The new Insolvency Act, however, provides for an expedited restructuring procedure whereby an agreement between the debtor and its majority creditors concluded out-of-court can be approved by the court and become binding on all affected creditors.

9.2 Other arrangements

Debtors and creditors may agree on any kind of arrangement for the suspension and restructuring of the debtor's obligations on a contractual basis.

In addition, taxpayers may request from the tax authorities to pay taxes in instalments by written agreement if they prove the risk of imminent insolvency. Nevertheless, according to the market participants this is not a common practice in Albania.

10. TRANSFER OF LOANS (NPL SALE)

10.1 General regulatory requirements and obstacles for security transfer

The receivables resulting from bank loans are transferable. Legal instruments available for the transfer are:

- (a) Assignment of loan receivables; or
- (b) Contract assignment.

No consent is required for the assignment of receivables; however, the debtor ought to be notified in order for the assignment to be enforceable against it. The consent of the debtor is necessary in the case of a contract assignment.

Transferability can be limited by agreement. There are no specific requirements related to the transfer of NPLs.

The type of loans to be transferred has no additional restrictions concerning the nature of the buyer. However, should the acquisition of the loan fall under the definition of financial activity the buyer must be a bank or a financial institution. Acquiring loans on a regular basis may be considered as financing activity, thus falling under the provisions of the Banks Act.¹⁴⁰ In such case, the entity is a subject to licensing requirements as a bank or other financial institution.

¹⁴⁰ Albanian Law no. 9662, dated 18 February 2006 "On Banks in the Republic of Albania", as amended ("**Banks Act**").

10.2 Additional requirements

In addition, foreign entities may purchase NPLs as well, as the relevant banking regulation adopted by BoA provides no restrictions in this respect.¹⁴¹ Indeed, as confirmed by BoA, there have been at least two cases when foreign entities have purchased NPLs from Albanian banks in the past.

10.3 Issues relating to collateral transfer

10.3.1 Form of transfer (notices, consents)

Securities granted are automatically transferred, except for cases where certain actions are required (e.g. loans secured by mortgage; in such case the transfer of the loan shall be deemed complete as from the date of registration with the real estate registration office).

10.3.2 Compliance with banking secrecy, data protection, requirement for license and permits

If information related to the transferred loans constitutes banking secrecy, which includes the financial information and the personal data of the borrower, the applicable restrictions provided under the banking legislation and/or personal data protection legislation will apply.

In particular, information contained in the Loans Registry (i.e. personal data and the information related to the credit balance and the credit exposure of the borrowers, information about the related persons and loan guarantors) is subject to data secrecy restrictions. To this effect, the data reporters (i.e. relevant lenders) are entitled to process/transfer such data upon authorization of the borrower. Such authorization is granted, in a standard form, on the date of application for loan and will be attached to the relevant loan agreement.

However, legislation on banking secrecy and data protection provide for the exception of justifying a legitimate interest: both these laws entitle the lender to process (including, but not limited to, to transmit) the borrower's information if required by its legitimate interests.

10.3.3 Taking over by NPL purchaser of any existing enforcement process

There is no specific provision on the taking over by the NPL of any existing enforcement procedure and no consensus in legal practice. Certain stakeholders consider that any existing enforcement procedure ought to be viewed as an accessory to the loan, and therefore automatically transferred with the latter; while others consider that a new enforcement procedure should be commenced.

Identified issues:

The lack of consensus on the whether the enforcement procedure ought to be considered as accessory or not to the loan is an issue which is of major importance for the transfer of NPL loans since it impacts on the willingness of a third party purchaser to buy the NPL.

Recommendations for reform:

According to market participants, it would be necessary to address and unify practices by providing legislative amendments that clearly establish that any existing enforcement

¹⁴¹ Decision No. 62, dated 14 September 2011 of the Supervisory Board of BoA on the approval of the Regulation "On the loan risk administration by foreign banks and branches of foreign banks".

procedure or enforcement order does automatically transfer with the loan, as an accessory to the latter.¹⁴² Debtors may accept creditors' claims through notarised deeds, which are enforceable based on a court enforcement order. The authors of this Report propose that in case of transfer of the loan, any notarial deed or court enforcement order is automatically transferred to the transferee. This would increase the efficiency of extrajudicial enforcement as the new creditor would not need to request the court to issue of a new enforcement order. Articles 510 and 511 CPC or Article 499 CC¹⁴³ and subsequent may be amended to reflect the proposed regulation.

11. DEVELOPMENTS IN LEGISLATION AND PRACTICE ON ENFORCEMENT

11.1 Legislative acts

As of the date of this report, no developments are expected in the near future in relation to the claims enforcement legal framework. Nevertheless, the judicial system is undergoing major reforms and the Parliament and government mandated in September 2017 may propose further amendments to the current legal framework.¹⁴⁴

11.2 Court practice

The Joint College of the Supreme Court has been invited to unify the case law in relation to certain aspects of regulation of personal guarantee (suretyship). Although this kind of guarantee is of secondary importance for creditors because of its general nature, unification of existing case law will help to make this instrument more effective (as envisaged under subsection on suretyship above).¹⁴⁵

¹⁴² Proposal for a Directive of the European Parliament and of the Council on credit servicers, credit purchasers and the recovery of collateral COM (2018) 135 final 2018/0063 (COD) Title V.

¹⁴³ Provisions on transfer of credits/loans to a new creditor.

¹⁴⁴ Most recent changes to the Civil Code were adopted in 2016, while new amendments to the Civil Procedure Code became effective in November 2017 so no immediate further legislative amendments are expected soon. In addition, as noted in the Insolvency section of this report the current Insolvency Act has entered into force only in May 2017.

¹⁴⁵ The Supreme Court is expecting the appointment of new judges in the vacant seats to reach the quorum for adopting a unified decision.

PART (B) INSTITUTIONAL FRAMEWORK REVIEW

12. INSTITUTIONAL FRAMEWORK REVIEW

The judicial system in Albania consists of first instance courts, Appeal Courts and the Supreme Court. There are no commercial courts or divisions within the first instance courts.

The highest judicial authority is the Supreme Court which under the Constitution is granted jurisdiction to review as an appeal instance court decisions of the lower courts. The Supreme Court represents therefore the last instance court of the system (no appeal can be made against its decisions, except for the issues of constitutional jurisdiction with the Constitutional Court). Besides providing both cassation and first instance judgments, the Supreme Court administers justice through unification and development of law practice, where the Supreme Court finds that the lower courts make inconsistent or uncertain interpretations of legal matters. Unifying judicial decision of the Supreme Court have the nature of a binding precedent for lower courts and serve to ensure consistency and legal certainty in application of legal norms by lower courts in Albania.

Judicial enforcement of claims is the most preferred instrument of enforcement for Albanian market participants. However, it is often observed that there are various drawbacks of the current judicial system in Albania. Mainly, market participant mentioned inconsistent law practice, a lack of legal certainty in application provisions regulating law of obligations, securities and enforcement process. In addition, the court of appeal often sends cases back to the lower courts. These factors in combination with often excessively lengthy proceedings make court proceedings less efficient. Even though market participants have not provided specific data in this regard, their opinion is that current rules of civil procedure regulating enforcement process in Albania give a possibility for unlimited appeals, which is often used by *mala fide* debtors to prolong enforcement process. However, today Albania is going through a major reform of judiciary.¹⁴⁶ The Judicial Reform will specifically address among others the appointment of the judges and end of term. Improved vetting/selection process for judges is expected to have a positive impact on two main issues in the court performance: judges overload with work and corruption in the judiciary. In this manner, the reform promises to significantly improve court performance, to have positive impact on fight with corruption within judiciary and is expected to make claims' enforcement process faster and more transparent.

Identified issues:

The Judicial Reform aims to remove from duty the members of the judiciary who do not justify revenues or do not comply with principles of integrity.¹⁴⁷ Nevertheless, Albanian judges also lack specialisation and struggle to establish a consistent case law, which illustrates that corruption is not the only problem. This is an issue which needs to be addressed for both the current judges and the new ones who shall replace the existing members of the judiciary as the result of the Judicial Reform.

¹⁴⁶ The Albanian Parliament established an ad hoc commission through the Decision No. 96/2014, dated 27 November 2014 for the elaboration and proposal of an unprecedented judicial reform, resulting in major amendments in 2016 to the Albanian Constitution and adoption of other legislative acts on the evaluation of judges and prosecutors, based on the following principles: compliance with the professional and integrity principles and justification of wealth and revenues. After some delays, the evaluation process started only in 2018 and a number of judges and prosecutors have already been removed from duty mainly for not being able to justify their wealth and revenues created during their term in office. A smaller number of members of the judiciary have resigned before being submitted to the evaluation process.

¹⁴⁷ According to most unofficial data reported by watchdogs and media, 12 judges and prosecutors have been removed out of 25 who have been submitted to the evaluation procedure, while 8 judges and prosecutors have resigned before the evaluation procedure was started earlier this year.

Recommendations for reform:

The authors of this report suggest that the court infrastructure must be improved in order to decrease the workload for the judges and provide additional assistance to judges during their work from the court administration.¹⁴⁸

Also, specialization and further trainings for judges who are dealing with enforcement and other enforcement officials would be helpful for the establishment of a consistent case law.¹⁴⁹

12.1 Enforcement agency

12.1.1 Public enforcement agency

The creditor claims enforcement system in the Republic of Albania is comprised of two bodies regulating correspondingly private and state enforcement proceedings: the Chamber of Private Bailiffs and the Directorate General of State Bailiffs. These two enforcement bodies are regulated by different pieces of legislation, are subject to different forms of State supervision and, in general terms, do not operate as a whole. Enforcement by means of public bailiffs is administered by the Directorate General of Public Bailiffs, which is structurally a part of the Ministry of Justice hierarchy. The Head of the Directorate directly subordinated to the Minister of Justice.

12.1.2 Private enforcement agency

Private bailiffs are organised under the auspices of the Chamber of Private Bailiffs, which is a body of free professionals supervised by the Ministry of Justice. The Ministry also supervises issuing license permissions for private bailiffs who must be lawyers. To obtain such a licence a professional test needs to be taken. Currently in the market public bailiffs give way to the use of private bailiffs, which is far more speedy and effective for enforcement process. The choice of appointing a public or private bailiff lies with the creditor. Generally State authorities submit their claims for enforcement to the public bailiff as a matter of tradition. Nevertheless, it is common for State authorities to enter into agreement with private bailiffs for debt collection.

Identified issues:

In the Republic of Albania there are two enforcement bodies: the Chamber of Private Bailiffs and the Directorate General of State Bailiffs. These enforcement bodies and their activities are regulated by different legislations. The choice of appointing a public or private bailiff is up to the creditor. Nevertheless the existence of two different bodies leads to differences in practice, which create uncertainty for creditors.

Recommendations for reform:

To increase the efficiency of bailiffs and enforcement procedures, we recommend, and market participants' support, additional trainings and guidelines for private and state bailiffs in order to establish unified market practice with regard to enforcement procedures.¹⁵⁰

¹⁴⁸ *Supra* note 6, WB Principles, D1, page 29.

¹⁴⁹ *Supra* note 79.

¹⁵⁰ *Supra* note 11, UNCITRAL Insolvency Guide, para. 40 page 175.

12.2 Registry system and registration

12.2.1 Competent bodies of registry system (Ministry of Justice, other authorities)

(a) Public and private notaries

Notaries in Albania are public officers operating upon a licence granted by the Ministry of Justice. A professional test and three years of professional experience as a registered notary trainee or an actively operating lawyer is a requirement for obtaining the license.¹⁵¹

Notary deeds by which borrowers/debtors accept the existence of a debt/claim can be enforced through the judicial system, which is a common practice in the market. Also, immovable assets or assets registered in public registries (i.e. Securing Charge Registry), may be transferred only through notarial deeds. Market participants have not raised any concern on notary tariffs or fees.

(b) Public registries

(i) Immovable property registry

Registration of the securities over immovable assets is performed by Real Estate Registration Offices (there is one in every cadastral zone in Albania). Each RERO office holds a local immovable property registry. Mortgage over immovable property constitutes the most common means of securing an obligation in Albania. Registration of the mortgage is compulsory for the enforcement of any future claims. Registration secures transparency and serves to inform the public about secured transactions.

Identified issues:

In Albania immovable property registration is hindered by lack of a proper land cadastre and inconsistent information on property rights over land plots. Immovable property registration includes several steps. Initially immovable property is registered with a respective IPR. At this stage every immovable property assets is attained an interim unique property number. Following the preliminary (interim) registration, the immovable assets may become an object of market transactions (sold, mortgaged, etc.). As of today, this preliminary registration in the database has not yet been completed.

Recommendations for reform:

Currently Albania is undergoing a process of digitalization of the registration databases (kept manually in each of the REROs) and simultaneously to bring the database up to date with currently existing properties. Approximately 340 cadastral zones, mainly forests and pastures, are currently under the registration process.¹⁵²

The acceleration of the digitalization process would bring important benefits to market participants as it would create the possibility to introduce in the future online registration of mortgages by market participants through e-application. Registration of such online applications could be completed by

¹⁵¹ Act of the Republic of Albania "On the notary", No. 7829 dated 1 June 1994, as amended.

¹⁵² *Supra note 6*, WB Principles A2, page 14; See also *Supra note 7*, UNCITRAL Legislative Guide, paras.67-69 and paras.82-89 pages 26 and pages 31-33 accordingly.

the secured party or its representative without the requirement of the debtor's involvement. This recommendation is supported by UNCITRAL best practice regarding the opinion that registry system should be digitalised and integrated. This results in more efficient access to registry services by users and greatly reduces the operational costs of the registry, translating into lower fees for registry users.¹⁵³

If such online registration is made without the debtor's consent and it does not cover an existing security interest or is incorrect, the debtor may require that it be removed or corrected.

(ii) Commercial registry

Companies in Albania are registered with the commercial registry administered by the National Business Centre.¹⁵⁴ Registration of a company with the NBC is valid against third parties upon its publication in the Commercial Registry.

Given that enforcement of pledges over shares (quotas of limited liability companies) is not effective due to the lack of legal clarity of the provisions in the Civil Code (as referred to in Section 3.5 of the Part A of the Study), registration of final court orders, i.e. executive titles against owner of shares is common in the Albanian market.

Identified issues:

There is a lack of consistency by officials of the Commercial registry in relation to registration of bailiff's enforcement orders, as market participants have noted. There are cases when enforcement orders are enforced against the shares that an individual or entity owns in a company, whilst the secured obligation itself lies with the company, while the case law is not consistent in this respect.

Recommendations for reform:

Commercial registry officials and bailiffs must be provided with trainings and opportunities for specialization in matters related to claims enforcement.

Also, as proposed for the other registries, it is proposed to amend the Companies Act and/or the Business Registration Act by introducing online registration of pledges by market participants through e-application. Registration may be effected by the secured party or its representative without the requirement for the debtor's involvement. Self-registration by a secured creditor which is a credit institution may improve efficient registration of secured interests, subject to the debtor's ability to rectify any error in the registry.¹⁵⁵

If registration is made without the debtor's consent and it does not cover an existing security interest or is incorrect, the debtor can require that it be removed or corrected in accordance with established procedure of registration of amendment and cancellation notices.¹⁵⁶

¹⁵³ *Supra* note 6, WB Principles, A5, page 15; *Supra* note 7, UNCITRAL Legislative Guide, pages 149-178; *Supra* note 8, UNCITRAL Guide, paras.135-150, page 53, para.150 page 57, paras.151-152 page 58, paras.39-43 pages 159-160; *Supra* note 10, Guide to Enactment, paras 145 and 146 pages 49 and 50.

¹⁵⁴ The Act of the Republic of Albania "On registration of the business" No. 9723, dated 3 May 2007, as amended ("**Companies Act**").

¹⁵⁵ *Supra* note 10, Guide to Enactment, Section D.

¹⁵⁶ *Supra* note 70.

(iii) Securing Charge Registry

The Registry of Securing Charges is created to maintain a database of securities on movable goods. The Securing Charge Registry is administered by a private company (R.B.S. sh.p.k.) on concession (private public partnership) basis, under the monitoring of the Ministry of Finance. The activity of the registry is regulated also by the act regulating concession activities in Albania: the Act "For Concessions" Nr. 9663, 18.12.2006, and the Decision of Council of Ministers Nr. 113, 02.02.2009 "For Contracting Authority Determination and the Commencement of Procedures on the Concession Assignment of the Services of Registry for Securing Charges".

The registry for securing charges includes two databases: a client database and a secured transactions database. The client database provides account status information to clients, revenue accounting to the registrar etc. The secured transactions database is an electronic registry of new charges, continuations, amendments, and terminations of existing charges.

Identified issues:

Registration in the Securing Charge Registry is useful for enforcement purposes and opposition to third parties, when the pledged assets are registered in an individualized/identifiable manner (using reference numbers, or unique qualities).

According to market participants, the Registry does not allow automatic checking of pledged properties by identification numbers assigned to these assets. Currently, search in the registry database is only possible by names of owners/ potential chargors, and not by identification features of assets. For market participants, this constitutes a substantial deficiency, which negatively affects the whole securing charge registration system.

Recommendations for reform:

To improve and make more efficient the functioning of the Securing Charge Registry, market participants have proposed the adoption by the entity which administers the Securing Charge Registry a specific regulation to allow better identification tools of pledged assets and improvement of the search modalities and access instruments in the Securing Charge Registry, enhancing therefore the enforcement proceedings which can be called as 'unique identification'.¹⁵⁷

(iv) Joint stock registry

The Shares' Registration Centre administers the joint stock registry¹⁵⁸ where creditors can register pledges over shares of joint stock companies to ensure public knowledge over shares status. Public joint stock companies are obliged to register themselves in this register together with the registration at the Commercial registry (which is mandatory for all types of companies in Albania). The status and actual purpose of this registration remains still unclear (according to observations made by market participants), as the scope to give

¹⁵⁷ EBRD, Guiding Principles for the Development of a Charges Registry, page 9 (2004) (<https://www.ebrd.com/downloads/legal/secured/pubsec.pdf>).

¹⁵⁸ The Joint Stock Registry is a joint stock private company owned by the Albanian State (majority shareholder) through the Ministry of Finance and Economy and other individuals (minority shareholders) following the privatization of part of the state-owned shares package.

publicity to the existence of a pledge over shares can be attained by any of the registrations. However, to enhance their chances for claims' enforcement, creditors register their claims for joint stock companies both at the Commercial Registry and the Joint Stock Registry.

Recommendations for reform

It is proposed for the Ministry of Economy and Finance to adopt a specific regulation providing the introduction of online registration of pledges by market participants through e-application. Registration may be effected by the secured party or its representative without the requirement of the debtor's involvement. If registration is made without the debtor's consent and it does not cover an existing security interest or is incorrect, the debtor can require that it be removed or corrected.¹⁵⁹

This recommendation is supported by the World Bank's Principles for effective Insolvency and creditor/ debtor regimes, which emphasize the importance of centralization and digitalization. While it is acceptable to have special registries for special assets, in this case it would be helpful to have a general registry for security rights over movable assets. A general registry is conceived as a body that has the important role to coordinate between special registries.¹⁶⁰

(v) The Albanian Civil Aircrafts Registry

is a public register kept both electronically and manually by the Albanian Civil Aviation Authority ("ACAA").¹⁶¹ The scope of this registry is to give publicity to the creation of pledge over the assets registered with the registry (aircrafts, real rights and obligatory rights which may exists over aircrafts personal status and other legally relevant facts).¹⁶² Albania has very few aircrafts and factually no practice regarding sell or transfer rights to them. According to market participants, online access to the aircraft registry will make it easier to receive information in the form of excerpts from the Registry.

(vi) The Albanian Ship Registry

This register is a manual registry kept by the General Maritime Directory ("GMD").¹⁶³ The purpose of the Ship Registry is to make public the legal and factual status of ships registered with the Registry.¹⁶⁴ Albania has a limited flotilla, numbering only 12 big ships and according to the market participants, the market practice is not very developed in this respect. Market participants observe that the Ships Registry must be kept electronically and an electronic data base to be accessed online would make possible to any interested party to receive information in the form of excerpts from the Registry.

¹⁵⁹ *Supra* note 70.

¹⁶⁰ *Supra* note 6, WB Principles, A5, page 15.

¹⁶¹ Order of the Minister of Transports No. 113, dated 12 October 2012 "For the approval of the Regulation On registration of the Albanian civil aircrafts".

¹⁶² Act of the Republic of Albania No. 10040, dated 22 December 2008 "Air Code of the Republic of Albania", as amended.

¹⁶³ Decision No. 462, dated 9 July 2014 "For the approval of the Regulation for the registration of ships in the Republic of Albania".

¹⁶⁴ Act of the Republic of Albania No. 9251, dated 8 July 2004 "Maritime Code of the Republic of Albania", as amended.

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6. Act of the Republic of Albania "On industrial property", No. 9947, dated 07.07.2008, as amended
7. Act of the Republic of Albania "On some amendments and additions to the Law No. 9947, dated 07.07.2008 "On Industrial Property", as amended, No. 17/2017, dated 16.02.2017, entered into force by March 2017
8. Act of the Republic of Albania "On insolvency", No. 8901, dated 23.05.2003, as amended
9. Act of the Republic of Albania "On insolvency", No. 110/2016, dated 27.10.2016
10. Act of the Republic of Albania "Maritime code of the Republic of Albania", No. 9251, dated 08.07.2004, as amended
11. Act of the Republic of Albania "On the notary", No. 7829 dated 01.06.1994, as amended
12. Act of the Republic of Albania "On the organization and functioning of the judicial bailiff service" No. 8730, dated 18.01.2001, as amended
13. Act of the Republic of Albania "On payments system", No. 133/2013, dated 29.04.2013
14. Act of the Republic of Albania "On the private judicial bailiff service" No. 10 031, dated 11.12.2008, as amended
15. Act of the Republic of Albania "On public auction", No. 9874, dated 14.02.2008, as

amended

16. Act of the Republic of Albania "On registration of immovable properties", No. 33/2012, dated 21.03.2012, as amended
17. Act of the Republic of Albania "On registration of the business" No. 9723, dated 03.05.2007
18. Act of the Republic of Albania "On sale-purchase of lands", No. 7980, dated 27.07.1995
19. Act of the Republic of Albania "On securing charges", No. 8537, dated 18.10.1999, as amended
20. Act of the Republic of Albania "On treatment of the property and completion of the process of properties compensation", No. 133/2015, dated 05.12.2015
21. Civil Code of the Republic of Albania, adopted by the Act of the Republic of Albania "The Civil Code", No. 7850, dated 29.07.1994, as amended
22. Code of Civil Procedure of the Republic of Albania, adopted by the Act of the Republic of Albania "Civil Procedure Code", No. 8116, dated 29.03.1996, as amended
23. Act of the Republic of Albania "On some changes and additions to the Civil Procedure Code", No. 114/2016, dated 03.11.2016
24. Decision of the Albanian Council of Ministers "On the establishment of the joint stock company "Qendra e Regjistrimit te Aksioneve"", No. 112, dated 19.02.1996
25. Decision of the Albanian Council of Ministers No. 113, 02.02.2009 "On Contracting Authority Determination and the Commencement of Procedures on the Concession Assignment of the Services of Registry for Securing Charges"
26. Decision of the General Maritime Directory No. 462, dated 09.07.2014 "On the approval of the Regulation for the registration of ships in the Republic of Albania".
27. Decision of the Albanian Parliament No. 96/2014, dated 27.11.2014
28. Decision of the Supervisory Board of Bank of Albania on the approval of the Regulation No. 62, dated 14.09.2011 "On the loan risk administration by foreign banks and branches of foreign banks"
29. Decision of the Albanian Council of Ministers No. 443, dated 16.06.2011 "On the creation, registration, manner of functioning, of administration and interaction and for the security of the judicial bailiff cases electronic system management (Albis)"
30. Instruction of the Albanian Council of Ministers No. 1, dated 13.04.2016
31. Order of the Minister of Transports No. 113, dated 12.10.2012 "On the approval of the Regulation "On registration of the Albanian civil aircrafts".

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1. A Primer On UCC Article 9 Sales, pages 7-8 (2014) URL: https://www.hodgsonruss.com/media/publication/84_A%20Primer%20on%20UCC%20Article%209%20Sales.pdf

2. EBRD, Core Principles on Insolvency Regime, para 5 (2011), URL: <http://www.ebrd.com/documents/legal-reform/core-principles-for-an-insolvency-law-regime.pdf>
3. Randall D Guynn, Modernizing Securities Ownership, Transfer and Pledging Laws (1996) page 33. URL: <https://www.davispolk.com/files/files/Publication/0da3a245-26b8-436b-b935-0c8ea6de773f/Preview/PublicationAttachment/b6f7e950-a5a4-4462-91bd-12a49ed316ab/modernizing%2520securities%2520ownership.pdf>
4. The World Bank Doing Business Score (2016), URL: <http://www.doingbusiness.org/data/exploreeconomies/albania#resolving-insolvency>
5. UNCITRAL Legislative Guide on Insolvency Law (2005). URL: https://www.uncitral.org/pdf/english/texts/insolven/05-80722_Ebook.pdf

ANNEX - LIST OF MARKET PARTICIPANTS

I. Governmental authorities Address details		
1.	Ministry of Justice	Blvd. Zogu I Pare, Tirane, Shqiperi
2.	General Directorate of Public Bailiff	Rr. e Kavajes, prane Ambasades Greke, Tirane, Shqiperi
3.	National Chamber of Private Bailiffs	Rruga "Nikolla Jorga", Ndërtesa 9, Kati 2, Tirane, Shqiperi
4.	Bank of Albania	Sheshi "Skenderbej", Nr.1, Tirane, Shqiperi
5.	Immovable Property Registration office	Rr. Jordan Misja, Tirane, Shqiperi
6.	Registry of Security Charges	Rr. e Dibres, Qendra Biznesit AK, prane Selvise Tirane, Shqiperi
7.	National Business Centre	Bulevardi "Zhan D' ark", Prona Nr.33, Tirane, Shqiperi
8.	Authority for Financial Monitoring	Rruga "Dora D' istria", Nr.10, P.O Box 8363, Tirane, Shqiperi
9.	Supreme Court of Albania	Rr. "Ibrahim Rugova", Tirane, Shqiperi
10.	Administrator of the former fraudulent companies	Bulevardi "Dëshmorët e Kombit", Nr.3, Tirane, Shqiperi
11.	Agency for Treatment of Loans	Rr. "Dora D' Istria" Ndertesa 22, Hyrja 1, Tirane, Shqiperi
II. Associations Address details		
1.	Albanian Association of Banks	Rr. "Ibrahim Rugova", Sky Tower 9/3, Tirane, Shqiperi
III. Banks Address details		
1.	Raiffeisen Bank Sh.a.	Rr. e Kavajes, Tirane, Shqiperi
2.	Intesa Sanpaolo Bank Albania Sh.a.	Rr. "Ismail Qemali", 1001 Tirane, Shqiperi
3.	Banka Kombetare Tregtare Sh.a. (National Commercial Bank)	Bulevardi "Zhan D' ark", Tirane, Shqiperi
4.	Alpha Bank Sh.a.	Blvd. Zogu I Nr. 47, Tirane, Shqiperi
5.	Credins Bank Sh.a.	Rr. Vaso Pasha, Nr.8, Tirane, Shqiperi
6.	American Bank of	Rruga e Kavajës, Nr. 27/1,1001 Tirane, Shqiperi

	Investments Sh.a.	
IV. Financial advisors		Address details
1.	PricewaterhouseCoopers (PwC) Albania	Bulevardi Deshmoret e Kombit, Twin Towers, Kulla 1, Kati 10, Tirane, Shqiperi
2.	Deloitte Albania Sh.p.k	Rr. Elbasanit, Pall. PoshteFakultetitGjeologjiMiniera, Rruga e Elbasanit, 1001, Tirane, Shqiperi
3.	KPMG Albania	Deshmoret e Kombit Blvd. Twin Towers, Kulla 1, Kati 13, Tirane, Shqiperi
4.	Ernst&Young Albania	Rr. "Ibrahim Rugova" Sky Tower, Kati 6, 1001, Tirane, Shqiperi
V. Others		Address details
1.	Shares Registration Centre	Rr. "George W Bush", Nr.13, Tirane, Shqiperi
2.	Raiffeisen Prestigj	Blv "BajramCurri" ETC, Kati 9, Tirane, Shqiperi
3.	Raiffeisen Invest Euro	Blv "BajramCurri" ETC, Kati 9, Tirane, Shqiperi
4.	Credins Premium	Rr. NikollaTupe, Nr.1, Kati 3, Tirane, Shqiperi

C CROATIA

1. EXECUTIVE SUMMARY

This study aims to review the current state of affairs with regard to the enforcement of creditor claims in Croatia. The study was conducted by the law firm Glinska & Mišković under the auspices of the European Bank for Reconstruction and Development and is a part of a wider research project conducted in five selected jurisdictions: Albania, Croatia, Cyprus, Greece and Ukraine.

The Croatian enforcement, restructuring and insolvency legal and institutional framework requires reassessment and, to a certain extent, future reform. While relatively comprehensive, there is a number of significant implementation issues – such as court practice of splitting of enforcement proceedings initiated on the basis of a single enforcement proposal and reservation of competent authorities and market participants towards certain recently introduced legal solutions and concepts, such as use of out-of-court enforcement which, although available for security over movables (other than in respect to out-of-court enforcement of shares issued in book-entry form), is still not used in practice.

The focus in this Report is on parameters that are influencing the effectiveness of the enforcement procedure. These parameters are simplicity, cost and overall predictability. The listed parameters represent the so-called "Key Determinants" of this Report. Key Determinants were assessed following the responses from market participants, including Ministry of Justice, Financial Agency and Croatian National Bank. A full list of market participants is set out as an Annex hereto. Potential issues in respect of enforcement relate to all Key Determinants of this Study: duration, simplicity, cost and overall predictability of the enforcement proceedings. For example, while statistical data on average enforcement duration of court enforcement proceedings (203 days in 2016 and 213 in 2017 according to the data compiled by the Ministry of Justice)¹⁶⁵ appear to be relatively good, it should be noted that this statistic arises as a result of the fact that a dominant number of the claims subject to enforcement are related to frequently provided services (e.g. gas, electricity, mobile services and similar). Furthermore, the statistic refers to all types of enforcement proceedings, including against consumers, and a large number of consumers is either not aware of their rights in enforcement proceedings or is not able to afford to participate properly therein. By contrast, enforcement proceedings involving assets of more significant value (such as real properties) and/or involving legal entities in the role of debtors, tend to be long, complicated and unpredictable.

In terms of costs, one of the major issues is the requirement for advance payments of enforcement costs by the party bringing the enforcement action, without any certainty that even the principal amount of the claim will be reimbursed within the proceedings. Hence, improving the efficiency of the enforcement proceedings, which would necessarily imply decrease of enforcement costs, should be one of the top priorities for the reform. There is room for further development of the enforcement infrastructure, including introduction of new e-trading venues, digitalization of the enforcement process and the development of existing security instruments (such as security over cash and financial collateral arrangements).

According to the World Bank Doing Business 2018 annual report, enforcing contracts in Croatia takes approximately 650 days, while the cost related to such

¹⁶⁵ <https://pravosudje.gov.hr/pristup-informacijama-6341/strategije-planovii-izvjesca/statisticki-pregled/6719>.

proceedings amount to 15.2% of the claim. On the other hand, the same report suggests that timeframe for resolving insolvency is significantly longer, at an estimated 3.1 years with a cost of 14.5% to the insolvency estate.

In respect of insolvency, the long lasting trend that insolvency proceedings resulted in cessation of business of the insolvency debtor and often insignificant settlement of the creditors' claims, has to a certain extent changed with the introduction of the pre-bankruptcy procedure and the extraordinary administration procedure for companies of systematic importance.

In the table below we highlight the main issues identified in the Report for discussion with the competent authorities, based on our review of the legal framework and feedback from market participants. A more detailed analysis of the *Issues and Recommendations for reforms* is found in the Report, which is divided into Part (A) *Legislative Review*, containing an analysis of existing legislative provisions regulating claims enforcement and recommendations for improvement; and Part (B) *Institutional Framework Review*, providing an analysis of the institutions involved in the enforcement process in Croatia.

The cut-off date for the legislative review was 30 November 2018. We note that the Croatian authorities have since published a first draft of a new Enforcement Act which is expected to come into effect later this year and which will focus on improving efficiency and transparency of enforcement proceedings. This will be supported by a number of by-laws, including Bylaw on Manner and Procedure for Sale of Real Properties and Movables in the Enforcement Proceedings. It is noted, however, that the new Enforcement Act will not address all of the issues raised in this report which contains a broader analysis of the enforcement framework, including issues connected with enforcement of certain security instruments, such as account pledges and the institutional framework, which are not capable of being addressed by the new Enforcement Act.

No.	Title	Issue	Recommendations for reforms	Report reference
1.	Enforcement proceedings			
1.1	Conduct of judicial enforcement proceedings - splitting of the enforcement proceedings	<p>An unlimited number of different security interests may be enforced within a single enforcement proceeding, provided that jurisdiction is the same. Jurisdiction is determined by several factors, including: the debtor's residence/place of business, the location of the assets, or the registration place, respectively, depending on the types of assets over which the enforcement is carried out.</p> <p>Nevertheless, courts often exercise the option to split the proceedings for each type of security, which causes lack of coordination, delays and additional expenses for the enforcement creditor.</p> <p>In addition, following a proposal by the enforcement</p>	<p>According to publicly available information, the concept of the new Enforcement Act should be to achieve faster and more efficient enforcement.</p> <p>In this respect, greater effectiveness could be easily accomplished by introducing judicial guidelines which provide:</p> <p>(i) when more than one asset are covered by the enforcement proposal, all these assets should be enforced in one enforcement proceeding, subject to limited exceptions for assets with</p>	Section 6.2

No.	Title	Issue	Recommendations for reforms	Report reference
		debtor, courts also tend to limit the enforcement proceedings to certain assets, which appear to be sufficient for the settling of the claim. This can be problematic since courts do not always take into consideration creditors' views on which assets claims can be more easily realised and/or the fact that the proceeds from such realisation may not always be sufficient.	<p>different jurisdictions, with the clear aim of promoting the effectiveness of the enforcement proceedings. If enforcement over one or more of encompassed instruments would not be possible (for any reason whatsoever), this should not affect the enforcement over the remaining assets and, in this case, subject to the creditor's consent, the court should be able to split the enforcement proceedings; and</p> <p>(ii) more guidance on designating certain assets for the satisfaction of creditors' claims e.g. the requirement for judges to take into account both the ease/speed of realisation and proportionality between the creditor's interests and the debtor's interests.</p> <p>Guidelines provided under (i) above could be subject to regulation of the Enforcement Act at least to a certain level (e.g. by regulating that the enforcement proceedings may be split only exceptionally (with clear reference to the scope and perspective of such exceptions), and the guidelines provided under (ii) above could be subject to judicial guidelines issued by the highest court instances. These measures would prevent such matters from being left to the exclusive discretion of a judge.</p>	

No.	Title	Issue	Recommendations for reforms	Report reference
1.2	Duration of judicial enforcement proceedings	<p>The most significant issue is the excessively long duration of court enforcement proceedings. While such duration depends on numerous circumstances, including the complexity of the case, overall number of cases being resolved by the first instance court, the attitude of parties to the proceedings and the judge assigned to the case, major delays can result also if the debtor decides to appeal any of the court decisions, which should not be the case having regard the nature of the enforcement proceedings and the fact that the appeal in general does not have suspensive effect.</p> <p>As noted, notwithstanding that an appeal against the enforcement resolution by the debtor does not have a suspensive effect on enforcement, in practice this often leads to the postponement of the enforcement proceedings and no further enforcement action is performed until the appeal has been resolved. This results in substantial delays, which last at least as long as the second-instance proceedings are in course (and in any case longer than the average duration of judicial enforcement (being estimated as 203 days for 2016 and 213 for 2017)¹⁶⁶).</p> <p>In addition, procedural steps for the delivery of decisions to the debtor may also have a negative impact on the duration of the enforcement proceeding, due to the delivery requirements prescribed by the Enforcement Act which rely on postal delivery.</p> <p>There is also an issue of short staffing of judges in certain</p>	<p>Reform of the enforcement legal framework is necessary to improve the efficiency of judicial enforcement proceedings. In particular, the courts should invest more efforts in electronic communication with other authorities and registries, rather than communicating via postal services which is inefficient and costly. According to public statements, this is something that the new Enforcement Act shall apparently take into account.</p> <p>Electronic communication and delivery of documents between parties could lead to faster enforcement proceedings. The new Enforcement Act should aim to make some progress in this respect. Namely, the legislator should consider whether there are any obstacles to introduce electronic delivery in respect of legal entities or in case of enforcement of claims arising under commercial relations. Or, alternatively, this could be at least the case if the debtor consents to such delivery in the underlying security interests.</p> <p>The grounds for appeal and effect of the appeal are regulated in the Enforcement Act at a general level. Therefore, it would be advisable for courts to establish more practice in</p>	Sections 7.1, 12.3

¹⁶⁶ <https://pravosudje.gov.hr/pristup-informacijama-6341/strategije-planovii-izvjesca/statisticki-pregled/6719>.

No.	Title	Issue	Recommendations for reforms	Report reference
		courts, particularly in Zagreb, caused by a case overload. Judges are not able to meet prescribed deadlines due to the large number of accumulated cases in front of the courts and an insufficient number of judges.	<p>rejection of appeals, especially if it is obvious that there are no grounds for the appeal and the same is aimed only at postponing the enforcement. Courts' practice should be even more restrictive regarding the effect of the appeal on any ongoing enforcement proceedings.</p> <p>As particular circumstances of the case in hand must be respected, it would be indeed difficult and inefficient to list exhaustively cases when appeals shall be rejected and may have suspensive effect. As grounds for appeals are provided in the Enforcement Act on a general basis, court guidelines provided by the highest court instances will be necessary to change the trend and to underline main purpose of the enforcement proceedings, being efficient settlement of the creditors' claims, arising under enforceable deeds.</p> <p>In addition, certain thresholds (related to the value of the claim) could be introduced, as this is the case under the German system, for a simplified appeals procedure, what would also have a positive impact on the duration of the enforcement proceedings and, consequently, on the overall number of enforcement cases before the courts.</p>	
1.3	Out-of-court enforcement and private sale	The Croatian market does not have a developed practice of either out-of-court enforcement or private sale, which are available for liquidation of movables only (including	Out-of-court enforcement (i.e. sale of assets and satisfaction of creditors out of court) should not be governed by the Enforcement	Section 6.3

No.	Title	Issue	Recommendations for reforms	Report reference
		<p>but not limited to shares in both joint stock companies and limited liability companies). In most cases, out-of-court enforcement and sale of movables is carried out before public notaries, given that public notaries are persons of public trust.</p> <p>With the exception of out-of-court enforcement of shares in joint stock companies (in book-entry form), which is recognized and well-developed in practice, the out-of-court enforcement process lacks legal certainty and parties fear that any out-of-court enforcement and private sale may be challenged.</p>	<p>Act provisions governing court enforcement, a position which has been confirmed also by the case law.</p> <p>The nature of out-of-court enforcement implies that it should be less formally regulated and that the parties opted to introduce different rules in case of enforcement.</p> <p>Nevertheless we note that Croatian law lacks legislation which would prescribe main principles and boundaries regarding out-of-court enforcement, in order to increase the attractiveness of out-of-court enforcement and assist the understanding of the courts and competent authorities.</p> <p>Certain guidelines, at least regarding the form and minimum content of the parties' agreement on out-of-court enforcement, should be regulated by positive legislation to promote its wider practice.¹⁶⁷</p>	
1.4	Out-of-court enforcement initiated before public notary on the basis of an	When a creditor's claim arises under an authentic instrument, the creditor has an option to commence (out-of-court) enforcement before the public notary. Following the creditor's enforcement proposal, the public notary renders the enforcement resolution which is served to the	Simplified fast track proceedings in front of the court which would issue payment orders could be considered as an alternative to the current system of enforcement proceedings based on authentic instruments conducted by	Sections 12.2, 12.3 (see also Section 5.1 of the

¹⁶⁷ The draft European Commission proposal for a directive on credit servicers, credit purchasers and the recovery of collateral dated March 2018, which contains an accelerated enforcement mechanism, may potentially have a positive impact if implemented in its existing form but would still rely on the willingness of market participants to use such contractually based enforcement mechanism.

No.	Title	Issue	Recommendations for reforms	Report reference
	authentic instrument	debtor. However, subject to the debtor's right to complain against the public notary's enforcement resolution, which is in practice often misused, the proceedings shall automatically lead to litigation in front of the court which takes a substantial amount of time. For the whole time of litigation, (direct) enforcement of the relevant claim is not possible.	public notaries, which suffer due to the fact that debtors commonly object to the public notary's decision.	Executive Summary)
1.5	Public auction – Financial Agency	<p>Unless the parties agree otherwise, the sale of real properties within judicial enforcement proceedings is administered through an electronic public auction system managed by the Financial Agency. In case of enforcement over movables, however, the sale shall be administered through an electronic public auction system only if the creditor so requests.</p> <p>Only a small number of real properties and movables have been sold electronically via the Financial Agency's website.</p> <p>The reason for this is that the electronic review of real properties listed in the electronic auction register is very time consuming.</p> <p>In addition, the option for a (physical) review of the property is not provided in a <i>user friendly</i> manner. Namely, in many cases, the physical viewing of the property is possible only on one particular day within the time frame set by the court bailiff for duration of approximately 60 minutes. Potential buyers are therefore often <i>prevented</i> from finding the property or viewing the same in a timely manner.</p>	<p>The auction system should be reformed to be more simple and <i>user friendly</i>, and should provide safe access to its users.</p> <p>In addition, to facilitate more sales by auction, the court bailiff, who is in charge of the physical viewing of the property subject to sale, should be required to offer more than one appointment to view the property and should provide potential buyers with sufficient time to see the property.</p> <p>These recommendations for reforms could be implemented through amendments to the bylaws governing the procedure for implementation of the sale of real properties and movables in enforcement proceedings (Bylaw on Content and Manner of the Registry of Real Properties and Movables subject to Sale in the Enforcement Proceedings).</p>	Section 12.4

No.	Title	Issue	Recommendations for reforms	Report reference
1.6	Question of proportionality between creditor's interests and debtor's interests	<p>The most recent amendments to the Enforcement Act introduced a higher protection for debtors in cases when their real properties are significantly more valuable than the claims of the creditor. The aim of the amendments was to ensure proportionality between the value of the debt being enforced and the value of real properties subject to enforcement action. The court therefore <i>must</i> refuse any enforcement proposed over real properties if the principal amount of the claim is less than HRK 20,000 (EUR 2,690) and <i>may</i> still do so where the principal exceeds the said threshold, if there is a clear imbalance or lack of proportionality between the debtor's and the creditor's interests.</p> <p>The availability of such court's discretionary decision may lead to a larger number of submitted appeals and consequently to: (a) different standpoints as to the matter of proportionality between the amount of the enforcement claim and value of the real property; and (b) significantly longer duration of the enforcement proceedings.</p>	<p>The reasons for discretionary refusal of the enforcement proposal should be clearly and unambiguously prescribed in the new Enforcement Act to ensure greater legal certainty for creditors and the market, particularly regarding the significant public pressure for socially sensitive matters (e.g. evictions of individual debtors).</p> <p>Consequently, the principle of what represents an imbalance or lack of proportionality between interests, where the court may exercise its discretion, should be clearly determined in the Enforcement Act.</p> <p>Moreover, as an obvious reason for introduction of the respective provision was to prevent that the debtors (mostly being natural persons) lose their real properties (often being their homes), we see no obstacle to limit the application of this provision only to natural persons, whereby such limitation should not apply if the debtor provided a mortgage over respective real property.</p> <p>The harmonization of standards between the courts may in general be accomplished by the guidelines established by higher instance courts.</p>	Section 3.2.2
1.7	Obtaining information on debtor's assets	Croatia still does not have a search engine or a competent authority for collection (and provision) of comprehensive information on a debtor's assets.	We would recommend linking all assets owned by a natural person or legal entity to their personal identification number, which would	Section 6.1

No.	Title	Issue	Recommendations for reforms	Report reference
		Competent bodies of registry systems are: Land Registry (held with municipal courts), FINA Registry (held with the Financial Agency), Ship Registry, Aircraft Registry, SKDD Registry.	substantially simplify the creditor's position and reduce the creditor's costs before initiation of enforcement proceedings. An alternative approach would be to authorise one body to be the competent body for issuing of a list of assets owned by a certain debtor. Mechanisms for (electronic) exchange of information between relevant registries where the debtor's assets are listed would also be helpful.	
2.	Registration			
2.1	Notarisation	There are two types of notarisation in Croatia: (a) notarization of a signature and (b) solemnization, i.e. notarization of the content of the document. Legislation acts, when imposing a notarization requirement, often do not address which of the two is required. So this is the case, for example, with the Registry Act, which provides that for the release of the security registered with the FINA Registry, a publicly notarised deed is required (which implies solemnization), while in practice the securities are regularly deregistered under a security release statement on which only a signature of the creditor is notarised.	Such uncertainty is completely unnecessary and, unlike some other problems, can be easily resolved with either a change of each of legislation setting out formality requirements for the documents or by a clear opinion issued by the highest court authorities related to the required formality for each particular form of security.	Section 5.1.1
2.2	Land Registry			
2.2(a)	Description of Real Properties	For a large number of real properties located in Croatia, there are still significant differences between (a) the land registry status of the real properties (including with	Given that the mortgage over real properties is still one of the most important and common forms of security, speeding up the finalization	Section A1.1.1(a)

No.	Title	Issue	Recommendations for reforms	Report reference
		<p>respect to their size, nature and use) and (b) the status in cadastral records and/or actual condition, because the two systems have not yet been reconciled.</p> <p>This results in potential uncertainties for the secured creditor regarding the actual value of the real property provided as collateral since its value may be lower than expected.</p>	<p>of the project for synchronization of the land registry and the cadastre must be a priority goal.</p>	
2.2(b)	Reliance on the Land Registry	<p>Case law has not been consistent with respect to whether the reliance on the land registry status of the real property (a) entails only review of the main book (providing description of the real property, details on ownership and encumbrances) or if (b) the underlying collection of documents (i.e. documents on the basis of which the real property, ownership rights and encumbrances had changed in the past) must be reviewed as well.</p>	<p>The Land Registry Act should clearly set out the position with respect to reliance on the Land Registry.</p> <p>In terms of market efficiency and supporting investments, our proposal would be that the Land Registry Act is amended to clarify that only a review of the main book should suffice for reliance purposes.</p> <p>As an alternative, unification of court practice, or issuance of clear guidelines, respectively, by the highest court instances could significantly reduce this uncertainty.</p>	Section A1.1.1(a)
3.	Secured claims			
3.1(a)	Real Properties	<p>A single real property, forming a unique unit in terms of use (i.e. no separate ownership is established), is often owned by tens or even hundreds of co-owners.</p> <p>For the successful commencement of certain types of litigation in respect of real properties, all co-owners must be included in the claim, which results in significant delays in the proceedings due to the aforementioned issues</p>	<p>A recommendation in this respect is to require the owners of real properties to inform the Land Registry on change of residence (as information on the owner's residence also forms part of land registry excerpts, which are available to the public).</p> <p>In order to be effective, such an obligation</p>	Section 3.2.2

No.	Title	Issue	Recommendations for reforms	Report reference
		with delivery and possibility of appeal given to each co-owner.	should be linked to a consequence that, if the owner fails to comply, failure of delivery to the (former) address shall not affect proceedings.	
3.1(b)	Non-registered Ownership over the Real Properties	<p>Croatia still recognizes non-registered ownership of real properties. The principle of reliance on the land registry protects thus only the acquirer who acts in a good faith – i.e. if the same had no knowledge or if the same did not have reason to doubt that information provided in the land registry was incomplete or did not correspond to a non-registered condition.</p> <p>This issue causes legal uncertainty due to the fact that a non-registered property may lead to court disputes in the future, regardless of the principle of good faith.</p>	<p>Non-registered beneficiaries of real rights were obliged to commence, at the latest by 1 January 2007, the process of registration with the Land Registry. This process is still pending, although its finalization was planned for the end of April 2018.</p> <p>Once final decisions have been rendered in all proceedings, Croatia will have a clearer picture in respect of this currently still pending issue.</p>	Section A1.1.1(a)
3.1(c)	Socialist System Relics	The Croatian land registry system still suffers due to the relics of the socialist system. It was quite common in former Yugoslavia for municipalities or the state to expropriate private land for the purpose of construction of a public development (e.g. roads) or allocate it to a "social enterprise" (for the purpose of construction), whereby a change of ownership resulting from such expropriation was never registered with the land registry.	The remains of the respective system still represent a relevant issue and have a negative impact on the financial and business sector. This should be discussed by the highest court authorities – in this case the Supreme Court of the Republic of Croatia, particularly in relation to questions which are highly sensitive from the perspective of the whole ownership system or further economic development of the country.	Section A1.1.1(a)
3.2	Movables			
3.2.(a)	Movable pledge	Movables are subject to registration with a number of different registries (including the Trademarks Registry, Ship Registry, Aircraft Registry and FINA Registry). This leads to different approaches within the registration	The Ministry of Justice has announced the intention to establish a unique register of pledges and securities, which should assist with simplification of the registration system	Section 3.2.3(a)

No.	Title	Issue	Recommendations for reforms	Report reference
		<p>system.</p> <p>A unique registry for all movables does not exist, what is not surprising given various different type of movable assets. However, this should be without prejudice to the interests of the creditors to collect information of all assets of a certain debtor and necessity for establishing of a certain mechanism for that aim (as referred in this Executive Summary under No. 1.6).</p> <p>Greater formalities are provided for registration of security governed by the Registry Act (i.e. for securities whose registration is administered by the competent FINA Registry) than for registration of security over real properties, which is not logical.</p> <p>Another issue relates to the inability to release one secured asset which is part of a security package previously registered within the same registry folder at the FINA Registry. In practice this has often led to deletion of the entire folder instead of a single piece of movable property.</p>	<p>and its transparency.</p> <p>However, as earlier noted, by appreciating the different nature of different type of movable assets, our impression is that the focus should be on, firstly, creation of a mechanism for collection of comprehensive information regarding the debtor's assets; secondly, correction of omissions recognized in FINA Registry's practice (as noted in the column on the left); and, finally, elimination of a more rigid form for creation of security over movables in comparison to creation of mortgage over real properties.</p> <p>In addition, a solution to the problem with the folders in FINA Registry is to raise awareness of the Financial Agency's officers regarding potential liabilities in cases of a mistake in security deregistration procedures.</p>	
3.2(b)	Shares	<p>There are several problems recognized in relation to share pledges: (i) discrepancies in legal sources governing the share pledge agreement (as far as shares in limited liability companies are concerned); (ii) existence of two separate registries, one with regard to general information regarding the company and the other regarding the share pledges; and (iii) large and significant projects are often operated through a special purpose vehicle which share capital is in the minimum possible amount (HRK 20,000 / EUR 2,690).</p>	<p>As court registries contain numerous details on companies and are quite transparent and user friendly, it would be preferable if the same contained also information on share(s) pledge(s). Example which may be followed here, is how in practice land registry courts operate – once a (e.g.) mortgage decision is adopted, a competent court <i>ex officio</i> directs to the land registry to evidence the created mortgage.</p>	<p>Sections 3.2.3(b), 3.2.3(b)(i)</p>

No.	Title	Issue	Recommendations for reforms	Report reference
3.2(c)	Floating Charge	<p>The floating charge was introduced into Croatian legislation under the Registry Act in 2005.</p> <p>Lack of familiarity with this type of security and no available case law leads to reservation of creditors in using this form of collateral. As case law is very poor, it is hard to predict what potential issues may arise on enforcement. It is not logical that the rules regulating floating charges are set out in the Registry Act and this requires amendment. Namely, the Registry Act is not the appropriate legislation to regulate the floating charge since it otherwise contains only provisions on registration of securities over movable assets.</p>	<p>It would be far more appropriate if the floating charge were regulated by the Ownership Act (regulating also other real rights), with clear references, subject to distinctions, to the pledge over other individual movable properties.</p> <p>The recommendation above applies also in terms of enforcement of the floating charge. Namely, the current legislation does not provide an exact procedural framework for enforcing the floating charge (which should be clearly encompassed by the Enforcement Act).</p>	Section 3.3.2
3.2(d)	Pledge over bank accounts	<p>Entry into force of the Enforcement over Monetary Funds Act has significantly changed the effectiveness of the account pledge in a way that the same is no longer enforceable in the event of the debtor's insolvency.</p> <p>The Financial Agency has become the competent authority for the seizure of funds available on all debtors' accounts and the debtor's account banks are no longer authorized to act in accordance with the creditors' instruction.</p> <p>The issue related to the enforceability of the account pledges arises as a result of the fact that when seizing the funds available on the debtor's account, the Financial Agency conducts these activities in accordance with the priority order as listed in the Registry of Payment Basis' Orders and irrespective of priority rankings of account pledges registered also with the Financial Agency (FINA Registry).</p>	<p>Given the fact that the Financial Agency is in this particular situation the authority competent for conducting of enforcement over funds available on the debtor's accounts on the one hand and, on the other, also authority holding all three involved registries (the FINA Registry, Unique Registry of Accounts and Registry of Payment Basis' Orders), we see no obstacle for information within the three to be harmonized in the event of enforcement and, consequently, that the granted security priority raking is respected.</p> <p>Considering that monetary funds regularly represent a significant portion of assets (particularly in the case of liquid entities), we are of the opinion that amending the current mechanism should be one of the top priorities for the legislator.</p>	Section 3.3.2

No.	Title	Issue	Recommendations for reforms	Report reference
4	Impact of insolvency and winding-up proceedings on enforcement			
4.1	Moratorium and continuation of ongoing enforcement proceedings	<p>The Bankruptcy Act provides that enforcement proceedings pending at the moment of the opening of bankruptcy proceedings shall be suspended and continued before the court conducting the bankruptcy proceedings, unless <i>certain enforcement actions</i> have been taken before the new Bankruptcy Act entered into force.</p> <p>Uncertainty of the scope of meaning of <i>certain enforcement actions</i> has resulted in the (bankruptcy) court conducting the enforcement proceedings after the initiation of the bankruptcy proceedings often raises the conflict of jurisdiction procedure before the Supreme Court of the Republic of Croatia, i.e. arguing that the bankruptcy court has jurisdiction over the enforcement and that such enforcement should be continued within the bankruptcy proceedings, which causes a delay in the enforcement proceedings. Also the market participants have pointed this out as one of the main procedural obstacles in the course of judicial enforcement by creditors.</p>	<p>In further amendments to the Bankruptcy Act, it is necessary to define which particular <i>enforcement action</i> shall be taken into account to assess whether the enforcement proceedings have been commenced before or after the initiation of the bankruptcy proceedings.</p> <p>In the meanwhile, the highest courts should provide guidance on how this unclear provision should be interpreted and provide their opinion to the bankruptcy courts.</p>	Section 8.2
5.	Institutional Framework			
5.1	Role of public notaries in out-of-court enforcement on the basis of an authentic instrument	<p>The recent standpoint of the Court of Justice of the European Union indicated that public notaries in Croatia, when acting in enforcement proceedings on the basis of an authentic instrument, cannot be deemed as courts within the meaning of the Brussels I Regulation or for the purposes of application of the Regulation on the European Enforcement Order.</p>	<p>We are of the opinion that this represents a topic which should be further discussed with the EU bodies (as certain exceptions are already provided for in Hungary and Sweden).</p> <p>Simplified fast track proceedings in front of the court which would issue payment orders could be considered as an alternative (or</p>	Section 12.2 (see also Section 1.4 of this Executive Summary)

No.	Title	Issue	Recommendations for reforms	Report reference
		<p>This may significantly threaten the efficiency of out-of-court enforcement over the debtor's assets located in another Member State.</p> <p>Namely, according to working versions of the new Enforcement Act available in media, it seems that the intention of the new Enforcement Act is to reflect the ECJ's standpoint. If this would be indeed the case, public notaries would no longer be authorized to adopt enforcement resolutions, but only to prepare a draft thereof and deliver the same to the court for deliberation.</p> <p>We are not sure if this shall have positive impact as to the perspective of the efficiency of the enforcement proceedings in Croatia (particularly in respect of the Key Determinants taken into account for the purpose of this report).</p>	<p>additional mechanism) to the current system of enforcement proceedings based on authentic instruments conducted by the public notaries, which suffer due to the fact that debtors commonly object to the public notary's decision.</p>	
6	Education and training			
6.1	Insufficient level of training and lack of coordination between different competent authorities	<p>There is an extremely high level of reservation to recently introduced legal concepts and to developments in existing legal concepts. There is, furthermore, no coordinated developed approach for dealing with enforcement issues, such as how to promote out-of-court enforcement and how to prevent unnecessary delays of procedures which are encountered in practice.</p>	<p>A training system involving seminars and workshops should be developed for judges, enforcement officers and notaries.</p> <p>Also, periodic training which would follow every amendment of the applicable laws should be helpful to all judges and other officers participating in enforcement proceedings.</p>	Sections 7.1, 3.7.2

2. GLOSSARY

Aircraft Registry	shall mean the Croatian Civil Aircrafts Registry
Bankruptcy Act	shall mean the Bankruptcy Act (Official Gazette nos. 71/2015 and 104/2017)
Brussels I Regulation	shall mean the Regulation (EU) No 1215/2012 of the European Parliament and of the Council
Capital Market Act	shall mean the Capital Market Act (Official Gazette no. 65/2018)
CCAA	shall mean the Croatian Civil Aviation Agency
Civil Obligations Act	shall mean the Civil Obligations Act (Official Gazette nos. 35/05, 41/08, 125/11, 78/15 and 29/2018)
Companies Act	shall mean the Companies Act (Official Gazette nos. 111/1993, 34/1999, 121/1999, 52/2000, 118/2003, 107/2007, 146/2008, 137/2009, 111/2012, 125/2011, 68/2013 and 110/2015)
Court Registry Act	shall mean the Court Registry Act (Official Gazette nos. 1/1995, 57/1996, 1/1998, 30/1999, 45/1999, 54/2005, 40/2007, 91/2010, 90/2011, 148/2013, 93/2014 and 110/2015)
Enforcement Act	shall mean the Enforcement Act (Official Gazette nos. 112/2012, 25/2013, 93/2014, 55/2016 and 73/2017)
Enforcement over Monetary Funds' Act	shall mean the Enforcement over Monetary Funds' Act (Official Gazette no. 68/2018)
FINA Registry	shall mean the Financial Agency's Registry of Courts' and Notary Publics' Securities of Creditors' Claims over Movable Assets and Rights
Financial Agency	shall mean the financial agency competent for holding of various registries (e.g. Unique Registry of Accounts, FINA Registry, Registry of Payment Basis Orders etc.), certain activities within out-of-court enforcement, payment transactions etc.
IP Rights	shall mean Intellectual Property Rights
Land Registry Act	shall mean the Land Registry Act (Official Gazette nos. 91/1996, 68/1998, 137/1999, 114/2001, 100/2004, 107/2007, 152/2008, 126/2010, 55/2013, 60/2013 and 108/2017)
Maritime Code	shall mean the Maritime Code (Official Gazette nos. 181/2004, 76/2007, 146/2008, 61/2011, 56/2013 and 26/2015)
Ownership Act	shall mean the Ownership and Other Real Rights Act (Official Gazette nos. 91/1996, 68/1998, 137/1999, 22/2000, 73/2000, 114/2001, 79/2006, 141/2006, 146/2008, 38/2009, 153/2009, 90/2010, 143/2012 and 152/2014)
Registry Act	shall mean the Law on Registry of Courts' and Notary Publics' Securities of Creditors' Claims over Movable Assets and Rights (Official Gazette no. 121/2005)
Registry of Payment Basis' Orders	shall mean the State electronical data base on payment basis' orders held by the Financial Agency

SKDD

shall mean the Croatian Central Depository and Clearing Company Inc.

Unique Registry of Accounts

shall mean the State electronical data base of accounts held by the Financial Agency containing information on all accounts opened by business entities, citizens, Republic of Croatia and local and regional self-government units

PART (A) LEGISLATIVE REVIEW

3. TYPE OF CLAIMS:

3.1 Unsecured claims

Croatian law does not provide for a general definition of unsecured claims. Typically those are the claims for which no security interest has been granted. Consequently, in terms of enforcement involving collateral, which has been granted to a certain creditor, unsecured claims are in a subordinated position, irrespective of the moment of their creation or of the moment of requiring their enforcement.

3.2 Secured claims

Compared to unsecured claims, the position of a creditor with secured claims is improved in the way that settlement of such claims is supported with a certain type of security.¹⁶⁸

In the event the debtor either (a) fails to fulfil its due obligation or (b) does not fulfil it to the extent and in a manner agreed with the creditor, the creditor shall be entitled to enforce the granted collateral in order to satisfy the (outstanding part of the) claim.

3.2.1 Types of security

Generally, the most commonly used securities under Croatian law are:

- (a) mortgage over immovable (real) property;
- (b) pledge over movables;
- (c) debenture bonds;
- (d) promissory notes;
- (e) surety and
- (f) bank guarantees.

3.2.2 Immovable

One of the most commonly used securities on the Croatian market is a mortgage over real property.¹⁶⁹ For a valid creation of a mortgage, two elements are needed: the legal title (ground) for the acquiring of a mortgage¹⁷⁰ and registration with the land registry. When the mortgage is acquired on the basis of a contractual agreement, the registration with the land registry is of constitutive nature (meaning that such registration is an essential element for the creation of a

¹⁶⁸ Whereby number of allowed securities for the same obligation is not limited and depends on the parties' agreement.

¹⁶⁹ Such opinion is also expressed by the market participants in their answers to the Questionnaire (Ministry of Justice, EOS MATRIX d.o.o., B2 KAPITAL d.o.o.), and this is also regularly taken standpoint in legal doctrine.

¹⁷⁰ Article 305 of the Ownership and Other Real Rights Act (Official Gazette nos. 91/1996, 68/1998, 137/1999, 22/2000, 73/2000, 114/2001, 79/2006, 141/2006, 146/2008, 38/2009, 153/2009, 90/2010, 143/2012 and 152/2014 – the "Ownership Act") lists the following legal grounds: (1) legal affair; (2) court's decision and (3) law. In case of creation of mortgage under a legal affair, for successful registration with a land registry, notarization of signature of a person who disposes of its right is mandatory.

mortgage).¹⁷¹

In terms of registration, although land registry courts are not bound with a time limit for rendering a decision,¹⁷² the registration system generally works smoothly and, in most cases, registration is made within one to four weeks. Delays with registrations are sometimes noted when the mortgage is to be created over numerous real properties and the competent land registry (e.g. often on the coast) is over-stretched. In our experience, a proactive approach by the parties is usually of great help – urgent requests and communication with the land registry court usually affect the speed of the registration proceedings.

The mortgage is typically established over (a) (whole or an aliquot co-ownership interest in) a real property individually determined by its land registry description; (b) a separate premise or business unit established through the institution of a (separate) condominium ownership¹⁷³ and (c) construction right.¹⁷⁴

There are several reasons why a mortgage over real properties is commonly used in banking practice.

Firstly, in comparison to the instability of value of other collaterals (including but not limited to funds, shares and other rights), real properties do have, to a certain extent, stable value. Secondly, the security registration system, its transparency and enforcement mechanism (regardless of the fact that the enforcement proceedings may take some time) are well developed and efficient, which enables the creditors to rely on the provided collateral. Finally, and which is particularly relevant to domestic debtors, real properties are still considered as one of the most reliable investments.

Besides mortgages, real properties may be used as a security also in the form of a transfer of title for security purposes (fiduciary ownership).¹⁷⁵ However, given its nature,¹⁷⁶ the fiduciary ownership is less used in practice, particularly in situations when a debtor is in position to negotiate the terms of transaction.

Identified issues:

The usual obstacles in practice, such as duration and unnecessary prolongation of the enforcement proceedings, may also occur during the enforcement of security over immovables.

In enforcement proceedings, real property must be sold through electronic public auction where it may not be sold for an amount lower than 4/5 of the appraised value at the first electronic public auction and 3/5 of the appraised value at the second electronic public auction. Should such second electronic public auction be unsuccessful, the court suspends the enforcement proceedings. The determination of such a high floor is quite common for an enforcement proceeding in comparative jurisdictions. For example, in Austria the starting price of a public auction shall not be lower than 3/4 of the appraised value. After an unsuccessful second round of auction, enforcement proceedings would also be suspended.

Valuation of the real property is conducted by court experts and assessors. However in

¹⁷¹ Unlike for a real right acquisition on the basis of court's decision or law.

¹⁷² This is the case for the FINA Registry.

¹⁷³ Croatian: *etažno vlasništvo*.

¹⁷⁴ Croatian: *pravo građenja*.

¹⁷⁵ Croatian: *fiducijarno vlasništvo*.

¹⁷⁶ As described below in Subsection C3.2.3(d).

practice sometimes the estimation is not accurate due to various reasons such as lack of parameters which affect the property value and/or due to use of inaccurate parameters for evaluation.

According to the Enforcement Act, all mortgage secured claims must be satisfied within the initiated enforcement proceedings (irrespective of which creditor initiated the respective proceedings) and all registered mortgages cease to exist once the sale of the relevant real property has become final, by virtue of law and irrespective of whether creditors' claims have been satisfied or not.

Finally, recent amendments to the Enforcement Act¹⁷⁷ introduced higher protection for debtors in cases when their real properties are significantly more valuable than the claims of the creditor. Namely, the court *must* refuse any enforcement proposed over real properties if the principal amount of the claim is less than HRK 20,000 (app. EUR 2,690). On the other hand, the court *has an option*, subject to its discretion, to refuse the proposal even in the event that the principal exceeds the said threshold, if a disproportion in the balance between the debtor's and the creditor's interests exist.

Recommendations for reform:

In terms of success of enforcement over real properties proceedings, improvement of the efficiency of public auctions, as an operational mechanism in the enforcement over real properties proceedings, would represent a significant step forward. For related *Identified issues* and *Recommendations for reform*, please see Section 12.4

The recently introduced option for the court's discretionary decision may lead to a larger number of submitted appeals and, consequently, to: (a) different standards as to the question of disproportion between the amount of the claim subject to enforcement and value of a real property and also (b) significantly longer duration of proceedings. Firstly, such protective measure should be reserved only for natural persons, as the option for the discretionary decision has been introduced with the aim of protection of natural persons (who often lose their homes due to the enforcement of claims provided for every day services). On the other hand, in the case of enforcement of commercial claims such protective measure should not apply, particularly when the enforcement is based on a mortgage which has been provided over the respective real property.

In addition, reasons for refusal of the enforcement proposal on the ground of disproportionality should be in any case clearly and unambiguously prescribed in the Enforcement Act. Alternatively, if such limitations are not made part of the Enforcement Act, it would be recommended as a minimum for there to be guidelines issued by the highest instance courts.

¹⁷⁷ Official Gazette nos. 112/2012, 25/2013, 93/2014, 55/2016 and 73/2017 – the "Enforcement Act".

(a) Mortgage¹⁷⁸ on land plots

A real property is defined in Croatian law as a land plot, together with everything that is permanently merged with the land on its surface or beneath.¹⁷⁹

Considering the provided definition, the accurate definition of a real property is by identification of (i) its land registry plot number; (ii) the description of the real property; (iii) the name of its cadastral municipality; and (iv) the land registry folder.

For the successful creation of a real right (including a mortgage), it is of essential importance to correctly describe the relevant real property, both in the underlying legal transaction as well as in the registration request to be submitted to the competent court.

Identified issues:

One of the open issues in Croatia is the significant number of real properties, where the description as provided in the land registry does not correspond to either the actual status of the property and its ownership or to cadastral records.¹⁸⁰ This may cause problems to creditors and investors who usually rely only on information provided in the land registry,¹⁸¹ as the provided collateral might not be of the value they expected.

Such situation gives rise to various practical issues. For instance, a single real property, forming unique unit in terms of use (i.e. no separate ownership is established), is often owned by tens or even hundreds of co-owners. Just as an example, for the successful commencement of certain types of litigation in respect of real properties, all co-owners must be included in the claim, which results in significant delays in the proceedings, as is often the case when numerous parties are involved (such as problems with delivery). For more details on this issue we refer to Section A1.1.1(a) below.

In addition, Croatia still recognizes non-registered ownership right,¹⁸² which is not the case for most developed countries. Thus the Land Registry Act,¹⁸³ in terms of acquisition of ownership rights, grants legal protection only to acquirer who has acted in good faith – if the same did not have knowledge of the fact that, or who, due to the circumstances, did not have reason to doubt that the information provided in the land registry is not complete or does not correspond to a non-registered condition.¹⁸⁴

¹⁷⁸ For both mortgage over real property, as well as the pledge described below relating to movable assets or rights, it is important to address that such rights are of an accessory nature, i.e. the existence of the same depends on the existence of the claims for which they were granted. Notwithstanding, this rule does not apply other way around – should a pledge (or mortgage, respectively) ceased to exist, this would not automatically imply cessation of the claim for which the same was provided.

¹⁷⁹ Article 2 par. (3) of the Ownership Act. Substantially the same definition is provided also under the Land Registry Act (Official Gazette nos. 91/1996, 68/1998, 137/1999, 114/2001, 100/2004, 107/2007, 152/2008, 126/2010, 55/2013, 60/2013 and 108/2017 – the "**Land Registry Act**"), which in addition provides that each of land registry plot is marked with its respective land registry plot number and name of cadastral municipality.

¹⁸⁰ In respect of any of the size, nature, constructed building(s) or use.

¹⁸¹ Such approach is understandable given how time consuming and expensive the determination of the actual status would be.

¹⁸² Croatian: *izvanknjižno vlasništvo*.

¹⁸³ Article 8 par. (3) of the Land Registry Act.

¹⁸⁴ Whereby it should be noted that investigation of actual condition is not required.

Such non-registered beneficiaries of real rights were obliged to commence, at the latest by 1 January 2007, the process of registration with the land registry.

Finally, the Croatian land registry system still suffers due to certain relics of the socialist system. For instance, it was quite common that municipalities or the state effected expropriation of private land for the purpose of construction of a public development (e.g. roads) or allocation thereof to a "social enterprise" (for the purpose of construction). However, such expropriation had never been implemented with the land registry. For this reason, the Ownership Act provides that the *"principle of protection of reliance in the accuracy and completeness of the land registries shall not apply with respect to acquisitions until 1 January 2017, to the extent that the subject of acquisition is a real property in respect of which social ownership was registered, and which was not deregistered before this Act has entered into force."*¹⁸⁵

In addition to such provision, which is itself completely unfavourable to investors, the term for enactment of this principle (five years as of the moment of the Ownership Act entering into force), set out initially, has been extended several times. Moreover, neither the case law nor the legal doctrine have provided clear answers on whether such further amendments apply retroactively or the relevant deadline is the one provided in the Ownership Act at the moment of execution of a contract.

At the end of 2016, these unfavourable extensions finally stopped which, in our opinion, is a significant development for the Croatian real properties market. This positive development, however, i.e. the protection of trust in the accuracy and completeness of the land registry, applies only to acquisitions of real properties, which were once registered as social ownership (as on 1 January 1997), that are made after 1 January 2017. This also means that acquirers are not protected by the same principle in relation to acquisitions of such real properties made before 1 January 2017, which, due to obvious legal uncertainties, leads to various problems in practice.

Recommendations for reform:

The described discrepancies in the case law should be subject to discussion by the highest court authorities – in this case the Supreme Court of the Republic of Croatia, particularly in relation to questions which are highly sensitive from the perspective of the whole ownership system or further economic development of the country.

(b) Mortgage on separate premises and separate business units

When a building functionally allows division into separate units (flats or business units), a (separate) condominium ownership may be established. By establishment of a condominium ownership, the use of co-ownership rights is related to, and focused on, the particular separated part.

Condominium ownership enables a facilitated approach where a credit institution participates in the investment of the construction of a building intended to be sold (or leased), in a way that in case of the sale of a separate unit, the mechanism of security release with respect to such separate unit is simplified and, in addition, by payment of the purchase price, the corresponding part of the loan is usually partially repaid.

¹⁸⁵ The Ownership Act entered into force on 1 January 1997.

Issues to be considered:

In terms of importance of a detailed description of real rights over such separate units and inconsistency problems, please see item A1.1.1(a) *Mortgage on land plots* which applies *mutatis mutandis*.

(c) Mortgage on a construction right

The only exception to the rule on equal legal treatment of a land plot and building¹⁸⁶ constructed thereon or thereunder is through the legal concept of construction right. The construction right is defined as a limited *right in rem* allowing its beneficiary to have its own building on or beneath a land plot, owned by a different person.

In its legal nature, a construction right represents, on one hand, an encumbrance over the land plot on which the building is constructed and, on the other, with respect to the constructed building, a construction right is equivalent to an ownership right. Thus, the beneficiary of the construction right is always the owner of the constructed building. Consequently, for the establishment of a construction right, double registration with the land registry is required: (a) as an encumbrance over the land plot in the existing folder and (b) in a separate, newly formed land registry folder dedicated particularly to the construction right, where the beneficiary of the construction right is registered as owner of the building. Given such separate legal nature of the construction right, the same can be subject to a mortgage.

Following the cessation of the construction right, the legal position of the mortgage depends on whether the building was indeed constructed or not. If the building was not constructed, the mortgage ceases to exist along with the construction right. However, if the mortgage encumbers the constructed building, following the cessation of the construction right, the subject of mortgage changes and it remains in existence over the contribution payable by the owner of the land for the benefit of the former beneficiary of the construction right.

(d) Transfer of title for security purposes (fiduciary ownership as a real right)

Besides the mortgage, the real property may serve as collateral also within the institute of fiduciary ownership. While the Ownership Act contains very few provisions on fiduciary rights, the Enforcement Act provides rules on courts' and public notaries' security by way of transfer of the ownership over assets or rights.

Issues to be considered:

The main reason why the legal concept of transfer of title for security purposes is typically not used in practice is the creation of a rather unequal position between the creditor and the debtor.

Notwithstanding the fact that the ownership is basically transferred to the creditor, the debtor is entitled to use the real property and the creditor is not able to use or to dispose of the property prior to maturity of its claim. However, if regardless of such disposal limitation the creditor sells the real property, such disposal shall be effective in relation to the third party purchaser and the creditor will be liable only to compensate for the damage caused to the debtor.

¹⁸⁶ Whereby, a term "building" should be interpreted extensively – the same does not include only houses and buildings, but the same may refer also to pools, draw-wells, cableways etc.

Recommendations for reform:

The Ministry of Justice's presentation in relation to the envisaged new Enforcement Act indicates that the fiduciary related provisions regulating transfer of title for security purposes intend to be abolished, despite certain benefits of fiduciary ownership.

For instance, by transferring the ownership of the property to the fiduciary creditor, the entire debtor's claim is considered as settled. On the contrary, in the case of sale of the mortgaged property, the existence of the debtor's claim will be decreased proportionally with the achieved selling price of the property. If the price would not be sufficient to settle the entire claim, the debtor would still be liable to the creditor for a difference.

Thus, although both mortgages and fiduciaries have certain advantages and disadvantages, it would not be recommended that the fiduciary ownership provisions in the Enforcement Act are abolished in their entirety.

3.2.3 Movables¹⁸⁷

If there is doubt as to whether a certain asset represents a movable or immovable, the same shall be considered as movable, nevertheless certain movables may be treated as if they were immovables under a special law and to the extent that certain movable represents an appurtenance to real property, it shall be treated as an immovable (unless otherwise recorded in the land registry).

(a) Movable pledge¹⁸⁸

In addition to the below listed assets and rights, certain other movables are also typically used as a collateral on the Croatian market.¹⁸⁹ Although there is no unique security registration system for all movables, for most movables the competent authority is the FINA Registry. There are more specialised registries for ships and aircrafts, as further detailed in Section 12.5 below.

In case of using a movable pledge subject to registration with the competent registry as collateral, it is important to note, the same as for immovable property, that the description of the same must be detailed enough for the relevant movable to be identified.

Finally, unlike in case of real properties, out-of-court enforcement is an option in the case of movables.¹⁹⁰ Moreover, when a security is provided under a commercial relationship, the option of out-of-court enforcement is assumed to apply, unless otherwise provided by the parties' agreement. Notwithstanding the fact that out-of-court enforcement is permissible for movables and, moreover, assumed in commercial

¹⁸⁷ Article 2 par. (4) of the Ownership Act defines movables as assets which may be moved from one location to another without damaging their substance.

¹⁸⁸ Given the scope of the Study, we shall limit our review only to voluntary movable pledge, subject to registration with a public registry.

¹⁸⁹ Such is the case, for example, for motor vehicles, vessels, various kinds of machinery (particularly those used in industry and agriculture), wind-turbines (and other movable assets used in energy sector) and others. Without prejudice to our opinion expressed herein, the Ministry of Justice is of the opinion that movables are not typically used as a security on the Croatian market.

¹⁹⁰ As noted by Mr Jurić, an out-of-court enforcement clause is always introduced, on the insistence of the banks, in agreements executed as a security for "capital" projects, such as construction of infrastructure, shopping malls, hotels, energy projects and similar.

relationships, such type of enforcement is rarely used in practice.

Identified Issues:

Regardless of the fact that rules governing the legal traffic of movables are less rigid than those provided for immovables, in order for a pledge agreement to serve the purpose of the creation of a pledge, the same must be executed in written form and, furthermore, for successful registration with the FINA Registry, the parties' agreement must be executed in the form of a notarial deed. We note that this creates an illogical situation in which a higher level of formality is provided for the registration of security over movables (i.e. notarial deed) in comparison to the registration of security over real properties (in which case the notarization of signature alone suffices).

Recommendations for reform:

We recommend removing the requirement for the movable pledge agreement to be in the form of a notarial deed for registry in the FINA Registry and to introduce reliance on notarisation of signatures, as this is the case for the creation of security over real property.

(b) Pledges over shares¹⁹¹

The rules governing pledges over shares differ depending on whether the shares in question are (a) shares (*dionice*) in a joint stock company (*dioničko društvo*) or business shares (*poslovni udjeli*) in a limited liability company (*društvo s ograničenom odgovornošću*).¹⁹² Also, the competent authorities are two different registries depending on this distinction. For both shares in a joint stock company, as well as business shares in a limited liability company, the option of out-of-court enforcement is available.

Issues to be considered:

Given that limitations for the disposal of shares or business shares, respectively, may be imposed under the company's incorporation act, it is always advisable for creditors to review the incorporation articles of the company, in order to determine whether any limitations are provided thereunder.

Also, given the (below described) differentiation in terms of the required form, we would advise creditors to always require the highest level of formality (i.e. solemnization) when executing a security agreement, particularly because that route enables also direct out-of-court enforcement.

Given that out-of-court enforcement for security over shares in limited liability companies is under-regulated in Croatia, parties often introduce out-of-court enforcement clauses into their agreements containing detailed provisions governing the way of their sale, including who will be a person authorized to determine the value and to conduct an enforcement.

Finally, Croatian companies are predominantly established in the form of a limited liability company, often with quite a low amount of share capital and with rather simple ownership and management structure. In a large number of cases, project companies (SPVs) are used. This results in the fact that, although business shares

¹⁹¹ Croatian legal doctrine systemizes share pledge as pledge over rights rather than the pledge over movables.

¹⁹² Given usual banking and finance practice, we shall limit our review only to shares in these two types of companies.

are often provided as collateral, enforcement over the same is not typically performed in practice. Namely, if the total share capital amounts to HRK 20,000, it is indeed logical that the investors are incentivised to save the project and/or to enforce other collaterals, as reimbursement on the basis of the business shares would probably be in an inconsiderable amount.

Recommendations for reform:

As court registries contain basically all company related details and are quite transparent and user friendly, it would be highly recommended that the same include also information on the existence of any share(s) pledge(s). An example which may be followed here is the practice of the land registry courts– e.g., once a mortgage decision is adopted, a competent court *ex officio* instructs the land registry to evidence the created mortgage.

(i) Pledge over business shares

The competent registry for registration of the business share pledge is the FINA Registry. For details on the FINA Registry and identified issues in relation to the registry we refer to Sections 5.2.1(b) hereto.

Issues to be considered:

Two different laws refer to the form of a share pledge agreement. Namely, while the Companies Act¹⁹³ provides that for validity of a pledge over business shares in a limited liability company a form of notarized deed is not required, such notarized form is, pursuant to the Registry Act, required for the purpose of registration of the business share pledge with the FINA Registry. Registration with the FINA Registry is relevant, not only for its valid creation (as in question is a registry pledge, i.e. the same is created only after registration with the FINA Registry), but also for its transparency and effectiveness towards third persons. In addition, such higher level of notarized form is not required for the registration of a pledge over shares in a joint stock company.

Notwithstanding these ambiguities, in project financing transactions the number of share pledges is constantly growing. One of the reasons is the possibility of out-of-court enforcement. However, in the analysis conducted by one of the market participants¹⁹⁴ it was noted that until 2015 no such out-of-court enforcement was performed by public notaries (for difficulties relating to out-of-court enforcement, please see Section 6.3 below).

The court registries, containing details on companies incorporated in Croatia (including on share capital, shareholders and other relevant data), are held with commercial courts. However, the competent registry containing information on the existence of share(s) pledges is the FINA Registry (and the information on the share(s) pledges is not provided in the court registries).

Besides the above mentioned relevant sources with respect to the business shares in limited liability companies (i.e. the court registry for general information on companies and FINA Registry for share(s) pledges), it is also important to consider the obligation of the management board to keep the book of business shares which has to contain information on existing encumbrances over the business shares. This is particularly important due to the reason that, in

¹⁹³ Official Gazette nos. 111/1993, 34/1999, 121/1999, 52/2000, 118/2003, 107/2007, 146/2008, 137/2009, 111/2012, 125/2011, 68/2013 and 110/2015 – the "Companies Act".

¹⁹⁴ Mr Ivan Jurić, on behalf of public notary's office Marijan Jurić.

most cases, the respective pledge agreements provide upon the occurrence of an event of default, the shareholder shall no longer be entitled to dividend payments or any other claim attributable to the business share and, consequently, the management board must have accurate information on the actual beneficiary of the dividend (or any similar) payment.

Recommendations for reform:

As court registries contain numerous details on companies and are quite transparent and user friendly,¹⁹⁵ it would be preferable if the same contained also information on share(s) pledge(s). Given that this was the case previously in Croatia, we would recommend that the old system be reinstated, at least regarding limited liability companies, as Croatian companies are predominantly established in the form of limited liability companies. Example which may be followed here as well, is how in practice land registry courts operate – once a (e.g.) mortgage decision is adopted, a competent court *ex officio* directs to the land registry to evidence the created mortgage.

(ii) Pledges over shares

Unlike business shares in limited liability companies, which are subject to registration with the FINA Registry, pledges over shares in joint stock companies issued in book-entry form are, firstly, governed by the Capital Market Act¹⁹⁶ and, secondly, the same are subject to registration with the Central Depository and Clearing Company on the account held for the respective book-entry securities (please refer to Section 12.5.5).¹⁹⁷

Compared to a business share pledge (in limited liability companies), shares in joint stock companies may be pledged only once. In other words, a subsequently provided security interest is not permissible as long as the first pledge is recorded with the Central Depository and Clearing Company.

Out-of-court enforcement is always available and in general is far more efficient compared to the out-of-court enforcement of business shares, especially in case of sale of shares listed on the stock exchange with stock market price, which are easily sold through an investment firm.

(iii) Pledge over corporate rights

Notwithstanding the fact that this is not a requirement under Croatian law, in most cases pledges over corporate rights are pledged together with shares to which the same are attributable. However, there is no obstacle for corporate rights to be used as separate collateral.

We would advise creditors to expressly encompass in the pledge agreement reference to all available corporate rights, in order to mitigate the risk of separate disposals of the same.

(c) Floating charge

The floating charge was introduced into Croatian legislation with the Registry Act, in

¹⁹⁵ Search in the court registry may be easily completed by entering a company name, personal identification number or registry number of the company, unlike the search engine of the FINA Registry – for more details on this issue please refer to Subsection C5.2.1(b).

¹⁹⁶ Official Gazette no 65/2018– the "Capital Market Act".

¹⁹⁷ Shares issued in materialized form are being pledged by transfer of deed issued for the respective share.

2005. A floating charge requires registration with the FINA Registry, the same as in the case of a movable (registry) pledge.

The main differences between a floating charge and a movable pledge are the following: (i) assets being subject to floating charge do not have to be specified individually but instead the place where such movables are situated needs to be specified; (ii) the floating charge is regulated by the Registry Act;¹⁹⁸ (iii) the debtor has the right to dispose of the pledged assets¹⁹⁹ (in which case the debtor is obliged to substitute replacements for the assets so disposed of, i.e. assets being subject to floating charge usually fluctuate during the security period) and (iv) the debtor does not have to be the owner of the pledged assets. Assets being subject to a floating charge refer either to the totality of assets located at certain premise(s) or only to assets of a certain category/type.²⁰⁰ Floating charge is a security typically used in the retail sector. Due to these reasons, although this is not a statutory requirement, it is recommended to determine by the parties' agreement either the total value of the assets or a mechanism for determination of the assets' value.

Issues to be considered:

Regardless of the clear advantages of a floating charge in the case of assets representing a certain kind of inventory and thus the same not having to be specified,²⁰¹ certain disadvantages arise mostly in relation to the following: firstly, the debtor may abuse the fact that it is in possession of goods and remove them in case of intended enforcement. Secondly, the debtor may not necessarily comply with its obligation to substitute disposed goods, in order to maintain the value of the pledged inventory. Further, given the fact that the premises in which the assets are located are in the direct possession of the debtor, the debtor may obstruct the enforcement proceedings. And lastly, the debtor may dispose of the premises in which the assets subject to the floating pledge are located – for instance, by lease or sub-lease agreement, in which case the inventory may also change.

The limited nature of the provisions set out in the Registry Act gives rise to the following implications: legal loopholes must be filled with other applicable laws (while keeping the specifics of the legal concept at the same time) and, secondly, the parties to such pledge agreement must pay particular attention to questions which are not expressly regulated in law. Although the floating charge was introduced over ten years ago, related case law is practically non-existent.²⁰² Hence, it is hard to predict what particular issues would arise in enforcement. The current legislation also does not provide exact procedural frame for enforcement of the floating charge. In any case, the usual obstacles related to concepts that have not been tested yet or

¹⁹⁸ What is quite inconsistent, given the fact that scope of the Registry Act is primarily related to questions of registration of securities over movable assets and rights with the FINA Registry.

¹⁹⁹ In the event of disposal, the floating charge ceases to exist in respect of the disposed asset and a third party receives the asset free of the floating charge.

²⁰⁰ Certain types of goods, stock, equipment, spare parts, furniture, tools or others.

²⁰¹ This is particularly useful for department stores, grocery stores, pharmacies and similar business premises.

²⁰² At the time of preparing of this Study, we have not managed to identify any decision related to the subject matter, which would be available on public search engine.

do not come before the courts regularly, may be expected.

Recommendations for reform:

The floating charge is currently governed by the Registry Act, which is not logical as the Registry Act (apart from the provisions regarding the floating charge) contains only provisions on registration procedure of securities over movable assets and rights. Hence, it would be far more appropriate if the floating charge were regulated by the Ownership Act (regulating also other real rights), with clear references, but also distinctions, in comparison to the pledge over other (individualized) movables.

We further recommend amendments to the Enforcement Act to clarify procedural steps for enforcement of the floating charge. As far as we are aware on the basis of information provided by the media, it is not envisaged for the new Enforcement Act to contain any provisions on the enforcement of the floating charge. In the meanwhile, the parties to a floating charge agreement must pay particular attention to questions which are not expressly regulated by law.

(d) Fiduciary ownership

In terms of fiduciary ownerships for movable assets, the points made above under Section 3.2.2 apply accordingly. Again, in comparison to movable pledges, this type of security does not represent market practice.

3.3 Rights²⁰³

Although subject to certain limitations, various types of rights may be used as collateral. In order for a right to be suitable for the creation of a security, the same must be individually specified and capable of realization.

3.3.1 Receivables pledge

To the extent that the receivables represent part of the debtor's property, the same may be subject to security and that is irrespective of the nature of the underlying legal contract, their maturity or whether the same are conditional or not, although certain limitations in terms of assignability of claims are imposed by the Civil Obligations Act.²⁰⁴

In the Croatian market, the importance of this collateral is constantly growing. According to statistical reports, the contribution of receivables in the total assets of business entities in recent years amounted to approximately 40 percent, which leads to the conclusion that such assets should be subject to evaluation by potential creditors and investors and made use of to the maximum extent.

Identified issues:

Receivables may be subject to collateral either in the form of a security assignment or pledge. Unlike the relatively clear distinction between movable and immovable asset pledges, on the

²⁰³ The same as for movable pledge, we shall limit our review only to the voluntary creation of a pledge over rights (or security assignment, respectively).

²⁰⁴ Article 80 of the Civil Obligations Act (Official Gazette nos. 35/05, 41/08, 125/11, 78/15 and 29/2018 – the "Civil Obligations Act") provides that the following claims may not be subject to (security) assignment: (i) claims assignment of which is prohibited by law; (ii) claims of a strictly personal nature and (iii) those which given their nature may not be subject to assignment. This leads to a strange legal solution where wider limitations are provided for creation of security over claims than with respect to limitations in the case of enforcement proceedings.

one hand, and security title transfer or fiduciary ownership, on the other, the distinction between a security assignment and a pledge of receivables is rather vague. Consequently, respective security agreements usually combine both types of security instrument.

Notwithstanding the fact that the existing legal framework allows for a combination of different types of security, in terms of registration with the FINA Registry, the clear distinction between such types of security is of great importance. Namely, once a security assignment of receivables is registered with the FINA Registry (i.e. beneficiary of receivables has effectively changed to the assignee), the same receivables may not be subject to another assignment (or pledge), which is not the case for registration of pledge over receivables. Notification to the third party debtor (i.e. the debtor's debtor) is mandatory for security assignments of receivables. In some cases, notification may result with cooperation of that third party debtor in case of event of default and enable alternative satisfaction of claims without involving the court. The obligation to notify leads, on another hand, to the situation where the Ownership Act and the Civil Obligations Act provide for the notification of third party debtor as a *constitutive element* for the creation of a pledge over receivables, similar to in Austria and Germany, whereas the Registry Act provides for registration with the FINA Registry as a constitutive element for creation of a security assignment over receivables. Therefore, in case the parties created a security over claims in the form of a security assignment, this leads to both a requirement to notify the debtor and register with FINA Registry for such security assignment agreements to be effective.

Given the aforesaid double regulation in terms of the constitutive element provided for creation of security assignment, we approached the FINA Registry with the question as to whether they would accept a request for a security assignment registration if it is clear from the underlying document that the same has already been assigned to another creditor, but such prior assignment has not been registered with the FINA Registry. Namely, two scenarios are possible in this situation: first, the FINA Registry would accept such registration proposal, given the express provisions of the Registry Act prescribing that the respective security is created only after registration with the FINA Registry and, the other, where the FINA Registry would respect (irrespective of the express provisions of the Registry Act) the fact that underlying document provides that the claims arising thereunder already were subject to the (civil) security assignment and, consequently, a new security assignment is not possible. The FINA Registry had no clear standpoint on the question. Notwithstanding the imminent inconsistency implications, we are also of the opinion that it is quite difficult to take a unique standpoint in this respect. Namely, in some cases it shall be rather easy to establish whether the claims are subject to (unregistered) security – for instance in case of receivables arising under an insurance policy, what would usually be reflected in a loss payee clause (and so, visible from the insurance policy). However, if receivables arising under certain other contracts were in question, that assignment would not be visible from the contract. In the latter case, the creditor must rely either on information provided by its debtor or information available in the FINA Registry.

Recommendations for reform:

Although the issues referred herein do not require extensive legal reform, with the aim of mitigating the risks potentially arising under such double provisions, it is recommended to include in the security agreement the obligation of the debtor to notify its debtor and also to register the security with the FINA Registry themselves to avoid uncertainty of perfection requirements. Subject to the parties' agreement and under assumption of the cooperation of the third party debtor (which is often the case with more sophisticated commercial counterparties, such as, for instance, insurance companies), the creditor may easily communicate the occurrence of the event of default with the third party debtor and require direct payment to the creditor.

Nevertheless, the FINA Registry should develop a generally accepted standpoint that where the security assignment is evident from the underlying contract a new security assignment should not be possible.

3.3.2 Pledges over bank accounts

Following the entry into force of the Enforcement over Monetary Funds Act,²⁰⁵ the effectiveness of the account pledge has significantly changed and the same is no longer enforceable in the event of the debtor's insolvency. By introducing the Unique Registry of Accounts and Registry of Payment Basis' Orders, the Financial Agency has become the competent authority for both registries and for the seizure of funds available on all debtors' accounts. Consequently, the debtor's account banks are no longer authorized to act in accordance with the creditors' instruction and transfer the funds available on the accounts directly to the creditors.

The issue related to the enforceability of the account pledges arises as a result of the fact that when seizing the funds available on the debtor's account, the Financial Agency conducts these activities in accordance with the priority order as listed in the Registry of Payment Basis' Orders, and irrespective of priority rankings of account pledges registered also with the Financial Agency (FINA Registry). It is important to stress that such activities are not a result of the Financial Agency's discretionary actions, or the Financial Agency's misinterpretation of applicable laws, but of the direct application of currently applicable Enforcement over Monetary Funds Act.

Accounts are blocked as a result of the delivery of a payment basis to the Financial Agency by a creditor entitled under respective payment basis (where there are insufficient funds to settle the claims arising thereunder), following which the order of settlement is determined by the timing of delivery of a respective payment basis to the Financial Agency, and irrespective of potentially earlier provided security interests over the funds available on the debtor's accounts.

Notwithstanding the aforesaid issues, creditors still typically use the account pledge as an additional security in more complex legal transactions. This is first because unenforceability of the account pledge is not the case in other countries (to the best of our knowledge, this refers to EU countries) and in project financings involving not only Croatian banks, foreign banks require also pledges over bank accounts, mostly due to their internally required conditions for providing of facility. A second reason is the fact that until the Enforcement over Monetary Funds Act entered into force, account pledges were enforceable also in Croatia. Therefore, given the fact that in complex projects, financings are provided for a longer period of time, we are of the opinion that obtaining of the respective security is indeed worthwhile in case the applicable laws change yet again.

Identified issues:

As noted in this Section above, the Financial Agency conducts the seizure of funds from the moment when the payment basis has been received with the Registry of Payment Basis' Order and irrespective of potentially earlier registered account pledge(s), even though such pledges are registered with the FINA Registry held also by the Financial Agency (i.e. the time of the creation of the pledge is completely irrelevant).

Recommendations for reform:

Given the fact that the Financial Agency is in this particular situation the authority competent for conducting of enforcement over funds available on the debtor's accounts on the one hand and, on the other, also authority holding all three involved registries (the FINA Registry, Unique Registry of Accounts and Registry of Payment Basis' Orders), we see no obstacle for

²⁰⁵ Official Gazette nos. 91/2010 and 112/2012.

information within the three to be harmonized in the event of enforcement and, consequently, that the granted security priority ranking is respected.

Considering that monetary funds regularly represent a significant portion of assets (particularly in the case of liquid entities), we are of the opinion that amending the current mechanism should be one of the top priorities for the legislator.

3.3.3 Pledges over IP rights

In terms of creation of the pledge and its enforcement, a copyright may neither be subject to transfer, nor may enforcement proceedings be conducted over a copyright. However, receivables arising out of the use of a copyright may be subject to disposal.

On the other hand, patents, trademarks and industrial design can be both subject to a pledge and to enforcement. Applicable laws expressly provide that a pledge is subject to registration with the registry held with the State Intellectual Property Office and that the creation of a pledge shall have effect towards third parties only once the same is registered with the respective registry.

Following the accession to the European Union, EU registered IP rights may also be subject to enforcement action, provided that Croatian courts have jurisdiction and Croatian law is the governing law.

3.3.4 Debenture bonds²⁰⁶

A debenture bond²⁰⁷ is a private deed solemnized by a public notary, under which the debtor provides consent for seizure of its accounts and for transfer of available funds to a creditor for whose benefit the debenture bond was issued. The amount in which (or up to which, respectively) the available funds may be seized are detailed in the debenture bond either at the moment of issuance of the debenture bond or subsequently.²⁰⁸

A debenture bond represents an abstract deed, independent of the legal purpose for which it was issued. A debenture bond is an unilateral legal act, executed only in one counterpart, in strictly prescribed form and content and which is evidenced with the registry held by the Public Notaries Chamber.

A debenture bond has a dual legal nature: (a) it represents an enforcement order suitable for direct enforcement before the Financial Agency over funds available on all the debtor's accounts,²⁰⁹ and (b) it serves the purpose of an enforceable deed, suitable for enforcement over any other available assets of the debtor.²¹⁰

It should be noted that, since the debenture bond is always issued only in one counterpart, the same debenture bond may not be used at the same time for both the seizure of funds available on the accounts and for enforcement over other potentially available assets. Therefore, creditors usually first try direct enforcement over funds with the Financial Agency and, subsequently, if such direct seizure remains unsuccessful, they commence proceedings before the court over

²⁰⁶ Croatian: *zadužnica*.

²⁰⁷ General provisions on debenture bonds are provided under the Enforcement Act, whereby By-law on Form and Content of Debenture Bonds (Official Gazette no. 115/12 and 82/2017 – the "**By-law on Debenture Bonds**") provides details on their form and content.

²⁰⁸ In the latter case, the debenture bond is issued as a blank debenture bond (Croatian: *bjanko zadužnica*).

²⁰⁹ I.e. without involvement of court.

²¹⁰ In the latter case, involvement of court is required.

other available assets. Notwithstanding the fact that the same debenture bond can be issued only in one counterpart, there is no obstacle for the issuance of more than one debenture bond for the same underlying debt and, in that case, each represents a separate security instrument.

Given its dual legal nature and the option for direct enforcement over the funds available on the debtor's account(s) without the involvement of a court and any scrutiny of the validity of the underlying enforcement claim, the debenture bond is popular with the Croatian market.

Namely, before the most recent amendments to the Enforcement Act (as noted in this Section below), delivery of the debenture bond to the Financial Agency resulted in an immediate seizure and transfer of available funds to the creditor's account, in some cases resulting in blockage of the debtor's account(s) due to insufficient funds available on the debtor's account(s). The blockage of the account(s) and related inability of the respective debtor to continue with its business operation has opened debates and questioning of this security interest at EU level (as debenture bonds, with such form and effect, typically only exist in other Balkan states, which basically all suffer from challenging market conditions).

Namely, the consequence of direct blockage of the accounts, particularly given that no judicial authority is involved in the process, and the fact that priority is afforded to the creditor which acts first, have been recognized as impediments to a successful restructuring of the company, which may have severe impacts on the overall economic situation. Due to these reasons, the *effectiveness* of the debenture bond (generally highly appreciated and used by the creditors) has recently been questioned.

In line with the aforementioned objections, the most recent amendments of the Croatian Enforcement Act, which entered into force as of 1 September 2017, amended the treatment of the debenture bonds, resulting in a reduction of efficiency of the enforcement of debenture bond.

As a result of these amendments, as of 1 September 2017, debenture bonds no longer represent a *final* enforcement order but only an enforcement order. In addition, although funds available on the debtor's account are seized immediately when the debenture bond is submitted for enforcement, the transfer of the funds is postponed for 60 days following delivery of the debenture bond. This 60 days' term has been introduced with the aim of evaluation by the court, upon being requested by the enforcement debtor, as to whether there are reasons for postponement of the transfer or for the determination of the seizure and transfer as being inadmissible.

3.3.5 Promissory note²¹¹

The promissory note represents a security instrument to a certain extent comparable with a debenture bond. Similarities arise from the fact that a promissory note also represents an abstract, unilateral deed entitling its holder to charge the amount specified therein from the person specified on the promissory note as debtor. The promissory note may be issued either in the amount specified in advance or the amount may be determined subsequently.²¹² The obligation arising under a promissory note must be unconditional, certain and monetary.

Unlike a debenture bond (which is an enforcement deed), a promissory note represents only an authentic instrument, based on which the enforcement proceedings before a public notary may be initiated (in relation to enforcement proceedings before public notaries we refer to Section

²¹¹ Croatian: *mjenica*.

²¹² In the latter case, the promissory note is issued as a blank promissory note (Croatian: *bjanko mjenica*).

12.2 below). Therefore, in terms of duration of enforcement action commenced on the basis of a promissory note, it should be noted that, if a complaint is raised by the enforcement debtor against the enforcement order issued by the public notary, the proceedings will (automatically) end up in litigation before the court. With respect to the average duration of litigation before Croatian courts, please note our points set out in Section 7.1 and Section 12.3 below.

Given the aforementioned possibility that enforcement of the promissory note, subject to the debtor's objection, will end up in litigation, promissory notes are not often used in project financings and are typically reserved for less sophisticated commercial relations.

3.4 Surety

Under a surety (guarantee) agreement, a guarantor undertakes the obligation towards the creditor to fulfil the valid and due obligation of a debtor. Depending on the particular terms of the surety, the guarantor may be called for fulfilment either only after the debtor has failed to fulfil its obligation²¹³ or irrespective of the prior non-payment or non-performance by the debtor – i.e. in the latter case, both debtor and guarantor may be called on for payment or performance at the same time.²¹⁴ The required form for undertaking of a surety obligation is in writing and a surety may be provided either for an existing obligation or for a future or conditional one.

As a general rule, the guarantor's obligation is of an accessory nature and the same depends on the main (debtor's) obligation. Thus, the guarantor may not be put in a less favourable position than the debtor. A certain exception to this rule represents the case of reduction of claims in bankruptcy proceedings. Namely, any such reduction provided in the bankruptcy proceedings shall not entail reduction of the guarantor's obligation and, consequently, the guarantor remains liable for fulfilment of the obligation in its full (unreduced) amount.

Finally, in terms of banking and finance transactions, when creditors decide to take a surety from the debtor's subsidiaries, we note that corporate benefit rules, introduced in the Croatian legal system under the Companies Act, must be adequately evaluated.

Identified issues:

In the event the guarantor fails to fulfil the obligation after being called on by the creditor to do so, and to the extent that the guarantor has not provided any collateral or statement enabling direct enforcement, the creditor must firstly commence litigation with an aim of determining the guarantor's obligation. Only after obtaining a final judgment in the relevant proceedings²¹⁵ may the creditor initiate enforcement proceedings against the guarantor. To clarify, if the guarantor refuses to settle the obligation after being invited to do so, in case there is no security enforceable directly against it, the litigation aimed for determination of its obligation must be completed first.

3.5 Assets not capable of being pledged

The Ownership Act provides a general rule that each movable or immovable asset may be subject to a real right, except those which are not capable of being owned by an individual.²¹⁶ In terms of such limitations, the Ownership Act provides limitation only with respect to common goods²¹⁷ (such as the air, water in the rivers, lakes and sea and seacoast). However, if a building or other construction is constructed on a common good on a basis of a party having obtained a concession, such building (or

²¹³ This is the case for civil relations (unless agreed otherwise between the parties).

²¹⁴ Guarantor – payer, which is a rule for commercial relations, unless agreed otherwise between the parties.

²¹⁵ With regard to the estimated duration of litigation proceedings, please note assertions made in Subsection 7.1 and Subsection 12.3 below.

²¹⁶ In other words, assets must be in legal traffic.

²¹⁷ Croatian: *opća dobra*. Common goods are managed by the Republic of Croatia.

other construction) shall not be considered to be part of the common good for the duration of the respective concession.

In addition to common goods, it is also important to address the existence of public goods²¹⁸, which may be either in common use or intended for special state purposes. Both types of public goods are owned by the state or by other public entities.

The rules governing pledges²¹⁹ provide some additional provisions with respect to the suitability of assets for being pledged – only an individually determined (movable or immovable) asset²²⁰ or a right capable of realization can be pledged.

Finally, when considering if assets are suitable for a security interest, limitations on enforcement proceedings should be considered accordingly. Namely, certain objects are exempted from enforcement (such as objects which are not permissible for circulation by law, tax receivables, weapons and equipment intended for defence etc.).

3.6 Bank guarantee²²¹

A bank guarantee upon request is a written payment obligation²²² under which a bank undertakes to pay a certain amount to the beneficiary of the bank guarantee, at its request and under assumption that the conditions of the guarantee are fulfilled. The bank guarantee represents an independent obligation, irrespective of the main contract pursuant to which it is provided. The termination of the bank's obligation under the bank guarantee is either connected to a certain date or to submission of a document evidencing the occurrence of a certain event.²²³

Here the importance of a distinction between a surety and a bank guarantee should be noted. A bank may provide both a surety and a bank guarantee, however, depending on which security instrument the bank provides, its obligation to a certain extent differs. While a surety is always related to and depends on the main contract to which it is ancillary, in such a way that the guarantor may not be put in a less favourable position than the original debtor, the issuance of a bank guarantee results in the conclusion of a standalone legal undertaking irrespective of the main contract in connection with which it is issued.

In business practice, bank guarantees are usually used as a counter-guarantee, for public tenders, for return of advance payments and for the proper fulfilment of a contract (in particular in construction related contracts).

With respect to the option of enforcement of the bank guarantees, please note Section 6.6 below.

3.7 Claims under financial collateral regulations

With certain exceptions (as noted below in Section 3.7.2), the Croatian Financial Collateral Act²²⁴ complies with Directive 2002/47 of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements.²²⁵

²¹⁸ Croatian: *javna dobra*.

²¹⁹ Article 298 of the Ownership Act.

²²⁰ With exception of the floating pledge, as explained in the Subsection C3.2.3(c) above.

²²¹ Croatian: *bankarska garancija*

²²² Unlike *surety*, described above under Subsection 3.4, which does not necessary encompass only monetary obligations but also non-monetary obligations, bank guarantees always provide only for an obligation for payment of a monetary obligation.

²²³ In the event that bank guarantee provides for both of these termination terms, the bank's obligation shall cease upon occurrence of the first of the two.

²²⁴ Official Gazette nos. 76/2007 and 59/2012 – the "**Financial Collateral Act**".

²²⁵ Hereinafter: the "**Financial Collateral Directive**").

3.7.1 Covered arrangements

In terms of covered arrangements, the Financial Collateral Act²²⁶ applies to the same arrangements as are listed under the Financial Collateral Directive: (i) a title transfer financial collateral arrangement and (ii) a security financial collateral arrangement.

3.7.2 Covered market participants

In terms of covered market participants, the Financial Collateral Act²²⁷ lists the following as potential market participants: (i) the public authority entities of Member States which are in charge of public debt management or are authorized to hold business accounts; (ii) the central banks of Member States, the European Central Bank, the International Monetary Fund, the European Investment Bank, the Bank for International Settlements, the International Bank for Reconstruction and Development, the International Finance Corporation, the Inter-American Development Bank, the Asian Development Bank, the African Development Bank, the Council of European Fund for Redistribution, the Nordic Investment Bank, the Caribbean Development Bank, the European Bank for Reconstruction and Development, the European Investment Fund and the Inter-American Investment Corporation; (iii) institutions which are credit institutions, investment firms, financial institutions, insurance undertakings, and undertakings for collective investment in transferable securities; and (iv) central counterparties, settlement agents or clearing houses. In addition, the parties to financial collateral arrangements may also be other entities and natural persons, provided that the other party is an institution as defined under items (i) – (iv) herein.

Hence, the scope of market participants provided under the Financial Collateral Act slightly differs from Article 1 of the Financial Collateral Directive, as the Financial Collateral Directive expressly excludes natural persons from its scope of market participants.

Identified issues:

Notwithstanding its clear advantages in terms of abandonment of formalities and efficiency in implementation, financial collateral is not typically used within the Croatian market. One of the main reasons is that financial collateral represents a rather "new" type of security and, thus, market participants are still not fully aware of its advantages.

Secondly, the Croatian market in terms of financial collateral instruments is still undeveloped, primarily due to the limited number of potential market participants, which results in uncertainties regarding the implementation of this collateral in Croatia.

Recommendations for reforms:

Generally existing difficulties with respect to newly introduced legal concepts are also recognized here (reservations towards the concept, lack of implementation in practice, etc.).

Such difficulties may to a certain extent be eliminated by organized approach of education of both involved authorities and relevant market participants.

In addition, oversight by the Croatian National Bank or other relevant authorities as on the use of financial collateral could indicate areas for improvement on the Croatian market.

²²⁶ Article 2.

²²⁷ Article 3.

4. RANKING AND PRIORITY OF CLAIMS

4.1 Unsecured claims

Please refer to Section 3.1.

4.2 Secured claims

Please refer to Section 3.2.

4.2.1 The first ranking security interest

The priority ranking ensures that a creditor granted a certain pledge is satisfied in accordance with the acquired priority ranking and only after satisfaction of a claim with a higher priority ranking in its full amount (i.e. including ancillary costs)²²⁸.

The priority ranking is acquired depending on the time of the submission of the registration request with the competent registry. In addition to filing of a registration request, a priority ranking may be reserved also through the concept of recordation of the priority ranking.²²⁹ The latter may be used at the time when the parties wish to reserve a priority ranking, but all the prerequisites (either of legal or commercial nature) have not been met yet. Notwithstanding the clear advantage of this concept, we note that in terms of registration of security interests, the same is not commonly used in practice.

As noted above, the priority ranking is determined according to the time when the competent registry has actually received the registration request.²³⁰ Therefore, with regard to priority rankings, the creditors should take into account that the generally applicable "*principle of submission*" does not apply in case of registration proceedings. Namely, while in most of the courts' cases the relevant time for a motion to be considered as delivered on a particular date, is either when a motion is submitted by registered mail or delivered directly to the court, irrespective whether the court is competent or not, that rule does not apply for registration matters. For acquiring of priority ranking, the time of actual receipt of the registration request by the competent registration authority is what is relevant.²³¹

Whenever a security interest over the same asset can be granted more than once, it is important to address the relevance of interrelation of priority rankings. A provision in the pledge agreement preventing a debtor from providing further security interest over the same asset would be null and void. Notwithstanding that, it is often the case that the creditors impose such a restriction in pledge agreements. However, such a provision may serve only to apply pressure on the debtor and may not be ultimately enforced before the court if the debtor decides not to comply with such a restriction.

Additionally, claims secured by a mortgage over a real property can be settled only after the

²²⁸ It should be noted that, in the case of enforcement proceedings before the court, the costs of the enforcement proceedings, as well as costs and interests determined in enforcement deed and accrued in last three years prior to the date of rendering a decision awarding the real properties to the buyer, have the same priority ranking as the principle amount. (Article 114 par. (4) of the Enforcement Act).

²²⁹ Croatian: *zabilježba prvenstvenog reda*.

²³⁰ If more than one registration requests have been received at the same time, they will be registered with the same priority ranking, under assumption that such registration is possible (i.e. this will be excluded for, for instance, security assignment of receivables).

²³¹ In other words, submission to the post office or to incompetent authority shall not be taken into account.

settlement of costs and taxes described in Section 4.2.4 below.

4.2.2 The security interest with subsequent ranking

Only after the creditor secured with a first ranking security has been satisfied in the full amount, can the creditor with a subsequent (second) priority ranking have its claims settled out of the same collateral. This rule applies accordingly to each claim having a lower priority ranking.

Finally, in terms of enforcement proceedings, the principle of proportionate settlement is applied in respect of claims having the same priority ranking.

4.2.3 Possibility of contractual assignment of a priority ranking

Under Croatian law there is no obstacle for a contractual assignment of a priority ranking.

The Land Registry Act provides that for the successful assignment of priority rankings, the consent of the beneficiary of the right which moves forward and of the beneficiary whose right moves backwards is required. Additionally, if the right moving backwards is a mortgage, the consent of the owner is needed as well. Finally, if there are one or more real rights registered in between mortgages which are subject to assignment, the consent of all the beneficiaries of such real rights is also required. This leads to the conclusion that if these beneficiaries are not cooperative, this could prevent or undermine the intended assignment. However, in case necessary consents cannot be obtained, the right moving forward shall move within the scope and quality of the right moving backwards.

In spite of the fairly extensive statutory explanation of priority ranking assignments within the Land Registry Act, there are certain issues encountered in practice in relation to which the law remains silent. Namely, it is still an open issue whether the priority ranking could be subject to contractual assignment even before the registration of securities with the land registry, since the mortgage over real estate is constituted only after being registered with the Land Registry. Hence, it is not yet completely clear whether a competent court would recognize or not assignment of such priority rankings which are not yet registered with the Land Registry.

Although at first sight it may seem that a clear legislative solution could prevent this uncertainty, it should be noted that in case the involved priority rankings are not one behind the other (i.e. if there are secured creditors in between the two involved), it would not be possible to fairly deal with the situation of assignment of yet not registered priority rankings. Therefore, in our opinion this should be available, if at all, in case there is no other secured creditors in between whose consent would be required for assignment of priority rankings.

4.2.4 Priority between public and private encumbrances (court rulings, tax pledge effect on a security instrument)

Out of the proceeds from the real property in enforcement proceedings, the following claims shall be subject to settlement with priority:²³²

- (a) costs of the enforcement proceedings (court fees and paid advances for the execution of enforcement actions); and
- (b) taxes and other fees due in the last year for the relevant real property.

²³² Article 113 of the Enforcement Act.

In addition, in case the sale of assets over which exist separate settlement rights registered with public registries is conducted in the bankruptcy proceedings, the following claims shall be subject to settlement with priority:

- (a) costs of realization of sale of assets (including actually occurred costs, other obligations of the bankruptcy estate and taxes (if applicable)).

In addition, even if subject to sale in the bankruptcy proceedings are rights or assets which are subject to separate settlement rights, claims related to the realization of those assets shall be settled with priority.

The favourable position of these (public) claims may not be derogated from by the parties.

4.2.5 General priority of satisfaction of claims in insolvency and winding-up

Pursuant to the Bankruptcy Act,²³³ there are two types of insolvency proceedings – bankruptcy proceedings and pre-bankruptcy proceedings.

There are four types of bankruptcy creditors: (i) creditors with a title over a certain property in the bankruptcy estate (i.e. creditors with exemption rights)²³⁴; (ii) creditors with a separate satisfaction right;²³⁵ (iii) creditors of the bankruptcy estate;²³⁶ and (iv) bankruptcy creditors.²³⁷

The creditors with exemption rights are entitled to request exclusion of a specific asset from the bankruptcy estate.²³⁸ This group of creditors enforces their exemption rights in accordance with the general rules, as if the bankruptcy proceedings had not been opened.

Secondly, creditors with a separate satisfaction right are creditors which have the right to settle their claims separately, out of a particular debtor's asset(s).²³⁹ Here should be noted that, while assets being subject to an exemption right do not form part of a bankruptcy estate at all, assets subject to a separate satisfaction right do form part of the bankruptcy estate, however such assets are primarily reserved for the satisfaction of the beneficiaries of the relevant right. Unfortunately, the separate satisfaction right is not respected in case of extraordinary administration procedure (for more details, please see Section 9.2).

Bankruptcy creditors (so called "*actual bankruptcy creditors*") are the bankruptcy debtor's personal creditors who have a specific claim against the bankruptcy debtor. In respect of assets being subject to a separate satisfaction right, the claims of the bankruptcy creditors may be settled only after settlement of the claims of the creditors having such a separate satisfaction right. Otherwise (i.e. with regard to other assets), their claims are firstly divided into ranks of payment orders applicable in bankruptcy proceedings and, secondly, the same are satisfied proportionally within such payment ranking orders. The creditors of each subsequent payment order may be settled only after satisfaction of the creditors having a prior payment order.

²³³ Official Gazette nos. 71/2015 and 104/2017 – the "**Bankruptcy Act**".

²³⁴ Croatian: *izlučno pravo*.

²³⁵ Croatian: *razlučno pravo*.

²³⁶ Croatian: *vjerovnici stečajne mase* – unlike *real bankruptcy creditors*, whose claims have occurred prior to opening of the bankruptcy proceedings, creditors of the bankruptcy estate are the creditors which have a claim towards the bankruptcy debtor based on the cost of the bankruptcy proceedings and other bankruptcy's estates obligations.

²³⁷ Croatian: *stečajni vjerovnici*.

²³⁸ The same is basically the case also for pre-bankruptcy proceedings.

²³⁹ And this is also the case for pre-bankruptcy proceedings, where such creditors have the right to choose whether they will be settled separately or not.

The first highest payment order includes: (i) employees' and former employees' claims occurred up to the opening of the bankruptcy proceedings out of employment relationship; (ii) budget, state offices or state funds (such as pension and health) claims in the amount corresponding to the total amount payable with regard to the salary or salary compensation, in accordance with special laws; (iii) severance payments; and (iv) compensation for damages claims incurred due to work injury or occupational disease. The second highest ranking payment order includes all claims towards a bankruptcy debtor except those classified in the first highest payment order or in a lower payment order.²⁴⁰

The classification of creditors within these groups may result in the passivity of certain creditors in bankruptcy proceedings. Practically speaking, creditors with an exemption right and with a separate satisfaction right are in a position to allow themselves to act passively in the proceedings, because their claims are settled in a particular and prioritised manner. Other bankruptcy creditors, on the other hand, must show more initiative in relation to their involvement in the proceedings.

Winding-up proceedings are conducted if a reason for the termination of the company occurs and the shareholders do not agree on a different method of calculation and division or if bankruptcy proceedings are not opened against the company.²⁴¹

The Companies Act remains silent on the payment order of creditors in winding-up proceedings. However, in spite of that, the Companies Act does provide different methods for protection of creditors. Namely, liquidators are obliged to settle claims of all the company's known creditors (regardless of the fact whether the creditors have registered their claim in the winding-up proceedings or not). Further, the company's assets may not be subject to disbursement to the shareholders prior to the expiry of one year after publication of the last call to the creditors to report their claims. Finally, the liquidators are liable for damage caused to the company's creditors. Also, it is important to note that, in case the liquidators cannot settle all company's creditors' claims, the opening of bankruptcy proceedings must be proposed.

4.3 Subordinated claims

Besides the above described cases of subordination of claims in terms of enforcement proceedings and insolvency proceedings, to the extent permitted under the applicable law, there is no obstacle for a contractual subordination of claims.

In addition, the recently enacted Act on Extraordinary Administration Procedure in Companies of Systematic Importance for the Republic of Croatia²⁴² (the provisions of which had been applied with regard to the company Agrokor d.d. and its affiliated companies) also introduces the option for the subordination of claims.

²⁴⁰ The lower payment order claims are settled in the following order: (i) statutory interests arising in the bankruptcy creditors' claims after the date of opening of bankruptcy proceedings; (ii) bankruptcy creditors' costs occurred as a result of participation in bankruptcy proceedings; (iii) monetary fines imposed for criminal or misdemeanour offenses and costs of related proceedings; (iv) claims arising from debtor obligations made without consideration; and (v) claims for repayment of loans substituting the share capital or any corresponding claims.

²⁴¹ Article 113 of the Companies Act.

²⁴² Official Gazette no. 32/2017 - the "Act on Extraordinary Administration Procedure".

5. REGISTRATION AND PERFECTION WITH REGISTRY SYSTEMS

5.1 Form

As a preliminary remark, in the case of the granting of collaterals as registry rights, their valid registration with the competent registry is required. Secondly, in most of the cases, for the purpose of such registration, and to the extent that a private deed represents the legal ground for such registration, the requirement for a specific form must be met as well.

Identified issue:

The provisions of the applicable Croatian law regarding the form of execution of security agreements with respect to certain types of asset (such as immovable property or shares) are quite ambiguous.

For instance, while the Ownership Act requires only a written form for disposals of real properties, the Land Registry Act requires a higher level of formality – the signature of the seller must be verified by a public notary, in order for such deed to be a relevant legal ground for the registration with the land registry.

The same issue arises in practice with respect to shares – while the Companies Act finds it sufficient for a share pledge agreement to be executed in a written form, the Registry Act requires the notarization of a private deed.

Recommendations for reform:

With the aim of legal certainty and consistency, future amendments of the above mentioned laws (the Ownership Act, in terms of the form for disposal of real rights of real properties and the Companies Act, in terms of the form for creation of shares pledge) should envisage the intended form requirement or, at least, for the purpose of this harmonisation, respective laws should provide a reference to the fact that some special laws may provide additional formal requirements.

In addition (as described above in Section 3.2.3(b)(i)), the currently applicable Registry Act provides for more formal requirements for registration of security instruments over movable assets and rights, in comparison to the formal requirements prescribed for creation of a mortgage over real properties. As this creates rather illogical situation, the Registry Act must be subject to amendments in this respect.

Until unification is completed, in cases when there is a doubt as to which form an agreement should be executed, creditors should always follow a higher level of formality. This advice is primarily given due to the sometimes unpredictable requirements of the competent authorities and the different approaches in the implementation of those requirements and, secondly, due to the fact that the court tends to change its opinion and practice.

5.1.1 Notarial deed (Prescribed form)

When speaking of notarial deeds in terms of the registration of securities, there are two types of notarization of private deeds which may be performed by public notaries.

The first one, the notarization of signature, represents only a confirmation (verification) that a certain signature belongs to a certain person. In case of this type of notarization, it is not relevant by which law the document is governed, in which language the same is drafted, nor does the public notary enter into or verify the content (or validity) of the respective document. Therefore, its notarization is limited only to the verification of the authenticity of the relevant signature.

The other type of notarization is solemnization²⁴³ - i.e. notarization as to the content of a document – a private deed. The solemnization represents the highest level of verification and notarization of a private deed, following which a private deed is, in terms of its legal nature, equalized with a public deed. The documents being subject to solemnization must comply with specified legal requirements, and the same must further be governed by Croatian law and prepared in the Croatian language.²⁴⁴

Identified issues:

Problems in practice and implementation arise as a result of the fact that certain special laws, when imposing a notarization requirement, do not expressly state which particular notarization the same refers to i.e. notarisation of a signature or solemnisation. (Please see Section 10.3, in terms of transfer of security interests when the secured claim is subject to transfer).

Moreover, even the court practice is often confused about such provisions, which leads to frequent changes in the relevant competent authorities' opinion and a practice. Consequently, this all results in rather uncertain legal requirements and prevents the parties from predicting which steps are required for effecting a certain relationship, or the costs involved²⁴⁵ and finally, the situation prevents the creditors from having confidence that their transaction and the security will not be subject to annulment or questioning in the future.

Recommendations for reforms:

Such uncertainty is completely unnecessary and, unlike some other problems, this one can be easily resolved – with either change of the relevant special laws or by a clear opinion issued by the highest court authorities which would set the grounds for determination of the formalities related to this issue.

5.2 Registration

As noted above, rights which are subject to registration with the public registries (so called "*registry rights*") are acquired only after the registration of the respective right with the competent public authority.

5.2.1 Registration with a public authority

As well as the assertions made in Sections 5.1 and 5.2 above, it should be noted that in Croatia there is no single registration system for all types of the securities. There are instead several different registration systems, depending on the asset that is the subject to the security.

Although the justification for such an approach may be found in the different nature of the assets used as security, as well as in the fact that not all assets are solely by virtue of their existence subject to registration, the existence of various registration systems requires a more proactive approach by the creditors in order to check the status of the debtor's assets.

The respective registries represent public books which should be available to the public. We, however, note here that, for some of registries, their transparency is limited to a certain extent, as noted below in Sections A1.1.1(a) and (b).

²⁴³ Croatian: *solemnizacija*.

²⁴⁴ However, there is an exception to the latter requirement when the public notary is also appointed as the court interpreter for the language in which the relevant deed is prepared.

²⁴⁵ The difference in costs between the notarization of signature and solemnization is quite significant.

(a) Land Registry

The land registry is one of the oldest registry systems in Croatia. The land registry books are held with the land registry departments of the municipal courts, with registry relevant depending on the location of the real property (for a more detailed description of the land registry in general, we refer to Section 12.5.1 below).

Of all (security) registration systems, we find the land registry to be the most developed one and, to the extent an interested party has information on a land registry folder (or land registry plot), the same generally represents a clear picture of the status of the immovable property. In this sense, the land registry system does not suffer from any serious problems.

Identified issues:

The land registry status of the real property does not always comply with its actual status (either in its nature or a description or an ownership);²⁴⁶ further, land registry plots and land registry folders may be subject to changes (such as a merger, diversion or write-off); information on current proceedings or other relevant facts often do not provide sufficient information on the actual status of the subject matter and thus additional investigation is required, etc.

Additionally, although the Land Registry Act provides that the land registry is based on the cadastral data, sometimes this is not the case in practice. In most cases, the data appearing in the land registry are not synchronized with the cadastral data and *vice versa*. The Land Registry Act prescribes²⁴⁷ that in case data from the land registry and the cadastre are not synchronized, for registry rights, the data from the land registry shall prevail.

It is expected that the project named "*regulated land*"²⁴⁸, currently conducted by land registry courts, the Ministry of Justice and the State Geodetic Office will significantly improve and modernize the land registry and cadastre system. Amongst others, the synchronization of data between the Land Registries and cadastre should be completed under that project. The finalization of the project was planned for end of April 2018. However, given that the same has been extended for a few times in the past few years, the process is still ongoing and there is no information about planned finalisation at the moment.

Further, as an additional issue, an open debate exists in relation to the application of the principle of reliance on the accuracy and completeness of the land registry and what is expected from acquirers of real rights, in order for it to be considered that they have acted in good faith.

Uncertainty arises in connection with the question of whether it is sufficient for the acquirer to investigate only the main book (providing description of the real property, details on ownership and encumbrances) or if the investigation must include a review of underlying collection of documents (i.e. documents on the basis of which the real property, ownership rights and encumbrances had changed in the past).

In terms of market efficiency and the support of investments, it is recommended that

²⁴⁶ It should be noted that a third party is not obliged to investigate the status of the property outside of the land registry, under the assumption that that third party acts in a good faith.

²⁴⁷ In Article 10 paragraph 3.

²⁴⁸ Croatian "*uređena zemlja*".

only a review of the main book should suffice. The main book can be successfully reviewed in a very short period or using a user friendly engine (available also on-line). However, a case law and a legal doctrine have not taken a single standpoint in respect of this issue. While certain courts have confirmed this view, there is also opposite case law which imposes the obligation to review the underlying collection of documents in order to be granted with the principle of good faith protection.²⁴⁹ For these reasons, investors and creditors often run due diligence processes with regard to the real properties in which the same are interested.

For additional issues related to the land registry we refer to Section 3.2.2 above.

Recommendations for reform:

Finalisation of the project for the synchronisation of the land registry and the cadastre must be a priority goal.

As it concerns the issue recognized with respect to the principle of reliance on the accuracy and completeness of the land registries, we would propose for this to be clearly covered by applicable legislation (i.e. amendments to the Land Registry Act) and by introducing of principle that review of only main book shall suffice. In the meanwhile, unification of court practice by highest court instances could have a significant impact on the reduction of above described uncertainties. Namely, although lower courts do not have generally the obligation to accept and follow legal considerations of the higher courts, once any recommendation or guideline is issued by higher instance courts, the lower courts tend to follow such instructions.

(b) FINA Registry

The FINA Registry is a publicly available book consisting of the main book (which is divided into registry folders) and the documents collection (for more details on the FINA Registry in general, we refer to Section 12.5.2 below).

Identified issues:

Regardless of the fact that the name of the FINA Registry leaves the impression that it contains information on the securities over all movable assets and rights, this is not the case.

In addition, there is no single approach in respect of the description of the security instruments provided,²⁵⁰ which results in quite different descriptions of the same or substantially similar securities.

Finally, the transparency of the FINA Registry is quite questionable and it is impossible to determine with certainty whether a security is created over certain assets. The interested party must provide details on the underlying transaction in order to verify this information, which is often not possible, particularly in cases when that interested party does not have a contractual relationship with the debtor.

For additional issues regarding registration of securities with the FINA Registry, we refer to the Section 12.5.2 below.

Recommendations for reform:

In order to easily and certainly determine whether a security is created over certain assets, the criteria for description of securities in the FINA Registry should be

²⁴⁹ Decision of the County Court in Bjelovar, GŽ-686/2002, dated 21 March 2002.

²⁵⁰ In comparison to immovable properties, where there are clear details as to how the same must be described.

unified. In addition, the search for registered securities should be enabled by entering of the personal identification number of the debtor, at least in the case of legal entities.

(c) Other registries

Besides the land registry and the FINA Registry, as notable registries the following registries should also be mentioned: ship registry (for details see Section 12.5.2 below), aircraft registry (for details see Section 12.5.4 below), registry of concessions, Central Depository and Clearing Company (for details see Section 12.5.5 below), registries held with the State Intellectual Property Office.

5.2.2 Consequences of absence of registration with the public authority

While the registry rights are validly created only when they are registered with the competent authority, certain security instruments are not subject to registration (such as promissory notes or bank guarantees) and the same are thus perfected without registration.

In addition, and as noted above, certain collaterals may be executed without registration (such as, for instance, in the case of a movable pledges by the handing over of the respective asset or a security assignment by only notifying the third party debtor), however, without their registration, neither the effectiveness against third parties nor the option for direct enforcement is available to a secured party.

Finally, the real properties (and any of the real rights in respect of the same) are generally acquired by a registration with the land registry, with the exception when such rights are acquired on the basis of a law or court's decision. In any case, we would advise also in those cases that the real rights are registered immediately thereafter, particularly having regard to the applicable principle of trust in the accuracy of the land registry.

Recommendations for reform:

Notwithstanding the fact that registration of the right acquired on the basis of a court's decision or law is only of a declarative nature, imposing a legal requirement for a registration term and/or registration obligation to a person who has acquired the real property on the ground of court's decision or law, would have positive impact on completeness and accuracy of the land registries and would ensure that the actual situation and land registry status is at least to some extent aligned. In addition, there is no obstacle to requiring a court, which adopted the respective decision, to deliver the same to the competent land registry (once such decision becomes final), with an instruction for the real right arising thereunder to be registered with the land registry.

5.3 Possession principle

In light of the fact that real (registry) rights are acquired only after the same are registered with a competent registry,²⁵¹ the possession principle has lost its significance in practice.

The possession principle is worth noting in terms of a civil title retention (which differs from a title retention as a real right), which enables the creditor of a due claim to withhold the asset held in its possession on a justified ground until the claim is properly fulfilled or to satisfy its claim out of the asset so held in a same manner as is provided for a security interest.

²⁵¹ Whereby a real right "follows" the asset, irrespective of in whose possession the same actually is.

5.4 Exemptions from perfection requirements for financial collateral

Financial collateral arrangements are, with regard to their perfection, to the greatest extent released from formalities. As is provided in the Financial Collateral Directive, the only imposition under the Financial Collateral Act in terms of form is a requirement for written evidence of the executed arrangement.²⁵²

The financial collateral is considered as delivered or acquired once the title transfer or security, respectively, is recorded with the account which is held by the registry evidencing the respective financial collateral instrument.

6. ENFORCEMENT PROCEEDINGS

6.1 Obtaining of information on debtor's assets

An option to obtain information on a debtor's assets is to a certain extent provided under the Enforcement Act. At the request of the interested person, the competent authorities holding the registry on the particular type of assets²⁵³ provide information on available asset(s).

Identified issues:

Given the experience in practice and as noted by most market participants, the obtaining of such information before or within the enforcement proceedings are often time-consuming and, in any case, non-comprehensive.

Firstly, the provided eight days' term for the delivery of information is sometimes not respected by most of the relevant authorities.

Further, it is hard to obtain comprehensive information on real properties when Croatia does not have a unique real properties search engine using the debtor's name or name of legal entity (or by any other identification information). Each municipal court provides information only for the particular local area it covers. That basically leads to the conclusion that an interested party, in order to obtain information for the whole country, must literally address its request to all land registry departments in Croatia. Besides an obvious time efficiency issue, the filing of such separate requests, in order to obtain relevant information for the whole country, is also expensive.

On the other hand, the State Geodetic Administration Office may provide information on real properties for the whole area of Croatia. In relation to that, however, at least two problems occur: firstly, in most cases the information recorded in the cadastral offices is not aligned with the land registries (as noted in Section A1.1.1(a) above) and, secondly, the State Geodetic Administration Office is not a competent authority for checking the ownership of real properties, as the same refers only to a possession.

Further, the Ministry of Justice in its answers to the Questionnaire noted that any research of the debtors' assets is subject to certain difficulties, including the fact that Croatian citizens still have not fully developed the practice of registration of a change of ownership with the public registries.

²⁵² In other words, provision of the financial collateral must be evidenced in writing or in a durable medium, ensuring the traceability of the collateral.

²⁵³ E.g. registry of vehicles, shares, etc.

Recommendations for reform:

When the concept of the personal identification number²⁵⁴ was introduced in the Croatian legal system, one of the intentions was to link all properties owned by a certain person to his personal identification number. However, this aim has not been achieved in Croatia.

Same as for real properties, also other assets owned by a certain person could be linked to their personal identification number, which would, if made available as an electronical registry of assets, substantially simplify the creditor's position and reduce the creditor's costs before initiation of the enforcement proceedings.

An alternative would be to authorise one body to be the competent body for issuing of list of assets owned by a certain debtor, which would, in comparison to the current solution, also be a substantial improvement on the creditor's position.

One of the main prerequisites for a unified asset registry would be to introduce a mechanism for (electronical) exchange of information between relevant registries.

6.2 Judicial (court) enforcement

Irrespective of availability of out-of-court enforcement for the certain types of security, judicial enforcement is still almost exclusively used in Croatia as a method of compulsory enforcement of the claims (with the exceptions for the cases of enforcement over shares in joint stock companies (in book-entry form) and the seizure of funds available on the bank accounts).

Judicial enforcement proceedings are commenced on the basis of an enforceable deed and the conducting of the proceedings is within the jurisdiction of the municipal courts. The way of conducting an enforcement action depends on the type of debtor's assets over which the enforcement is carried out.

Identified issues:

Statistical reports provide information that the average duration of a judicial enforcement before the competent municipal courts was 203 days in 2016 and 213 in 2017.²⁵⁵ These numbers leave the impression that the enforcement before Croatian courts is not excessively lengthy.

However, given the overall economic situation in Croatia and the rather low standard of living, a large portion of the enforcement cases involve rather small amounts being subject to the enforcement process, often related to everyday expenses, such as mobile operators, electricity providers, water fees and similar. In these cases, enforcement requests are simple, enforcement resolutions are rendered quickly and the enforcement proceedings are finalized by delivery of the enforcement decision to the Financial Agency (for seizure of funds available on the enforcement debtor's accounts).

However, contrary to these cases, and in most of the cases when the enforcement debtor is a legal entity, the enforcement debtors make every effort to prolong the enforcement proceedings, particularly if subject to the enforcement action are assets of a value or assets necessary for continuation of their business operations. This means that enforcement proceedings for such legal entity debtors may continue for significantly longer than six to seven months. For further assertions on the topic, i.e. how the enforcement debtors may affect the duration of the enforcement proceedings, please refer to Sections 7.1 and 12.3 below.

An unlimited number of different types of security may be encompassed by a single enforcement proposal (under assumption that the jurisdiction is the same for all of them). Jurisdiction is determined by various factors, including depending on the debtor residence/place of business, the

²⁵⁴ Croatian: *osobni identifikacijski broj (OIB)*.

²⁵⁵ <https://pravosudje.gov.hr/pristup-informacijama-6341/strategije-planovi-i-izvjesca/statisticki-pregled/6719>.

location of the assets, or registration place. In other words, the jurisdiction depends on the types of assets over which the enforcement is carried out.

Recommendations for reforms:

With the aim of efficiency and speed of the proceedings, enforcement should be performed as a single proceeding, without division due to the number of the different security types encompassed by the enforcement action.

However, in practice there are at least two difficulties with that suggestion; firstly, following a proposal by the enforcement debtor, courts tend to limit the enforcement only to particular means and assets, if that is sufficient for the settling of the claim, and, secondly, courts have the option to split the proceedings for each of the included types of security, which option is indeed often used by the courts.

One of the goals of the Enforcement Act should be to accomplish faster and more efficient enforcement procedure.

In order to achieve desirable efficiency, this issue could be easily resolved by introducing rules or guidelines on (i) when it shall be considered that only one of the included types of security is sufficient for successful satisfaction of the creditors' claims and (ii) to introduce a clear picture when and due to which reason the enforcement proceedings may be split, so that that should not be left to the exclusive discretion of a judge.

6.3 Extrajudicial (out-of-court) enforcement

Except direct (out-of-court) enforcement with the Financial Agency (for details please see Section 12.4 below), Croatian laws provide very limited regulation of out-of-court enforcement. Namely, only the Ownership Act and the Maritime Code provide provisions relating to the out-of-court enforcement.

Out-of-court enforcement is reserved for movable assets and rights which are not considered to be real property, as well as for ships over which a mortgage has been created.

In a commercial relationship, a debtor's consent to the out-of-court enforcement is assumed, however the parties may agree otherwise (i.e. to exclude option of out-of-court enforcement). Out-of-court enforcement must either be conducted through a public auction or in such other manner as the parties have agreed or is available under a special law.

Identified issues:

Such under-regulation with regard to the out-of-court enforcement opens, on the one hand, wide options for the parties to arrange performance of out-of-court enforcement in a manner which suits them best. On the other hand, this under-regulation also results in reservations with regard to its use in practice.

Therefore, although such option has existed for quite some time now in Croatian law and the same is commonly inserted by the parties into the security agreements, the number of out-of-court enforcements actually conducted is still very low. Naturally, this results in a complete lack of case law with regard to the potential difficulties which may come across in practice.

As generally agreed by the parties, extrajudicial (out-of-court) enforcement is in most cases carried out by public notaries, given that public notaries are persons of public trust.

One of the market participants²⁵⁶ noted that in the last twenty years, not a single out-of-court enforcement proceeding was conducted in respect of business shares, regardless of the fact that such option has existed in Croatian legislation for quite some time, as well as of the fact that parties

²⁵⁶ Mr Ivan Jurić, on behalf of public notary office Marijan Jurić.

usually introduce an option for out-of-court enforcement in the underlying security documents. The same public notary is currently participating in the first (or one of the first, to the best of our knowledge) such proceedings in Croatia. In that respect, in course of those particular out-of-court enforcement proceedings some of the critical questions have been answered by the appellate court which will, hopefully, result in a more open minded approach to this type of enforcement.

The County Court in Zagreb²⁵⁷ has asserted two important facts: firstly, courts do not participate in out-of-court enforcement and, secondly, the Enforcement Act does not apply. This decision represents a huge step in the handling of all other legal remedies which would rest on the basis of the application of the Enforcement Act to out-of-court enforcement or addressed to the court which would be competent for the enforcement as it is in hand judicial and not extrajudicial enforcement. Hence, this decision clearly states that out-of-court enforcement represents an autonomous proceeding in which intervention of the courts is not allowed.

Recommendations for reform:

Out-of-court enforcement (in the sense of sale of assets and satisfaction of the creditors out of court) should not be governed by the rules of the Enforcement Act governing for the judicial enforcement (what has been confirmed also by the case law). The nature of out-of-court enforcement implies that it should be less formally regulated and that the parties opted to introduce certain different rules for the case of the enforcement.

However, given the overall reservation regarding the use of out-of-court enforcement proceedings, the Croatian legal system should provide the main principles and boundaries for out-of-court enforcement (and, at the same time, without limiting the parties' more than it is necessary). This would have significant impact to attractiveness of this type of enforcement for the parties and, also, assist the courts and other competent authorities. In other words, certain guidelines, at least regarding the form and minimum content of the parties' agreement on out-of-court enforcement, should be regulated by a positive law.

6.3.1 Enforcement of unsecured claims

For the subordinated position of unsecured claims in comparison to secured ones, please refer to Section 4.3 (and closely related Section

²⁵⁷ Decision no. Gžovr-7483/13 dated 20 May 2014.

Ranking and priority of claims).

Except for the favourable position of secured creditors in terms of priority in the enforcement of claims over particular assets (in comparison to unsecured one), ultimately there is no difference in the mechanism of conducting the enforcement of unsecured and secured claims.²⁵⁸

6.3.2 Enforcement of secured claims (depending on the type of security)

(a) Seizure of debtor's funds available on the bank account(s)

The seizure of the debtor's funds available on bank account(s) is governed by the Enforcement over Monetary Funds Act and by the Enforcement Act.

Without prejudice to the issues stressed in respect of the account pledges (for more details, please see Section 3.3.2), following the introduction of the Unique Registry of Accounts²⁵⁹ and Registry of Payment Orders,²⁶⁰ held by the Financial Agency, both payment orders and seizure of funds available on all of the debtor's accounts have become practical, transparent and efficient.

Identified issues:

Creditors still face some issues in relation to the Financial Agency.

For instance, for unknown reasons the Financial Agency sometimes refuses to accept interest rates and the calculation of interest, which are not equal to the rates introduced by Croatian laws, regardless of the fact that the parties agreed for a different rate within the boundaries provided under Croatian laws or have validly agreed on the application of a foreign law.

More issues related to seizure of debtor's funds available on bank accounts with the Financial Agency are addressed in Section 12.4 below.

Recommendations for reform:

Each such question and issue which is either regulated or applied and interpreted in practice differently, or which contravenes particular Croatian laws, respectively should be subject to evaluation and, thereafter, a clear determination by the Financial Agency and, if necessary, by the highest court's authorities or the Ministry of Justice.

(b) Enforcement by way of transfer of claims

The mechanism of transfer of a seized claim depends on whether in question is (i) the transfer for the purpose of settlement or (ii) instead of settlement of the claim.

In terms of either the security assignment or pledge of claims, the available mechanism is also out-of-court enforcement. Namely, claims are successfully assigned (by a civil assignment)²⁶¹ only after notification to the debtor's debtor and such notification is often also used in case of pledges. This allows the creditor (under

²⁵⁸ This reference is however made without a prejudice to a special treatment in the insolvency proceedings.

²⁵⁹ The Unique Registry of Accounts represents an electronic data base containing information on all accounts opened by business entities, citizens, Republic of Croatia and local and regional self-government units.

²⁶⁰ Whereby payment order depends on time of actual receipt by the Financial Agency and irrespective of the timing of the occurrence or the maturity of the claim or a request for payment.

²⁶¹ What is without prejudice to the necessity of registration with the FINA Registry for the purpose of creation of a registry security, having its effect towards third persons and being directly enforceable.

the assumption that the debtor's debtor is willing to cooperate) the option to control the income related to the respective receivables. This mechanism is particularly often used in case of a security assignment of insurance claims, where not only that insurance company is notified of the assignment but the relevant agreed loss payee clause²⁶² is inserted in the underlying insurance policy. Moreover, we find this mechanism as useful for all receivables where a debtor's debtor is solvent.

Identified issues:

Creditors should note that when they decide to use the relevant collateral, a review of the document(s) regulating the underlying transaction is highly advisable as the assignment (or pledge of the claims) may be prohibited or limited by the respective parties' agreement.

²⁶² Croatian: *vinkulacija*.

(c) Enforcement by way of private sale of collateral

The permissibility of a private sale of collateral within the enforcement process depends on the type of collateral securing the claim.

For instance, the sale of real property may be conducted only through a public sale.

On the other hand, movable property as well as rights which are not equalized with real property could be sold through out-of-court enforcement (i.e. including through private sale).

Identified issues:

With the exception of out-of-court enforcement of shares in joint stock companies (in book-entry form), which is recognized and well-developed in practice, the out-of-court enforcement process lacks legal certainty and parties fear that any out-of-court enforcement and private sale may be challenged. Consequently, it is hard to predict difficulties which could arise on the implementation of out-of-court enforcement.

In terms of *Recommendations for reforms* for improvement and attractiveness of out-of-court enforcement (including private sales), please see Section 6.3.

(d) Enforcement by way of public (auction) sale of collateral

Certain types of collateral may be subject only to a public sale (as noted for real properties). For real properties, most commonly used in practice is an electronic public auction.

The electronic public auction is conducted by the Financial Agency, upon request of the court. The notice on the sale of real property by electronic public auction is published on the Financial Agency's web-site. Exceptionally, the real property may be sold through a direct settlement. The parties, pledgees and the beneficiaries of rights which cease to exist following the sale may agree on such sale up to the moment of the sale of a real property within a public auction.

If requested by the creditor, the Financial Agency may perform an electronic public auction also for the sale of movables (otherwise the sale of movables is performed by the court bailiff).

Additionally, certain other collaterals may be subject to sale only in a particular manner, such as securities registered on the accounts held with the Central Depository and Clearing Company.

For *Issues* and *Recommendations for reforms* related particularly to public (electronic) auction, please see Section 12.4.

6.4 Exemption for enforcement requirements for financial collateral

A prerequisite for the realization of a financial collateral instrument is a failure to fulfil the secured obligation or any other event provided under the financial collateral arrangement or under the law, following which the beneficiary of the financial collateral is entitled to enforce the collateral either by its realization or seizure (including through set-off and/or netting), i.e. without the involvement of the court or any other third party.

6.5 Direct enforcement over funds on debtor's account(s)

As noted in Section 6.3.2(a), direct (out-of-court) enforcement over the funds on the debtor's account(s) is initiated by delivery of the payment basis²⁶³ to the Financial Agency either by the competent authority or the creditor itself. The payment bases are executed in priority rankings registered with the Financial Agency's Registry of Payment Orders (i.e., as noted in Section 3.3.2, irrespective of priority ranking(s) earlier saved (registered) with the FINA Registry in the respect of the debtor's account(s)).

We note here that the payment bases are registered according to the time of their actual receipt by the Financial Agency and, thus, this Section should be read together with the assertions made in Sections 3.3.2 and 6.3.2(a) above.

6.6 Bank guarantee

For general assertions regarding bank guarantees, please note Section 3.6 above.

In terms of enforcement, and given the fact that a financial (bank) guarantee provides a payment obligation irrespective of the underlying legal transaction, the bank is not in a position to raise any objections in respect of the underlying agreement for which the guarantee was issued.

Identified issues:

The Supreme Court of the Republic of Croatia expressed its opinion that the written request of the user should be accompanied by a written statement providing that the user's debtor has not (at all or properly) fulfilled its obligations. It is indeed advisable to take into account that court practice, which to a certain extent mitigates the risks occurring as a result of rather incomplete provisions applicable to bank guarantees.

However, bank guarantees may not serve the purpose of commencement of direct enforcement, as the same represent neither enforcement nor an authentic instrument. Hence, the bank's obligation for payment must firstly be determined in litigation and only after obtaining of the final decision, judicial (court) enforcement proceedings may be initiated. With regard to the average duration of litigation before Croatian courts, please see assertions made in Sections 7.1 and 12.3 below.

6.7 Enforcement cost

Enforcement proceedings costs include either public notary's costs or/and courts' fees, respectively, as well as paid advances. However, the parties usually also bear the costs of attorneys and translation costs, as well as certain other actual costs.

Costs related to court fees and representations of attorneys are determined with regard to the value of a claim. The enforcement creditor may request in the enforcement proposal from the court to render the enforcement resolution also with regard to the predictable costs of the enforcement proceedings (which is usually done in practice).

Identified issues:

The relevant costs must be paid in advance by the enforcement creditor. Ultimately, subject to successful enforcement, the enforcement debtor is obliged to compensate the costs of the enforcement creditor recognized by the court.

This may lead to certain practical difficulties. Namely, if the collateral is not sufficient for satisfaction of the claim, this may have the consequence that the enforcement costs will not be reimbursed.

In complex financing transactions, the court may not necessarily recognize and, consequently, award

²⁶³ Which documents represent the payment basis are prescribed under the Enforcement over Monetary Funds Act.

all costs incurred by a creditor (as the parties may agree so in underlying finance documents) but only those costs which were necessary for successful finalization of enforcement.

7. PROCEDURAL APPEAL

7.1 Appeal in judicial (court) enforcement of secured claims

The enforcement resolution rendered by the court may be subject to appeal within eight days of the delivery of the respective decision. The appeal is submitted to the first instance court (i.e. the court which has rendered the decision) which decides on the appeal (the appeal may be dismissed or accepted by the first instance court).

If the first instance court does not dismiss or accept the appeal, the course of the enforcement proceedings after the appeal has been filed will depend on the reasons on which the appeal is based.

The Enforcement Act provides an exhaustive list of reasons due to which the enforcement debtor (and in a limited number of cases the enforcement creditor) may file an appeal against the enforcement resolution.

Appealing on the particular grounds (as exhaustively listed under the Enforcement Act) may trigger the initiation of litigation. The purpose of such litigation would be to declare the enforcement as inadmissible, to suspend the enforcement and to abate the enforcement actions conducted so far. In these cases, enforcement debtors regularly also file a request for postponement of the enforcement while the litigation is in course.

If the appeal has been submitted on other grounds and the court finds the appeal unfounded, the relevant file will be delivered to the second instance court for decision making.

Considering the statutory provisions that, firstly, the appeal in the enforcement proceedings is not of a suspensive nature and, secondly, the terms for deciding on the appeal are limited by law, the submission of the appeal should not have, in regular circumstances, an impact on the duration of the enforcement proceedings.

Identified issues:

Problems occur as a result of the fact that many Croatian courts are overloaded with cases and, thus, they cannot meet the requirements imposed by law in terms of the specified timeframes. There is not, nor has there ever been, a mechanism which could affect the speed in decision making (for example through certain awards or benefit system for judges who meet either imposed or targeted requirements).

If the enforcement proceedings end up in litigation following an appeal, the enforcement debtors usually file also a request for postponement of the enforcement for the time period when the respective litigation is continuing.

There are several reasons for the courts' acceptance of such a postponement proposal by the debtor. Firstly, the enforcement debtor only needs to argue that he will suffer irrecoverable or hardly recoverable damage, as a result of enforcement (i.e. such damage need not actually be proved by the enforcement debtor). Further, a postponement of the enforcement necessarily means instant relief from a case for a certain time (what is important from the abovementioned perspective of overload of the courts) and, finally, it prevents a need for repeating of proceedings where the enforcement has been finalized but afterwards the reasons for the appeal would be found as justified in the litigation. Regarding available case law, we have noted that postponement of the enforcement proceedings is more common when the enforcement debtor is a natural person and the underlying relationship is not of a commercial nature.

This is the case mainly due to the fact that it is easier to make a plausible case that irrecoverable or hardly recoverable damage would occur to a natural person. Additionally, commercial entities are expected to act with higher level of diligence which also includes a higher level of expectations when

the same provide certain collateral or waive certain rights provided under the Enforcement Act.

In addition, by evaluation of the case law, we have noted that some important questions have been answered by the courts. For instance, a case law and a legal doctrine clearly indicate that potential future damage shall not be taken into account (but only the damage which would have occurred as a direct consequence of conducting of the enforcement).

Also, the courts have indicated that the size of the company or the fact that enforcement creditor is a foreign entity is not a sufficient reason for postponement of the enforcement.

Recommendations for reform:

Some of the market participants have indicated that the courts should reject appeals more often, rather than deciding to refer the parties to litigation or to refer the legal remedy to the second instance court (as described above), given that debtors' appeals in practice often contain reasons for appeal which are not provided for in the Enforcement Act and should therefore be subject to the (first instance) court's rejection. We agree with such expressed opinion by the market participants.

A commonly taken standpoint by the legal doctrine is that appellate reasons are to be interpreted restrictively. However, court practice is still not following this approach completely, which should not be the case, particularly having regard to the nature of the enforcement proceedings, as well as the fact that claims subject to enforcement are more or less determined under firm and final grounds.

A solution to this problem could be the issuance of exact standpoints taken by the highest court authority and afterwards their circulations to judges who are conducting enforcement proceedings. Additionally, given that amendments of laws are rather frequent in Croatia, a more appropriate solution would be the introduction of a periodical training system for all judges participating in enforcement proceedings which would follow every amendment of the law.

7.2 Objections available in out-of-court enforcement of secured claims

In enforcement proceedings before public notaries (i.e. on the basis of an authentic instrument), the enforcement debtor is entitled to file a complaint against an enforcement resolution rendered by a public notary. In this case, the public notary forwards the case to the court and the proceedings are continued as litigation (for more detailed overview we refer to Section 12.2 below).

This basically means that in most cases efficient and fast enforcement with public notaries, in respect of authentic instruments, is illusory, given that most enforcement proceedings conducted between legal entities end up in litigation.

A different situation is when the out-of-court enforcement over collateral which may be subject to such enforcement is in question. In this case, the jurisdiction of public notaries is wider and, moreover, it may depend on the parties' agreement and the framework set out for that type of enforcement.

7.3 Appeal in insolvency and winding-up proceedings and the process of challenging of claims

Pursuant to the Bankruptcy Act, the parties may appeal against a number of decisions rendered in the course of the insolvency proceedings. In general, the appeal does not delay the execution of the decision.

Amongst other decisions, a bankruptcy debtor is entitled to submit an appeal against the decision on opening of the insolvency proceedings. *Vice versa*, an appeal against a decision by which the proposal for opening of insolvency proceedings was denied may be submitted by the bankruptcy proponent.

Furthermore, every creditor is entitled to submit an appeal against the decision on identified and disputed claims, contesting the part of the decision which refers to its claim.

Additionally, if a creditor's claim, as listed in the abovementioned decision, has been disputed by the bankruptcy (or pre-bankruptcy) trustee, the court shall instruct the creditor to initiate litigation against the bankruptcy debtor. However, if the claim was disputed by another bankruptcy creditor, the court

shall instruct the bankruptcy creditor who has disputed the claim to initiate litigation against the creditor whose claim the same had disputed, which, in that case, acts on behalf of the bankruptcy debtor.²⁶⁴ Notwithstanding the fact that such matters are treated as urgent, the same may be time-consuming and prolong the duration of insolvency proceedings.

As per the winding-up proceedings, the Companies Act is silent on legal remedies available against a decision rendered during the liquidation proceedings. However, the Court Registry Act²⁶⁵ provides the right of appeal against the decision on deregistration of the resolution on deletion of the subject from the court registry.

8. IMPACT OF INSOLVENCY AND WINDING-UP PROCEEDINGS ON ENFORCEMENT

8.1 Exemptions to security enforcement from insolvency

Exemptions to the security enforcement from insolvency exist in relation to creditors with title over certain assets of the bankruptcy estate (i.e. creditors with exemption rights) and creditors with separate satisfaction rights as described under Section 4.2.5 herein. While enforcement proceedings initiated by the creditors with exemption rights will not be affected by insolvency proceedings, pending enforcement proceedings initiated by the creditors with separate settlement right (e.g. creditors with a mortgage or a pledge) will be interrupted and continued before the court conducting the insolvency. (For related *Issues and Recommendations for reforms*, please see Section 8.2.) Also, the creditors with exemption rights are allowed to enforce their rights outside the insolvency proceedings, while the creditors with separate settlement right could enforce their respective right only within the insolvency procedure.

8.2 Moratorium

For a period of six months after opening of bankruptcy proceedings, enforcement of claims against the bankruptcy estate is not allowed, except for claims which arise as a result of the bankruptcy trustee's activities (i.e. obligations undertaken by the bankruptcy trustee following commencement of the bankruptcy proceedings).²⁶⁶ Moreover, rights to assets which are part of the bankruptcy estate may not be validly acquired after the opening of bankruptcy proceedings, unless such acquisition refers to the disposal of the debtor (i.e. to the bankruptcy trustee) or to enforcement in favour of the bankruptcy creditor.²⁶⁷

The complex situation around the relevant applicable law and jurisdiction in relation to the conduct of enforcement proceedings after the opening of the bankruptcy should be additionally noted, given that it often occurs in practice. Pursuant to the final provisions of the Bankruptcy Act, the bankruptcy proceedings initiated before the respective act entered into force, must be completed in accordance with the rules of the previously applicable Bankruptcy Act,²⁶⁸ with the exception of certain specifically listed provisions. Those specifically listed provisions apply to all bankruptcy proceedings, regardless of the time of the opening thereof, unless the enforcement actions have been undertaken

²⁶⁴ One should note that during the insolvency proceedings, the parties have the possibility to appeal against a number of decisions rendered in the course of the respective decisions and thus influence the course of the proceedings. For example, the creditors with separate right of settlement as well as the bankruptcy trustee have the right of appeal against the decision for the sale of the debtor's property within the insolvency proceedings. (Article 247 par. 2 of the Bankruptcy Act).

²⁶⁵ Court Registry Act (Official Gazette nos. 1/1995, 57/1996, 1/1998, 30/1999, 45/1999, 54/2005, 40/2007, 91/2010, 90/2011, 148/2013, 93/2014 and 110/2015 – the "Court Registry Act").

²⁶⁶ Article 170 par. 1 of Bankruptcy Act.

²⁶⁷ Article 171 par. 1 of Bankruptcy Act.

²⁶⁸ Official Gazette nos. 44/1996, 161/1998, 29/1999, 129/2000, 123/2003, 197/2003, 187/2004, 82/2006, 116/2010, 25/2012, 133/2012, 45/2013 and 71/2015.

before the currently applicable Bankruptcy Act entered into force.²⁶⁹ Such provision is not clear given the fact the same does not imply which action would represent "*enforcement action*" and thus results with uncertainty by the courts both in respect of question of jurisdiction (as the same has changed by the new Bankruptcy Act), as well as in respect of applicable bankruptcy laws, as noted below.

Identified issues:

The Bankruptcy Act provides that enforcement proceedings pending at the moment of the opening of bankruptcy proceedings shall be suspended and continued before the court conducting the bankruptcy proceedings (i.e. the commercial court, as opposed to the municipal court which conducts enforcement proceedings in normal circumstances) under certain statutory conditions which have not been clearly defined. Therefore, the court continuing the enforcement proceedings, after the commencement of the bankruptcy proceedings, often raises the conflict of jurisdiction procedure before the Supreme Court of the Republic of Croatia and thereby causes a further delay of the enforcement proceedings.

The market participants have pointed this out as one of the main procedural obstacles in the course of judicial enforcement by creditors.

Recommendations for reform:

A solution for the problem requires a clear statutory determination as to which conditions have to be fulfilled for the interruption of enforcement proceedings and their continuation before the commercial court. A recent decision of the Supreme Court of the Republic of Croatia²⁷⁰ may be of assistance with respect to the determination of these conditions. In this decision the Supreme Court of the Republic of Croatia concluded that the bankruptcy proceedings shall be completed in accordance with the provisions of the Bankruptcy Act which was in force at the time of their initiation, which should be indicative and helpful for the courts for such future cases.

Additionally, a clear determination as to the scope of meaning of *certain enforcement action* is also necessary.

8.3 Pre-bankruptcy proceedings

The Bankruptcy Act provides that the initiation of enforcement is not allowed after opening of the pre-bankruptcy proceedings. Pending enforcement proceedings shall be interrupted.²⁷¹

Except for the creditors with separate settlement rights, the unsecured creditors can only settle their claims by reporting them in the pre-bankruptcy proceedings. Under assumption that creditors with separate settlement right do not waive their right to separate settlement, they will be allowed to settle their claims by initiating (or continuing already pending) enforcement proceedings.

In relation to the abovementioned, it is important to emphasize that the legal consequences of the opening of pre-bankruptcy proceedings occur at the moment of publishing the decision on opening on the court's e-notice board.²⁷²

Interrupted enforcement proceedings will be continued after the termination of pre-bankruptcy proceedings, however only with respect to the claims which have been denied in the pre-bankruptcy proceedings (i.e. if the claim of the involved creditor has been reduced by force of conclusion of pre-bankruptcy settlement, the same may not be further enforced after (successful) termination of the pre-bankruptcy proceedings).

Pre-bankruptcy proceedings have to be terminated – by way of having a court settlement with the

²⁶⁹ Article 441 of Bankruptcy Act.

²⁷⁰ Decision of the Supreme Court of the Republic of Croatia, reference number Grl – 39/2016, as of 16 February 2016.

²⁷¹ Article 68 par. 1 and 2 of Bankruptcy Act.

²⁷² Article 65 par. 1 of Bankruptcy Act.

involved creditors in place – within 300 days as of the opening of proceedings, which term may be exceptionally extended for an additional 60 days, if such extension would be purposeful for conclusion of pre-bankruptcy settlement.

The purpose of the pre-bankruptcy proceedings is to prepare a restructuring plan²⁷³ which needs to be adopted by a qualified majority of creditors (both in general and in creditors' groups). Based on such restructuring plan, the debtor enters into a court settlement with its creditors and continues its operations without bankruptcy and liquidation.

The approved restructuring plan is effective towards all creditors regardless of whether they have voted in favour of or against the plan, with an exception regarding creditors with separate settlement rights i.e. secured creditors.

Creditors with separate settlement rights i.e. secured creditors (including creditors whose claims are not affected by the plan) are not allowed to vote unless they waive their separate settlement right. If they waive their separate settlement right, they will be entitled to vote (and influence the adoption of the plan) but they will have to release their security or – in line with the restructuring plan – amend it.

Identified issues:

As noted in Executive Summary, pre-bankruptcy is a rather new concept in Croatian legislation and thus the same frequently opens certain questions in its implementation.

Recommendations for reform:

The same as for other new (or not frequently used) concepts, education of involved authorities and officials is critical for achieving the intended purpose in practice.

8.4 Insolvency proceedings

With respect to the impact of the opening of bankruptcy proceedings on enforcement, please refer to Section 8.3 above. Namely, the relevant provisions of the Bankruptcy Act apply accordingly in case of bankruptcy proceedings.

8.4.1 Initiation of insolvency proceedings and conducting of preliminary proceedings

Insolvency proceedings may be initiated in the event of either:

- (a) insolvency²⁷⁴ (i.e. the debtor is unable to meet its payment obligations in due time); or
- (b) over-indebtedness²⁷⁵ (i.e. the debtor's liabilities exceed its assets).²⁷⁶

The proceedings are opened by filing a proposal for initiation with the competent commercial court. The relevant proposal may be filed by a particular creditor or by the debtor itself.²⁷⁷ In certain cases the Financial Agency, as well as the debtor, is obliged to file the proposal for the initiation of the bankruptcy proceedings.²⁷⁸

Upon filing of the proposal, the competent court initiates the proceedings for determining whether the conditions for the opening of bankruptcy proceedings are met (preliminary

²⁷³ Restructuring plan includes both financial and operational restructuring measures.

²⁷⁴ Croatian: *nesposobnost za plaćanje*.

²⁷⁵ Croatian: *prezaduženost*.

²⁷⁶ Article 5 of Bankruptcy Act.

²⁷⁷ Article 109, par. 1 of Bankruptcy Act.

²⁷⁸ Article 110 par. 1 and 2 of Bankruptcy Act.

proceedings).²⁷⁹ ²⁸⁰ Within the scope of the preliminary proceedings the court schedules a hearing, following which, either a decision on the opening of bankruptcy proceedings or a decision on refusal of the proposal for the opening of the bankruptcy proceedings is rendered.²⁸¹

Identified issues:

Failure to initiate insolvency proceedings when such conditions are fulfilled, the passive attitude of the creditors as well as the failure to enforce sanctions against the authorised representatives of the debtor have led to existence of significant number of insolvent (or over-indebted) companies which continue to do business and assume additional liabilities. In addition, late initiation of bankruptcy proceedings has also led to the consequence that the debtor's assets are insufficient (or barely sufficient) for settlement of the creditors' claims.

As per the initiation of shortened bankruptcy proceedings,²⁸² certain issues may arise in practice. In relation to the course of the proceedings, the court invites the company's legal representatives to deliver the list of the company's assets and obligations certified by a public notary within 15 days as of publishing of the relevant notice.

However, the applicable legislation neither provides for a manner of verifying the accuracy of delivered list nor for the possibility of the court (or any other authorised body) establishing whether the company has any assets if the list has not been delivered. Accordingly, legal representatives (directors) may illegally dispose of all the assets of the company, because such conduct cannot be verified by any authorised body or any third party with a legal interest (i.e. creditors).

In any case, each creditor can engage in obtaining information regarding the debtor's assets whereby all of the issues emphasised in the Section 6.1 above should be noted.

Moreover, the creditors are invited to propose the opening of bankruptcy proceedings and to pay the costs of the proceedings in advance,²⁸³ within 45 days of the date of publishing the notice.²⁸⁴ In case that neither the debtor nor one of the creditors (at least) complies with the invitation, the court will render a decision on both the opening and the conclusion of the bankruptcy proceedings and the company will be deregistered from the court registry.²⁸⁵

It is common practice that the debtor's legal representatives do not act in accordance with the court's invitation.

Due to the difficulties with obtaining information on the debtor's assets (as described in

²⁷⁹ Article 115 par. 1 of Bankruptcy Act.

²⁸⁰ However, in some cases the court may render a decision on the opening of the bankruptcy proceedings without the preliminary proceedings being conducted (e.g. if determines that company is over indebted or insolvent on the basis of proposal for initiation of bankruptcy proceedings, if the proposal for opening of the bankruptcy proceedings is initiated by Financial Agency, etc.). (Article 116 of Bankruptcy Act).

²⁸¹ Article 128 par. 6 of Bankruptcy Act.

²⁸² Shortened bankruptcy proceedings are conducted if the following conditions are met:

1. the company has no employees;
2. the debtor has unsettled payment basis registered with FINA's Register on sequence of payment bases for 120 days continuously; and
3. if the conditions for initiation of another deregistration (from court registry) proceedings are not met. (Article 428 of Bankruptcy Act).

²⁸³ Max. HRK 20,000.00.

²⁸⁴ Article 430 of Bankruptcy Act.

²⁸⁵ Article 431 of f Bankruptcy Act.

Section 6.1), the creditors often do not manage to collect information on the assets within the period of 45 days and, in that case, can only propose the opening of the bankruptcy proceedings and pay the costs without knowing whether this will get them closer to satisfaction of their claims.

Further issues appear in relation to the Bankruptcy Act rule providing that the advance costs payment has to be effected jointly and severally by the creditors who proposed the initiation of bankruptcy. Creditor(s) usually do not know whether other creditors have already proposed such opening and if so whether they will advance the relevant costs.²⁸⁶

If the costs are not paid, the court will dismiss the proposal for the opening of the bankruptcy proceedings as inadmissible and thereby, as a consequence, the company must be deregistered from the court register.

Recommendations for reform:

The issue reflected in this Section can only be resolved on a national level by the state introducing effective mechanisms of asset control, as well as by insisting on application of the sanctions for non-compliant representatives of the debtor, as provided by law.

Also, creditors should communicate with each other regularly in order to avoid issues related to joint and several payments of the bankruptcy costs.

8.4.2 Insolvency estate administration and sale of insolvency estate

The bankruptcy estate administration is in the remit of the bankruptcy trustee. The bankruptcy trustee is obliged to take over the bankruptcy estate immediately after the opening of the bankruptcy proceedings and to make a list of the assets included in the estate (indicating the value of each asset).²⁸⁷ Furthermore, the trustee is obliged to liquidate the bankruptcy estate assets, in accordance with the decisions of the creditors' assembly and creditors' committee (if such committee is established).²⁸⁸

The assets are sold in accordance with the rules on the sale of assets within the enforcement proceedings.²⁸⁹ However, the creditors may agree on a different manner and conditions for the sale of the debtor's assets.²⁹⁰ As a specific rule of the bankruptcy proceedings, the real property of the debtor may be sold only through electronic auction before the Financial Agency (whereby the sale upon immediate agreement is excluded).

Identified issues:

According to the Bankruptcy Act, if the real property cannot be sold at the third auction (for at least ¼ of its determined value) it can be sold at the fourth auction for HRK 1. This rule has been introduced by the (new) Bankruptcy Act and it places separate creditors holding a mortgage over the real property in a less favourable position making their mortgage (i.e. separate right) basically worthless under certain circumstances.

²⁸⁶ The court usually do not give such information by the phone and written response is (in most cases) not provided in time for the creditors to make the decision on filing the proposal for opening of the bankruptcy proceedings.

²⁸⁷ Articles 216 par. 1 and 221 of Bankruptcy Act.

²⁸⁸ Article 229 par. 1 and 2 of Bankruptcy Act.

²⁸⁹ Movable assets may also be sold by negotiation. (Article 249 par. 1 of Bankruptcy Act).

²⁹⁰ Articles 229 par. 4, 247 par. 1 and 249 par. 1 of Bankruptcy Act.

Recommendations for reform:

A separate creditor with a first priority ranking mortgage should be able to acquire the real property by virtue of set off of its secured claim against the determined value of the property (as set out in the initial appraisal). Thus, such a creditor shall no longer have the right to participate in the bankruptcy proceedings, unless the appraised value of the real property is lower than the amount of the relevant creditor's claim recognized in the bankruptcy proceedings i.e. the secured creditor is unsecured for a portion of the secured debt.

Since the separate creditor acquires the title over the asset by virtue of set off, the asset will be considered as sold.

This mechanism enables the first ranking mortgage creditor to avoid the potential scenario where the real property would be sold for an insignificant amount, as described in first paragraph of this Section and/or where there are no buyers.

8.4.3 Settlement of insolvency creditors' claims and conclusion of insolvency proceedings

The distribution of cash (acquired through the sale of assets of the bankruptcy estate) is performed by the bankruptcy trustee, following the recovery of the cash. The distribution may start after the examination hearing,²⁹¹ while the consent of the creditors' committee is required prior to each distribution of cash.²⁹²

The obligations of the debtor related to the employment matters, including but not limited to claims of the debtor's employees (or former employees), state claims related to an employment matters and a severance payments, are placed in the first higher priority rank. All other claims are placed in the second higher priority rank.

However, both priority ranks do not include the claims related to the (a) interests to the creditors' claims occurred after the opening of the bankruptcy proceedings, (b) expenses of the creditors occurred within the bankruptcy proceedings, (c) fines for the criminal and/or misdemeanour acts, (d) free of charge transactions and (f) shareholders loans (i.e. subordinated loans). The latter claims will be settled only after the settlement of the first two priority ranks.²⁹³

Once the liquidation of the bankruptcy estate is finished, the final distribution of cash is conducted.²⁹⁴ As soon as the final division is completed, the court renders a decision on the conclusion of the bankruptcy proceedings. The respective decision is delivered to the court registry which then carries out the deregistration of the company from the court registry.²⁹⁵

8.4.4 Termination of insolvency proceedings

As regards to the termination of bankruptcy proceedings, it is important to note the inadequate statutory solution in case that the bankruptcy estate remains in existence after deregistration of the debtor from the court registry. If the bankruptcy estate is not sufficient to cover the costs of the bankruptcy proceedings, and the creditors do not agree to advance them, the court will render a decision on the termination of bankruptcy proceedings.

In such circumstances, pursuant to the Bankruptcy Act, the trustee may decide to continue with

²⁹¹ A hearing on which claims registered within the respective bankruptcy proceedings are being examined. (Article 130 par. 1 of Bankruptcy Act).

²⁹² Article 273 of Bankruptcy Act.

²⁹³ Articles 138 and 139 of the Bankruptcy Act.

²⁹⁴ Article 282 par. 1 of Bankruptcy Act.

²⁹⁵ Article 286 of Bankruptcy Act.

the liquidation of the bankruptcy estate. However, further liquidation is not the statutory obligation of the trustee and it depends merely on the will of the trustee.²⁹⁶

Identified issues:

Should any of the debtor's assets be found after the conclusion of the insolvency proceedings, the court will decide upon continuation of the proceedings. The main issue here is the non-existence of any legal manner of verifying the number of debtor's assets, especially if they are not entered into any public registry. Practically, in the majority of cases, only a debtor's real property is correctly determined (especially if it is encumbered) due to its value and high importance in legal relationships. The creditors must rely upon the information provided by the authorised representative of the debtor, i.e. bankruptcy trustee.

In addition, in the event that certain assets of the debtor are subsequently found after the insolvency proceedings have been terminated, the court has the ability to decide that a further division will not be conducted due to the insignificance of monetary assets found or the low value of the assets and due to the costs of continuation of the proceedings.²⁹⁷ That could also result in the situation of the continuing bankruptcy estate of a company which is already deregistered from the court registry, as explained above.

8.4.5 Insolvency plan – Solvency renewal administration (restructuring /investor step-in)

Pursuant to the Bankruptcy Act, it is permitted to make a bankruptcy plan by which the statutory provisions on the liquidation and division of the bankruptcy estate may be derogated from. The bankruptcy plan is submitted to the court by the bankruptcy trustee and is made in collaboration with the creditors' committee and the debtor itself. The Bankruptcy Act offers a range of possible solutions which can be incorporated in the bankruptcy plan. Among other things, the plan may provide that all or part of the assets may be left in the hands of the bankruptcy debtor with the purpose of continuation of its business or determine the way of settling the creditors' claims or transfer the debtor's obligations into a loan, etc.²⁹⁸

The bankruptcy plan made within the bankruptcy proceedings over PEVEC d.o.o. has often been emphasized as an example of a successful bankruptcy plan and consequently successful bankruptcy proceedings. Namely, the bankruptcy trustee's plan (with certain amendments) was adopted by 94,57 % of votes from the creditors' assembly. As per the aforementioned, it is evident that the preparation of a sustainable bankruptcy plan is primarily based on the compatibility of the creditors' interest, which is rarely the case in practice.

The main objectives of the plan were, *inter alia*, the continuation of business, the satisfaction of separate creditors of first and second higher priority ranking in a manner that it provides for a more favourable position as oppose to regular bankruptcy proceedings, preservation of the employment, etc. For achieving these aims, various methods were used, such as transformation of the claims of the second higher ranking creditors into company shares (debt-to-equity-swap), share capital decrease to cover the losses, merger of one company with another, etc.

Identified issues:

The duration of the proceeding involving a bankruptcy plan is highly dependent on the size of the debtor and the number of creditors participating in the bankruptcy proceedings, varying from a period of a year for extremely simple proceedings to up to a decade in a case of

²⁹⁶ Article 293 of the Bankruptcy Act.

²⁹⁷ Articles 302 and 289 par. 3 of Bankruptcy Act.

²⁹⁸ Article 303 and 304 of Bankruptcy Act.

complicated proceedings. The creditors having a separate settlement right are not allowed to vote with respect to the bankruptcy plan, unless they waive their separate settlement right. However, the same remarks on the issues of the debtor's affiliated companies being allowed to vote in favour of the restructuring plan in pre-bankruptcy proceedings²⁹⁹ applies here as well.

8.5 Winding-up proceedings

With regard to the general rule of the Enforcement Act on the appropriate application of the Civil Procedure Act, the enforcement proceedings shall be terminated in case one of the parties (legal entities) in the proceedings cease to exist.^{300, 301} For that reason it is important that the creditors of the company in a winding-up proceedings register their claims within the relevant proceedings, in accordance with the liquidator's call as mentioned under Section 4.2.5 herein.

8.6 Deregistration *ex officio* of a subject from the court registry

The Court Registry Act provides the reasons for deregistration *ex officio* of a subject from the court registry (e.g. in cases where the company has no assets or has assets of insignificant value, if the company did not coordinate with the regulation it was required to coordinate with within the specified deadline, if the company did not submit its financial statements for three consecutive years, etc.).

The decision on initiation of the deregistration proceedings is registered with the court registry and published on the court registry's website.

Such a publication has the effect of the delivery of the aforementioned decision to the company being subject to deregistration proceedings (and to its legal representatives), as well as to all potentially interested parties (including creditors). The company subject to deregistration, or other parties having a legal interest, could object to such decision due to the non-existence of statutory reasons for deregistration *ex officio*, initiated bankruptcy, pre-bankruptcy or liquidation proceedings over the company or submitted proposal for initiation of bankruptcy or pre-bankruptcy proceedings.³⁰²

However, it is a common practice that such objection is not filed (even where the reason thereof indeed exists), due to the delivery of the decision through the court registry's website, which results with the fact that potentially interested third parties are not even aware of the respective deregistration proceedings being in course.

Identified issues:

As noted above, a decision on initiation of the deregistration *ex officio* proceedings is registered only with the court registry and published on the court registry's website. By such publication, the respective decision is deemed to be delivered, not only to the involved company, but also to any potentially interested party. This literally means that the creditor would need, for each of its debtors, regularly open the relevant court registry's website in order to determine whether the deregistration *ex officio* decision has been rendered against any of the companies in which it is interested.

Namely, unlike for decisions adopted in insolvency proceedings, there is no publication mechanism implemented with respect to publication of decisions aimed for deregistration of the company *ex officio*.

²⁹⁹ Please see Subsection 8.3.

³⁰⁰ Article 21 of Enforcement Act and Article 212 point 4 of Civil Procedure Act (Official Gazette nos. 4/1977, 36/1977, 36/1980, 6/1980, 69/1982, 43/1982, 58/1984, 74/1987, 57/1989, 20/1990, 27/1990, 35/1991, 53/1991, 91/1992, 112/1999, 129/2000, 88/2001, 117/2003, 88/2005, 2/2007, 96/2008, 84/2008, 123/2008, 57/2011, 25/2013 and 89/2014).

³⁰¹ Upon completion of winding-up proceedings the company shall be deregistered from the court registry and ceases to exist.

³⁰² Article 70 of the Court Registry Act.

Recommendations for reforms:

Having regard to the fact that such decisions are adopted by commercial courts acting by their right of service (and irrespective of the fact that certain service providers provide services of notifying their clients on the respective occasion), there is no obstacle for implementation of publication mechanism also in the case of rendering of deregistration *ex officio* decisions, particularly given the fact that the same may result in cessation of the company and, in this case, leave creditors permanently unable to settle their claims or meet their other justified interest.

8.7 Financial collateral: close-out netting and treatment in insolvency procedure

The realization of rights and obligations arising under financial collateral arrangements (including the option for early termination and close-out netting) are made in accordance with such arrangements and irrespective of the initiation of insolvency or winding-up proceedings, or the implementation of restructuring measures, respectively.

Moreover, regardless of the fact that the bankruptcy plan normally allows quite wide deviations from the applicable insolvency laws, neither the bankruptcy plan may affect the rights acquired under the financial collateral arrangements. In addition, these special rules apply also in terms of available claw-back provisions.

9. FINANCIAL (CONSENSUAL) RESTRUCTURING AND OTHER WORK-OUTS

9.1 Standstill

Without prejudice to the mandatory provisions applicable to certain types of claims, as well as for certain aspects of insolvency proceedings, voluntary standstill are an available option under Croatian law.

However, there are a very few examples where such a standstill arrangement and a consensual work-out have been used in practice. The reasons for this are diverse and depend on various circumstances.

In general, business entities' creditors are usually mutually conflicted in their interests, further, in terms of insolvency, in most of the cases also the state has a significant portion of outstanding claims, and, finally, in case of large companies there is usually a significant amount of employees' claims. Hence, regardless of the fact that such option exists under Croatian law and has clear advantages both in respect of the creditors and in respect of the relevant debtor, the same is not typically used in Croatia.

9.2 Extraordinary administration introduced for systematically important companies

Act on Extraordinary Administration Procedure enacted in 2017 has been introduced with the aim of the protection of the continuance of business operations of systemically important companies.

For now, such proceedings have only been conducted in respect of company Agrokor d.d. (and its affiliated companies), and have resulted in adoption of a final settlement.

Here should be noted that, at this moment, no other company in Croatia meets the requirements provided in the Act on Extraordinary Administration Procedure for the initiation of such proceedings. I.e. there is no other company which would be considered as a *systematically important* in terms of the Act on Extraordinary Administration Procedure.

Ever since the respective Act entered into force, the same is subject to public debates. The legal doctrine had raised some questions in respect of the legality of certain provisions and certain difficulties which might be met in practice: ignorance of the need to protect the creditors in the described aim of this Act (Article 1); the state has been granted with authority powers which allow a high level of interference in private relations (Articles 11 and 16); separate satisfaction rights, arising under granted security interests, may not be enforced within extraordinary administration proceedings

(Article 41 par (5)); an irrationally long timeframe provided for the conclusion of the proceedings (15 months) (Article 47); lack of compliance with EU laws and many others. However, irrespective of these objections and questions, the Constitutional Court of the Republic of Croatia confirmed that the respective Act is in compliance with Croatian Constitution. Moreover, the same is also recognized by the EU as being in compliance with *acquis communautaire*.

Identified issues:

Since the Government of the Republic of Croatia nominates the trustee (subsequently appointed by the court), it could be expected that this will influence the choice of trustee by the court on the grounds of political preferences. Even more so, creditors are not authorized to exercise control over the choice of the trustee or require his dismissal if the trustee does not perform his duties properly.

Further, creditors with separate settlement rights are not allowed to exercise their rights (i.e. to liquidate the encumbered property) during the extraordinary administration proceedings. Such provision restricts the rights of creditors with separate settlement, which directly contradicts the purpose of obtaining of security interests.

Execution and conduct of civil, enforcement, administrative proceedings, as well as out-of-court settlement against the debtor (and its affiliates encompassed by the proceedings) are not allowed during the extraordinary administration proceedings. This might result in creditors and/or suppliers refusing to enter into business with these companies because of the uncertainty regarding payment, i.e. enforcement thereof.

Recommendations for reform:

From the creditors' perspective, the most sensitive issue is the fact that no separate settlement right may be enforced while the extraordinary administration proceedings are in course. This is particularly problematic from the perspective that the rule applies also towards the security instruments which have been provided prior the Act entered into force.

While the purpose of the Act on Extraordinary Administration Procedure is to encourage reorganisation and survival of the debtor's business and employment, meaning that some form of moratorium on creditor action is indeed needed, further consideration should be given to the role of secured creditors. Future amendments to the Act on Extraordinary Administration Procedure should take into account this perspective.

10. TRANSFER OF LOANS (NPL SALE)

10.1 General regulatory requirements and obstacles for security transfer

As a general rule set by the Civil Obligations Act, claims can be transferred to a third party. There are a few exceptions: if such transfer is prohibited by law, if the claim is of a strictly personal nature or if the claim cannot be an object of transfer due to its nature.

Pledges represent accessory rights, which follow the secured claim. In that light, both the Ownership Act and the Civil Obligations Act provide that, together with the claim, accessory rights, including pledges are also transferred. Such express provisions of both acts leave the impression that, for the transfer of securities, no further requirements are needed. Speaking from the perspective of the *ex lege* transfer of accessory rights, that is indeed the case, however, in terms of registry rights and potential enforcement, further formalities must be satisfied.

Therefore, while the Civil Obligations Act and the Ownership Act do not provide for any specific requirements related to the form of the transfer agreement, if certain security (e.g. mortgages) is to be transferred along with the claim, the agreement should have the form of a public deed or a notarized

private deed,³⁰³ which will provide a basis for the transfer process with the relevant registry.

In addition, if the claim reported in the bankruptcy proceedings is the subject of the transfer, a particular formality in relation to the agreement is also required by the Bankruptcy Act, as mentioned under Section 10.2 herein.

10.2 Form of transfer (notices, consents)

In respect of notices and consents, notice to the debtor as to the change of the creditor is mandatory.

Parties to a particular transaction may limit the transferability of rights and obligations arising thereunder by their contract, whereby either the consent of the debtor may be required (if the assignment has been made subject to the debtor's consent) or, if the parties have excluded the option to transfer, a waiver of the provision providing such exclusion will be needed. Accordingly, a potential purchaser must always be well aware of the terms and conditions of the underlying legal relation.

If the bankruptcy creditor transfers the claim, it may be recognized in the proceedings only upon the public (or publicly notarised) document or upon such consent of the bankruptcy creditor given before the court.

10.3 Issues relating to collateral transfer

As noted under Section 10.1 above, collaterals are the subject of assignment together with the assigned secured claim. Regardless of the lack of the formalities imposed by the Ownership Act and the Civil Obligations Act, when registry rights or securities (or other collaterals which impose certain formalities) respectively are in question, either a public deed or a notarized private deed is needed in order for the respective collaterals to be successfully transferred.

Identified issues:

As indicated in Section 5.1.1, it is quite unclear, and subject to different interpretations in practice (including courts' practice) whether a "*notarized private deed*"³⁰⁴ entails the notarization of signature(s) or the solemnization (i.e. notarization as to the content) of the document by which the claims and collaterals were transferred. While we are of the opinion that a *notarized private deed* requires the need for a higher level of formalities, which was previously also interpretation of case law, more recent views indicate that a notarization of the signature shall suffice.

Specifically, two of the second instance courts (i.e. the courts of appeal) have expressed their different views in relation to the form of the agreement, while the Constitutional Court of the Republic of Croatia confirmed that the notarized signature would suffice. However, since the first instance courts are not directly bound by the decision of the higher instance courts, different practice contributes to the legal uncertainty.

Recommendations for reform:

Solemnization of the private deed, having the higher level of formality, would in any case be more efficient for the purpose of avoiding the abovementioned uncertainties as it would have to be accepted by every court. However, the solemnization of the private deed often involves significantly higher expenses (e.g. fees of the public notary).

³⁰³ Please see the Subsection 10.3.

³⁰⁴ As provided under the applicable Enforcement Act.

10.4 Compliance with banking secrecy, data protection, requirement for licence and permits

Regulatory requirements, including those in relation to a banking secrecy, data protection and licensing, must be followed by the purchaser of the claims. In most cases there are no particular difficulties related to such requirements, except when the same include the involvement of state authorities, in which case obtaining them may be time-consuming. Non-compliance with the respective rules usually results in a misdemeanour liability.

Generally, the obligation of the bank (or a credit institution) to preserve banking secrecy does not apply to the case when the bank (or a credit institution) is realising the sale of its claims.

10.5 Taking over by NPL purchaser of any existing enforcement procedure

Enforcement proceedings may be commenced or continued, respectively, by a person who is not listed in the enforcement deed as creditor, provided that the same proves under a public deed or private notarized deed that the claim has been transferred. The consent of the enforcement debtor is not required. (For related implications, please see Section 10.3 and thereto related Section 5.1.1)

11. DEVELOPMENTS IN LEGISLATION AND PRACTICE ON ENFORCEMENT OF CLAIMS

11.1 Legislative acts

Recent amendments of the Enforcement Act which entered into force on 3 August 2017 and 1 September 2017 are mostly focused on the protection of the natural persons by way of a higher protection of the debtor's only real property and the amount of salary being excluded from the enforcement.

Other significant amendments are related to the postponement of the immediate transfer of the debtor's funds to the creditor, which was previously the case in relation to all deeds which represent the basis for direct (out-of-court) enforcement with the Financial Agency (now this option is reserved only for some of them).

For example, debenture bonds have previously been used for direct and immediate seizure and transfer of funds (if available on the debtor's accounts). In accordance with newly implemented amendments, the seizure of funds can be made immediately, but the transfer of the relevant funds seized is postponed for at least 60 days. For a more detailed overview regarding this issue please see Section 3.3.4.

Some amendments on the other hand have a more positive effect for the creditors. For example, the scope of deeds which represent the basis for direct (out-of-court) enforcement with the Financial Agency has been extended to the European enforcement order³⁰⁵ and the European order for payment,³⁰⁶ which was previously not the case.

In addition, provisions on the implementation of the Regulation 655/2014 on the Establishing of a European Account Preservation Order procedure to facilitate cross-border debt recovery in civil and commercial matters have been inserted into the Enforcement Act.

Besides recent amendments in the Croatian enforcement system, in July 2017 a new piece of (rather controversial) legislation entered into force – the Act on Nullity of Credit Facility Agreements executed in the Republic of Croatia on a Cross-border Basis with Unauthorized Creditors.³⁰⁷ The Act

³⁰⁵ On basis of the Regulation 805/2004 of the European Parliament and of the Council.

³⁰⁶ On basis of the Regulation 1896/2006 of the European Parliament and of the Council.

³⁰⁷ Croatian *Zakon o ništetnosti ugovora o kreditu s međunarodnim obilježjima sklopljenih u Republici Hrvatskoj s neovlaštenim vjerovnikom* (Official Gazette no. 72/2017).

provides that a credit facility agreements executed with an *unauthorized creditors* are null and void. *Unauthorized creditors* are defined as creditors who provide services on the territory of the Republic of Croatia, but who have not met requirements provided under applicable special laws (whereby a reference to particular *special laws* is not provided in the respective Act).

For now, there are several issues recognized with respect to this Act, which resulted with significant legal discrepancies in relation to the laws enacted before entering into force of the respective Act and, moreover, which are contrary to certain principles of Croatian Constitution. For instance, the Act is envisaged to be applied retroactively, i.e. irrespective of the moment of execution of the credit facility agreement. Secondly, a referral to the Act by the side of a debtor may affect already initiated enforcement proceedings and we were informed (on unofficial basis) that the debtors indeed abuse such option.

Further, in discussions with a certain authorities (including Croatian National Bank, which is authority competent for regulatory questions regarding credit institutions, and the Ministry of Justice), we found out that these bodies are also of the opinion that the scope of the Act is completely unclear and questionable from the above mentioned perspectives.

We are of the opinion that the intention and the scope of the Act, as well as questionable retroactive application of the same, are the questions which should be urgently dealt with by the side of competent authorities and the legislator.

11.2 Court practice

One of the most relevant decisions in favour of creditors within the enforcement proceedings is the one rendered by the Constitutional Court of the Republic of Croatia in 2011. Between two opposing interests – on one hand, the principle of reliance on land registries when a mortgage has been created over the whole real property and, on the other hand, the interest of the subsequent establishment of co-ownership on the basis of property acquired during the course of duration of marital alliance, the court ruled in favour of the principle of reliance on land registries.

Namely, it is often the case in practice that one spouse, registered as the sole owner of the real property, creates a mortgage over the whole real property, without the consent of the other spouse. Given that only one spouse is not allowed to dispose with matrimonial property without the consent of the other, such legal transactions have in the past been declared as null and void.

However, the above mentioned court decision protected the interest of creditors and ruled that the creditor's expectation to be able to enforce against the whole real estate, over which mortgage was created, represents a higher level of interest than regulations governing collective ownership. Courts have recognized the importance of protection of creditors' rights even in relationships with natural persons.

Case law has made significant developments with regard to out-of-court enforcement. The County Court in Zagreb in a decision of 2014 has asserted two important facts: firstly, courts do not participate in an out-of-court enforcement and, secondly, the Enforcement Act does not apply. Such decision clearly states that an out-of-court enforcement represents autonomous proceedings in which intervention of the courts or the application of the Enforcement Act (unless agreed between the parties), respectively, is not allowed.

PART (B) INSTITUTIONAL FRAMEWORK REVIEW

12. INSTITUTIONAL FRAMEWORK REVIEW

12.1 Summary

1. *Role of Public Notaries / Judgments of the Court of Justice of the European Union* – the recent standpoint of the Court of Justice of the European Union indicated that public notaries in Croatia, when acting in enforcement proceedings on the basis of an authentic instrument, cannot be deemed as courts within the meaning of the Brussels I Regulation or for the purposes of application of the Regulation on the European Enforcement Order. This may significantly affect the role and position of the public notaries in Croatia and may threaten the efficiency of the out-of-court enforcement over the debtor's assets located in another Member State. According to working versions of the new Enforcement Act available in media (i.e. the same does not represent official draft), it seems that the intention of the new Enforcement Act is to reflect the ECJ's standpoint. Namely, public notaries would no longer be authorized to adopt enforcement resolutions (on the basis of an authentic instrument), but only to prepare a draft thereof and deliver the same to the court for deliberation. We are not sure if this shall have positive impact as to the perspective of the efficiency of the enforcement proceedings in Croatia (particularly in respect of the Key Determinants taken into account for the purpose of this report). Moreover, we are of the opinion that this represents the topic which should be further discussed with the EU bodies (as certain exceptions are provided for in Hungary and Sweden). In addition, simplified fast track proceedings before the court which would issue payment orders could be introduced instead. For a more detailed analysis of this question please refer to Section 12.2;
2. *Objection against Public Notaries' Enforcement Resolution* – a debtor's objection against public notaries' enforcement resolution ends up in the litigation by the force of law, irrespective of the challenging reason. This leads to the situation that the enforcement is significantly prolonged (i.e. until conclusion of litigation by a final court's decision), although the objection may be completely ungrounded. For a more detailed analysis of this question please refer to Section 12.3;
3. *Registration of more than one security interests in the same registry folder of the FINA Registry* – we have faced certain problems in relation to registration and subsequent deletion of securities with the FINA Registry. When a party aims to release one out of more securities previously registered within the same registry folder, the FINA Registry tends to delete the entire folder, notwithstanding the fact that the request for the deletion of the security has been directed only towards one (out of more) registered securities. Currently the only solution to this problem is to register securities within separate folders, i.e. to separate the applications for registration into independent application forms. For a more detailed analysis of this question please refer to Section 12.5.2;
4. *Maritime Liens* – the enforcement proposal for initiation of court enforcement over a ship should contain also information on known maritime liens, whereby the creditor has no certain way of gaining knowledge about existing maritime liens, as these represent statutory liens and are not subject to registration with a public registry. A solution to this issue would be the establishment of a registry regime for the maritime liens. For a more detailed analysis of this question please refer to Section A1.1.1;
5. *Aircraft Registry* – although available on-line, data contained in the electronically held Aircraft Registry is being updated every first day of the month. In order to obtain the

latest information, users are instructed to directly address the CCAA for the extraction of current data from the manually kept main book of the Aircraft Registry. In order to be more transparent and user friendly, the information available on the electronically held Aircraft Registry should be updated upon every change thereof. For a more detailed analysis of this question please refer to Section 12.5.4.

12.2 Public Notaries

Public Notaries are persons of a public trust and independent carriers of the public notary services³⁰⁸ having a significant role in the creation of securities and out-of-court enforcement in Croatia.

Parties may solemnize a private deed³⁰⁹ on a legal transaction with the public notary ("**Solemnized Private Deed**"). The Solemnized Private Deeds are equal to the public deeds. In this case, if the Solemnized Private Deed determines certain obligation³¹⁰ and contains a statement of the obligor that on the basis of the Solemnized Private Deed immediate enforcement may be commenced, it represents also an enforceable deed.³¹¹ Security interests provided in Croatia (particularly for more sophisticated transactions) are regularly provided in the form of Solemnized Private Deed.

In addition, public notaries have a significant role within enforcement proceedings as authorities competent to decide on enforcement proposals based on authentic instruments.³¹² Once adopted by the public notary, the enforcement resolution must be delivered to the debtor. If the enforcement resolution is directed towards enforcement over debtor's accounts receivables held with the bank or in general over the debtor's property and becomes final and binding, the creditor may directly enforce the debtor's funds with the Financial Agency (out-of-court enforcement).

Identified issues:

A recent decision by the Court of Justice of the European Union³¹³ indicated that the public notaries in Croatia, when acting in enforcement proceedings on basis of an authentic instrument, cannot be deemed as courts either within the meaning of the Brussels I Regulation or for the purposes of application of the Regulation on the European Enforcement Order.

These findings have significant impact on equal treatment of subjects from Croatia and those who originate from another EU Member States. Hence, public notaries' decisions based on authentic instruments are enforceable only within the Republic of Croatia, which means that the creditor is not authorized to conduct enforcement over debtors' assets outside of Croatia, i.e. in another EU Member State.

Findings of the Court of Justice of the European Union are in line with the definition of the court from Article 2 of the Brussels I Regulation. However, pursuant to Article 3 thereto, for the purposes of the Brussels I Regulation, the term "court" includes also notaries competent for issuance of orders to pay in Hungary as well as the Enforcement Authority competent for the issuance of orders to pay in Sweden.

Enforcement proceedings based on authentic instruments are initiated in front of public notaries.

However (as also noted by market participants), debtors commonly misuse their right to complain

³⁰⁸ Article 2 of the Public Notary Act (Official Gazette nos. 78/1993, 29/1994, 162/1998, 16/2007, 75/2009 and 120/2016 – the "**Public Notary Act**").

³⁰⁹ Provided the same have prescribed form and content.

³¹⁰ Which may be subject to Parties' settlement.

³¹¹ Public Notaries provide certificates on the enforceability of their deeds.

³¹² Authentic instruments are invoices (including calculation of interests), bills of exchange, check with protest, public deed, excerpt from business books, certified private deed and deed which is deemed to be a public deed on basis of special laws.

³¹³ Judgements no. C-484/15 and C-551/15.

against the public notary's enforcement resolutions in order to delay the enforcement. Filing a complaint against the enforcement resolution based on authentic instruments postpones its finalization and leads automatically to a litigation procedure in front of the court which takes substantial amount of time (as explained in Section 12.3 below).

Recommendations for reform:

Given that Croatia entered into the European Union on 1 July 2013, specific competence given to Croatian public notaries could not have been taken into consideration at that time (as it was taken into account for Hungary and Sweden) and therefore the Brussels I Regulation would need to be amended to specifically mention Croatian notaries.

Given the substantial issues the enforcement proceedings based on authentic instruments suffer due to the fact that the same are currently conducted by public notaries and debtors commonly object the public notaries' decision, simplified fast track proceedings in front of the court which would issue payment orders could be introduced as an alternative.

12.3 Courts

Generally, municipal courts are competent to order and to conduct enforcement proceedings (except in case of initiation of the bankruptcy proceedings, in which case the commercial court may be responsible, as noted in Section 8.2).

Identified issues:

The most significant issue regarding enforcement in Croatia is the duration of enforcement proceedings before the courts. This is mostly as a result of the debtor's ability (or a third person's ability) to obstruct the enforcement through available legal remedies.

An appeal against the enforcement resolution does not have a suspensive effect on the enforcement itself (for more detailed clarification of the appeal procedure within court enforcement we refer to Section 7.1 above). However, the enforcement debtor may cause the postponement of the enforcement, provided certain conditions are met. In a case the postponement is granted by the court, no enforcement action can be performed during that time.

As postponement of the enforcement proceedings is generally related to the determination of a certain appellate reasons in the litigation, the duration of the postponement depends on the duration of the related litigation (as noted in Section 7.1).

The average duration of a litigation before Croatian courts last from three up to five years before rendering of a final decision (which is usually rendered only upon decision of an appellate court). This term depends on numerous circumstances, including a complexity of the case, overall number of cases being resolved by the first instance court, attitude of parties to the proceedings, the judge, etc.

In addition, market participants have indicated that the procedural steps for the delivery of decisions to the debtor may also have significant impact on the duration of the enforcement proceeding,³¹⁴ as well as the fact that courts (regardless of the fact that the appeal against an enforcement decision is not of suspensive nature) commonly decide to stay the proceedings until the decision related to the filed appeal is made.

Further, as noted by some market participants, although the Enforcement Act provides short terms for rendering of both first and second instance decisions, this is often not the case in practice, i.e. often judges do not meet prescribed deadlines due to a large number of accumulated cases in front of the courts and an insufficient number of judges in some courts (for additional references, note Section 6.2).

³¹⁴ Repeated delivery in case of unsuccessful first delivery, publication on the e-notice board etc.

Recommendations for reform:

Given that the structure of the enforcement proceedings allows debtors several possibilities to obstruct the time-efficient conclusion of the enforcement proceedings, the new Enforcement Act should envisage measures aimed at increasing efficiency. For example, the introduction of new IT solutions which would secure an electronical communication and a delivery of documents between parties to the proceedings (at least in case of enforcement of commercial claims) could lead to faster and more efficient enforcement proceedings. This requires a change of basic provisions of the Enforcement Act, but also of the Civil Procedure Act (to the extent to which the Enforcement Act refers to the Civil Procedure Act).

More importantly, the court should be able to communicate with other authorities and registries electronically rather than via postal services.

Additionally, the new enforcement legislation should simplify grounds for legal remedies as well as the proceeding connected to it.

A significant step forward would be also made with the introduction of a legal framework for out-of-court enforcement, which would make the concept more attractive for commercial parties and would consequently release the courts from a certain number of future cases. (For more detailed review, please see Section 6.3).

A system of awards and benefits for the judges who meet prescribed terms for rendering of decisions in the enforcement proceedings could provide an incentive for the judges to terminate the proceedings along the prescribed terms and, consequently, to be more restrictive when deciding on the debtor's appeals.

Finally, the new Enforcement Act should be applicable to all enforcement cases, including the ones already in course, rather than to make exemptions and apply different legal provisions to the same proceedings depending on when the provisions entered into force. If the new Enforcement Act shall indeed provide solutions for the existing efficiency issues, this will also help the efficient resolving of already pending proceedings and help to prevent the overloading of the courts.

12.4 Financial Agency

The Financial Agency has a significant role in the direct (out-of-court) enforcement of debtor's funds.

Namely, as the Financial Agency is the authority competent for holding of the Unique Registry of Accounts, the Financial Agency, upon request of the creditor, performs seizure and transfer of all funds available on the debtor's bank accounts.

In addition, the Financial Agency has an exclusive competence for the sale of real properties within the enforcement proceedings by electronic public auction.

Once the decision on the sale of an asset which is subject to enforcement is rendered by the court, the same is delivered to the Financial Agency. The decision on sale of an asset contains the value of the asset, as well as the terms and conditions of the sale. In addition to the real properties (in which case only Financial Agency conducts electronic public auctions), if requested by the creditor, the Financial Agency may perform electronic public auction also for the sale of movables (otherwise the sale of movables is performed by the court bailiff).

The Financial Agency charges a fee for the sale of assets which must be paid by the creditor in advance, otherwise the auction shall not be performed.

Identified issues:

Although the legislative framework for electronic public auction exists since 2015 in Croatia, we note that (according to unofficial information) only a small number of real properties and movables have been sold electronically via the Financial Agency. The reason for this may lie with the fact that the electronical review of real properties listed in the register for electronic auction is very time consuming. We also note that in many cases, the (physical) review of the property is possible only

on one particular day within the time frame set by the court bailiff (who is in charge of the review of the property). This means that a lot of potential buyers may not have a chance to see the property given the tight timeframe for its review set by the bailiff.

Recommendations for reform:

The auction system should be reformed to be more simple and *user friendly*, and should provide secure access to its users.

In addition, to facilitate more sales by auction, the court bailiff, who is in charge of the physical reviewing of the property subject to sale, should be required to offer more than one appointment to view the property and should provide potential buyers with sufficient time to see the property.

These recommendations could be implemented through (amendments to the) bylaws governing the procedure for implementation of the sale of real estate and movable property in enforcement proceedings (Bylaw on Manner and Procedure for Sale of Real Properties and Movables in the Enforcement Proceedings³¹⁵ and Bylaw on Content and Manner of the Registry of Real Properties and Movables subject to Sale in the Enforcement Proceedings³¹⁶).

12.5 Competent bodies of registry system

12.5.1 Land Registry

Land Registries keep the records on legal position of real properties and are publicly available.

Land Registry books are held with municipal courts in electronic form³¹⁷ and certified excerpts thereof are equal to public deeds.

The land registry consists of the main book (which is divided into land registry folders) and the collection of documents. Besides general information³¹⁸ on a real property (A folio), a land registry folder also contains information on ownership rights (B folio) and encumbrances³¹⁹ over the real property (C folio).

According to Land Registry Act, the land registry truly and completely reflects the legal and factual status of the land.

Subject to registration with the land registry are real rights, certain obligation relations³²⁰ and certain other facts important for the status of the real property.³²¹ A priority ranking of the registration with the land registry is determined on the moment of application of a registration request to the land registry court³²² (for details please see Section 4.2.1). Assignment of priority ranking of registered rights is permissible, provided certain conditions are met (for details please see Section 4.2.3 above).

Registration with the land registry is of a constitutional nature for the acquisition of ownership or the creation of mortgages based on a legal transaction.³²³ This applies accordingly for the

³¹⁵ Official Gazette no. 156/2014

³¹⁶ Official Gazette nos. 115/2012 and 156/2014.

³¹⁷ Available on the web page address: <https://oss.uredjenazemlja.hr/public/lretracts.jsp?action=publicLdbExtract>.

³¹⁸ As noted above in Subsection A1.1.1(a).

³¹⁹ Including but not limited to mortgages.

³²⁰ Such as concession right, pre-emption right, right to repurchase, lease and rent. In case of these rights, registration with the registry shall be only of declarative nature.

³²¹ Such as whether the real properties is subject to dispute, which result could affect real rights registered thereunder.

³²² Submissions made at the same time have the same priority ranking.

³²³ Unlike for the acquisition based on court's decision or the law.

acquisition of other real rights.

Identified issues:

For issues related to the land registry system we refer to Section A1.1.1(a) (Land Registry) above.

12.5.2 Financial Agency's Registry of Courts' and Notary Publics' Securities of Creditors' Claims over Movable Assets and Rights

The FINA Registry is electronically kept³²⁴ and publicly available.³²⁵

The FINA Registry consists of the main book (which is divided into registry folders) and the collection of documents. Subject to registration with the FINA Registry are rights and measures which are not subject to registration with any other public registry; such as pledge over movables, rights, business shares, floating charge, retention rights, certain measures etc.

Registry security interests are acquired at moment of registration with the FINA Registry. In case of voluntary providing of registry security interests, an executed agreement in the required form is a precondition for registration with the FINA Registry in accordance with the Enforcement Act and Registry Act. Subject to the proper application and fulfilment of other prerequisites, the security interest is acquired on the day, hour and minute when the application was submitted to the FINA Registry.

The Registry Act provides eight days' term for rendering of a registration decision.³²⁶ Pursuant to our earlier experience with FINA Registry, the Financial Agency registration offices comply with this term, which makes security registration time-efficient, what is particularly important in terms of finalization and closing of large projects and transactions.

Identified issues:

One of the most notable issues in practice which may arise with the FINA Registry is related to the registration and the subsequent deletion of securities. When a party aims to release one out of more securities previously registered within the same registry folder, the FINA Registry shall delete the entire folder, notwithstanding the fact that the request for the deletion of the security has been directed only towards one (out of more) registered securities.

Recommendations for reform:

The said problem does not occur as a result of loopholes in legislation but rather due to omissions of the competent authority.

Currently the only solution being often advised to the creditors is to register securities within separate folders, i.e. to separate the applications for registration into independent application forms. This way, a potential future security release will be possible only towards one out of more registered securities and creditors' interest will be properly protected.

For other practical issues, such as complete data about securities over all movable assets and rights, different approaches when describing the securities and questionable transparency concerning determination of certain security over certain asset related to the FINA Registry we refer to Section 5.2.1(b) above.

³²⁴ Available on the web page address: <http://zaloznaprava.fina.hr/>.

³²⁵ Any individual can request insight into the FINA Registry.

³²⁶ Article 36 par. (10).

12.5.3 Ship Registry

Ship Registries are held by competent port authorities. Depending on the type of the vessel, eleven different registries are held by port authorities in Croatia.³²⁷ Ship Registries are kept in the form of a publicly available book or electronic form and contain database for the whole territory of the Republic of Croatia.³²⁸ Ship registries consist of the main book and collection of documents, whereby the main book consists of registry folders, which are divided into folios.³²⁹ Every ship shall be registered with its separate, individual registry folder. Certificates issued from the ship registry are equal to public deeds.

Ownership title and mortgage³³⁰ over ships, yachts and boats may be acquired, transferred, restricted and revoked only by way of registration with the respective registry.³³¹ This applies accordingly to floating objects and fixed offshore objects. However, it should be noted that for the establishment of maritime liens³³² as a pledge over a ship established by virtue of law, and its effectiveness towards third persons,³³³ registration with the Ship Registry is not necessary.

Identified issues:

Court enforcement over a ship is related to certain portion of risk with regard to certainty of settlement. Namely, the enforcement proposal for initiation of court enforcement over a ship should, amongst other matters, contain information on known maritime liens. Given that maritime liens have priority in settlement compared to other creditors, the risk that the enforcement creditor who initiated the respective proceedings does not settle its claim completely (or at all) cannot be excluded.

Recommendations for reform:

Given the nature of maritime liens and, to a certain extent, their unpredictability, the enforcement authorities should take an open approach towards the creditors in terms of their obligation to list known maritime liens. In other words, term *known* should not be interpreted as to impose obligations on the creditors which would prevent the same to successfully commence the enforcement.

12.5.4 Aircraft Registry

The Croatian Civil Aircrafts Registry ("Aircraft Registry") is a publicly available book³³⁴ kept electronically and manually by the Croatian Civil Aviation Agency ("CCAA"). It is considered that the Aircraft Registry truly and completely reflects the legal and factual status of aircrafts.³³⁵ Aircraft Registry folders are divided into folios and each aircraft shall be registered within its

³²⁷ Commercial ships registry, fishing ships registry, public ships registry, yacht registry, floating objects registry, fixed offshore objects registry, registry of ships under construction, registry of yachts under construction, registry of floating objects under construction, registry of fixed offshore objects under construction and smaller boats registry.

³²⁸ Article 195 paragraph 2 of the Maritime Code (Official Gazette nos. 181/2004, 76/2007, 146/2008, 61/2011, 56/2013 and 26/2015 – "Maritime Code").

³²⁹ A Folio contains information on the identity of the maritime facility, B folio contains information on the ownership and C folio contains information on encumbrances, ship agreements, pre-emption rights etc.

³³⁰ According to Article 219 of the Maritime Code, mortgage over a ship authorizes the creditor to settle its claim from the purchase price of the ship acquired by way of court or out-of-court sale, or by taking the ship into the creditors' possession and exploiting it.

³³¹ With exception to certain cases exhaustively listed in the Maritime Code.

³³² Croatian "*Pomorski privilegiji*".

³³³ Having effect *erga omnes*.

³³⁴ Any individual can request insight into the Aircraft Register and obtain excerpts therefrom.

³³⁵ Article 4 of the Ordinance on the Croatian Civil Aircrafts Registry (Official Gazette no.137/2012).

separate, individual registry folder. Excerpts from the Aircraft Registry are equal to public deeds.

Subject to registration with the Aircraft Registry are aircrafts, real rights and obligatory rights which may exist over aircrafts, personal status and other legally relevant facts. Real rights subject to registration with the Aircraft Registry are ownership and mortgage over aircrafts.³³⁶ The registration with the Aircraft Registry is of constitutive nature for the acquisition of ownership and mortgage over aircrafts (if the same are based on a legal affair)^{337 338} Priority ranking of registration of rights shall be determined according to the date and hour the application has been submitted to the CCAA.³³⁹

Identified issues:

Although available on-line,³⁴⁰ data contained in the electronically held Aircraft Registry is being updated every first day of the month. In order to obtain latest information, users are instructed to directly address the CCAA for the extraction of current data from the manually kept main book of the Aircraft Registry.

Recommendations for reform:

In order to be more transparent and user friendly, the information available on the electronically held Aircraft Registry should be updated upon every change since lack of regular updating means that there is a "blind spot" for the creditor trying to ascertain ownership rights.

12.5.5 SKDD

The Central Depository and Clearing Company Inc. ("SKDD")³⁴¹ is a joint stock company³⁴² authorized to manage the Central Depository.

The Central Depository is the central registry for book-entry securities. Subject to registration with the Central Depository are rights arising from book-entry securities, holders of such rights or rights of third persons over the securities.

Securities accounts held by the SKDD contain data on type, quantity, real rights and holders of such rights or limitations thereof. Book-entry securities and rights arising thereof are acquired at the moment of registration on the securities accounts. Holder of book-entry securities are authorized to request insight into their securities accounts.

Security over shares kept in the book-entry form in the SKDD depository can typically be enforced either within judicial (court) enforcement or out of court enforcement. Unlike out-of-court enforcement for other type of assets and related difficulties, out-of-court enforcement of shares issued in form of a book-entry is quite an efficient manner of enforcement and it is well recognized in practice.

³³⁶ Some obligatory rights such as lease and pre-emption right may also be subject to registration with the Aircraft Registry.

³³⁷ Unlike acquisitions based on inheritance, court's decision or the law.

³³⁸ Articles 132 and 146 of the Act on Obligatory and Real Rights in Air Transport (Official Gazette nos. 132/1998, 63/2008, 134/2009 and 94/2013).

³³⁹ Applications submitted at the same time shall have the same priority ranking. Assignment of priority ranking of rights over the same aircraft is possible.

³⁴⁰ http://www.ccaa.hr/english/list-of-registered-aircraft_101/.

³⁴¹ Croatian: *Središnje klirinško depozitarno društvo d.d. ("SKDD")*.

³⁴² Holders of regular shares of the CDCC are the Financial Agency, the Republic of Croatia and other capital market participants (such as banks, brokerage houses, organized markets).

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11. Enforcement over Monetary Funds' Act (Official Gazette no. 68/2018);
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Jaime Ruiz Rocamora, Principal Counsel, EBRD, Story Written By Mike McDonough

ANNEX - LIST OF MARKET PARTICIPANTS

I.	Governmental authorities	Address details
1.	Ministry of Justice	Vuka Karadžića 3, 81000 Podgorica
2.	Financial Agency	Ulica grada Vukovara 70, HR-10000 Zagreb, Croatia
3.	Croatian National Bank	Trg hrvatskih velikana 3, 10000, Zagreb, Croatia
II.	Associations	Address details
1.	Croatian Banking Association	Centar Kaptol, Nova Ves 17, Zagreb, 10000, Croatia
2.	Croatian Notaries Chamber	Radnička cesta 34, 10000, Zagreb, Croatia
3.	Public Notary Office Marijan Jurić	Savska cesta 56, 10000, Zagreb, Croatia
III.	Banks	Address details
1.	Zagrebačka banka d.d.	Josipa Jelačića 10, 10000, Zagreb, Croatia
2.	Privredna banka Zagreb d.d.	Rackoga 6, 10000, Zagreb, Croatia
3.	Erste&Steiermärkische banka d.d.	Jadranski trg 3A, 51000, Rijeka, Croatia
4.	Raiffeisenbank Austria d.d.	Petrinjska 59, Zagreb, Croatia
5.	Splitska banka d.d.	Rudera Boškovića 16, 21000, Split, Croatia
6.	Addiko Bank d.d.	Slavonska avenija 6, 10000, Zagreb, Croatia
IV.	Financial Advisors	Address details
1.	ERNST&YOUNG SAVJETOVANJE d.o.o.	Radnička cesta 50, 10000 Zagreb, Croatia
2.	ERNST&YOUNG d.o.o. za reviziju i porezno savjetovanje	Radnička cesta 50, 10000 Zagreb, Croatia
3.	Deloitte d.o.o. za usluge revizije	Radnička cesta 80 Zagreb, 1000, Croatia
4.	Deloitte Savjetodavne Usluge d.o.o.	Radnička cesta 80 Zagreb, 1000, Croatia
5.	McKinsey & Company, Inc. Croatia	Ulica grada Vukovara 269a, HR-10000, Zagreb, Croatia
6.	Pricewaterhouse Coopers d.o.o. za reviziju i konzalting	Heinzelova 70, Zagreb, Croatia
7.	KPMG Croatia d.o.o. za reviziju	Ul. Ivana Lučića 2, 10000, Zagreb, Croatia
8.	KPMG savjetovanje d.o.o. za poslovno savjetovanje	Ul. Ivana Lučića 2, 10000, Zagreb, Croatia
V.	Others	Address details
1.	B2 KAPITAL d.o.o.	Radnička cesta 41. 10000 Zagreb, Croatia
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D CYPRUS

1. EXECUTIVE SUMMARY

This study aims to review the current state of affairs with regard to the enforcement of creditor claims in Cyprus. The study was conducted by the law firm Pamboridis LLC under the auspices of the European Bank for Reconstruction and Development and is a part of a wider research project conducted in five selected jurisdictions: Albania, Croatia, Cyprus, Greece and Ukraine.

The Cypriot statutory framework for security rights, enforcement and insolvency is relatively comprehensive, but needs amendment as highlighted throughout the Report. Cypriot legislation allows both court enforcement and out-of-court enforcement. In comparison with court enforcement, out-of-court enforcement is more preferable due to its flexibility. The document creating a security usually includes provisions for the out-of-court enforcement of such security and/or the appointment of a receiver, such as for example with floating charges. Where out-of-court enforcement of a particular security is possible, as is the case with the majority of types of security where the document creating the security includes relevant provisions and mechanisms, with the exception of guarantees and assignments where the third party debtor is not cooperating, creditors will usually elect to proceed out of court and will only resort to courts where absolutely necessary i.e. in order to avoid possible disputes or where the procedure has become contentious. Court enforcement has significant shortcomings due to its long timeframe, high workload, and lack of specialised judges, and is as a result rather complicated. According to the World Bank Doing Business 2018 annual report, it takes approximately 1100 days to enforce a contract in Cyprus. The costs expressed as a percentage of the claim value are estimated to account for 16% of the claim. In addition, the timeline for resolving insolvency is considered to take approximately 1,5 years with a cost of 14,5% to the insolvency estate.

The focus in this Report is on parameters that are influencing the effectiveness of the enforcement procedure. These parameters are simplicity, cost and overall predictability. The listed parameters represent the so-called "Key Determinants" of this Report. The Key Determinants of effective enforcement are negatively impacted by ambiguities and 'gaps' in the relevant legislation allowing debtors to abuse the system and cause significant problems and delays in the enforcement of creditors' claims. This is exacerbated by the lack of specialised courts and judges and the relatively low number of judges compared with other EU countries. As indicated in the Erotocritou Report of 2016³⁴³ the number of judges in Cyprus per 100,000 habitants is 12, while in other Member States (e.g. Slovenia, Croatia, Luxembourg etc.) the number is between 40-50 judges per 100,000 habitants. As for the costs and duration, for instance, there are jurisdictions with a value limit for the appeals, such as Germany, and where the whole appeal process may only last up to two years.

Key Determinants were assessed following the responses from market participants, including Bank of Cyprus Public Company Ltd, Hellenic Bank Public Company Ltd, the Supreme Court, PricewaterhouseCoopers Ltd, the Insolvency Service Department. A full list of market participants is set out as an Annex hereto. Considering the abovementioned low number of judges and legal shortcomings, the enforcement system would be developed by clarification of ambiguities in relevant enforcement-related legislation including the Companies Act and the Mortgage Act, review of the Civil Procedure Rules, adoption of

³⁴³ Report of the Supreme Court on the operational needs of the Courts and other related issues of 2016.

such measures as digitalisation of court proceedings and the security rights registry, promotion of arbitration and dispute resolution procedures, increasing the number of judges, and establishment of specialised courts.

Part (A) Legislative Review contains an analysis of existing legislative provisions regulating claims enforcement and recommendations for improvement. Specifically, these provisions set out various forms of security and rules regulating enforcement of claims, including rules of procedure, registration and perfection of claims. Part (B) Institutional Framework Review provides an analysis of the institutions involved in the enforcement process in Cyprus and, where applicable, suggestions for reform.

The cut-off date for the legislative review was 30 November 2018.

No.	Title	Issue	Recommendations for reforms	Report reference
1.	Enforcement proceedings			
1.1	Out-of-court enforcement	While most forms of security where the underlying document creating the security contains relevant provisions and mechanisms are capable of being enforced out of court, in the case of assignments, non-cooperation by the third party debtor may still hinder the out of court enforcement of a charge and assignment over receivables or an assignment or a charge and assignment of a bank account where the charged bank account is maintained at a bank other than the lender/chargee.	This problem could be handled through introduction of relevant provisions in the Contract Act or the introduction of a new law that would explicitly provide that the third party debtor or third party bank upon receipt of notice of assignment or charge and assignment and subject to the occurrence of a default under the underlying secured obligation, is bound to pay the assigned/charged receivables directly to the assignee/charge.	Section 6.3
1.2	Enforcement of the floating charge	Market participants emphasized that the legal framework on the appointment of the receivers is outdated and this may delay the appointment of receivers/managers and the overall enforcement of a floating charge.	We suggest a revision of the Companies Act to provide clarity on the powers of the receivers and the procedure they follow in exercising their duties. In this way resorting to the court for clarification of certain issues or seeking an order in relation to exercising such duties can be avoided. In this context, it would be helpful to amend the Companies Act, i.e. to consider (i) an	Section 6.3.2(b)

No.	Title	Issue	Recommendations for reforms	Report reference
			inclusion of provisions allowing the receiver to take the assets of the debtor in his possession and dispose of them at a fair market price to repay the debt, (ii) an inclusion of provisions on the remuneration of the receiver without the need to apply to the Court and (iii) an extension of certain periods prescribed by the law within which the receiver must fulfil certain obligations thus abolishing of the need to apply to the Court in order to be granted an extension.	
1.3	Court-led enforcement	<p>Court led procedures are slow and lengthy due to a number of factors including:</p> <ul style="list-style-type: none"> the workload of the courts which is in part due to the large volume of cases compared to the small number of judges, inefficient procedural rules, lack of expertise and organisation; lack of continuous hearings, together with the time consumed by judges in dealing with routine matters such as first appearances, or appearances by the parties before the judge for directions which contribute to the existing backlog; the system is still paper based and no technology, such as digitalisation of the court proceedings or electronic case administration was introduced; debtors that are strategic defaulters take advantage of the 	<p>The following changes are recommended, supported also by the majority of market participants:</p> <ul style="list-style-type: none"> the employment of more judges and establishment of Commercial Courts with jurisdiction over matters including claims arising from contracts, which is supported by the Minister of Justice of Cyprus and the Supreme Court and which could also cover matters relating to enforcement and insolvency;³⁴⁴ reform of the legal system through the amendment of the Civil 	Section 6.2

³⁴⁴ To be discussed. It would make sense for enforcement and insolvency to be covered as division(s) of any Commercial Court.

No.	Title	Issue	Recommendations for reforms	Report reference
		<p>inefficiencies and vulnerabilities of the enforcement procedures by lodging unnecessary and unfounded objections/appeals which result in significant delays;</p> <ul style="list-style-type: none"> • ambiguities and 'gaps' in the relevant legislation allow debtors to abuse the system and cause significant problems and delays in the enforcement of creditors' claims; and • many laws allow the debtors to raise unsubstantiated objections or defences at any stage contributing to the lengthy court procedures and hindering the enforcement process. 	<p>Procedure Rules which would also address the issue of debtors obstructing the course of justice with ungrounded appeals, the modernisation of the courts and introduction of technology such as computerisation/digitalisation of the court proceedings, electronic case administration, etc.</p> <ul style="list-style-type: none"> • many pieces of legislation such as the Companies Act, the Mortgage Act etc., need to be amended in order to either eliminate ambiguities and 'gaps' or to clarify the procedures provided therein. 	
1.4	Numerous Appeals	<p>The restrictions/limitations to the right of the debtors to file unsubstantiated appeals against notices or actions provided and/or taken by the secured creditors introduced by the Mortgage Act do not benefit and in general do not affect other types of security instruments, since the Mortgage Act deals only with mortgages over immovable property.</p>	<p>Although the newly amended Mortgage Act has expanded the objections available to the debtors in relation to the contents and/or due service of the various notices required, it has restricted/limited the right of the debtors to file unsubstantiated appeals against notices or actions provided and/or taken by the secured creditors.</p> <p>Given the fact that the Mortgage Act has been recently amended, it remains to be seen if in practice the latest amendments will facilitate the procedure and eliminate the abuse and/or the delays caused by the debtors</p> <p>Other pieces of legislation could</p>	<p>Sections 6.2.1(a), 6.3.2(a)</p>

No.	Title	Issue	Recommendations for reforms	Report reference
			<p>introduce similar restrictions/limitations in the context of enforcement of other types of security, so long as such restrictions/limitations do not preclude a party from resorting to court.</p> <p>In some other jurisdictions there is a value limit for the appeals, such as Germany. According to the Survey of appellate justice in other jurisdictions compiled by Allen and Overy from 2015, an appeal from a first instance decision in Germany can always be made if the value of the matter is more than 600 Euros. For matters with a lesser value the first instance court needs to give permission to appeal. Generally, in Germany the whole appeal process may last from eight months to two years, depending on court workload, complexity and need for witness or expert evidence.</p> <p>Further, it would be also helpful to build safeguards into the process to discourage grantors of security from making unfounded claims. That can be achieved with procedural mechanisms, such as adding the costs of the proceedings to the secured obligation in the event that they are unsuccessful or requiring affidavits from grantors of security as a prerequisite to launching such proceedings. In addition, it can be</p>	

No.	Title	Issue	Recommendations for reforms	Report reference
			permitted to seek damages against grantors that bring frivolous proceedings or fail to comply with their obligations and to add these damages to the secured obligation. ³⁴⁵ It is suggested to introduce damages to the person who fails to comply with its obligations under the provisions on enforcement.	
1.5	Identifying debtor assets	Over the years, enforcement measures have proven to be ineffective due to the fact that strategic defaulters/debtors cannot be easily located or alienate their assets in an effort to defraud creditors and hinder the enforcement process.	A single registry searchable through the ID or registration number of a specific debtor could be introduced, which creditors could easily access in their effort to locate debtors' assets for the purposes of enforcement.	Section 6.1
2.	Impact of insolvency and winding-up proceedings on enforcement			
2.1	Impact of insolvency on enforcement	Although the Companies Act contains certain provisions with regard to the impact of insolvency on enforcement, the position and rights of the secured creditors and in particular their rights to enforce their securities once the liquidation and winding up have commenced, is still not entirely clear.	An amendment of relevant laws such as, inter alia, the Companies Act, could be introduced whereby more clarity in relation to the position and rights of the secured creditors and in particular their rights to enforce their securities once the liquidation and winding up have commenced, could be given.	Section 8
2.2	Creditors' rights in insolvency	Although the Companies Act provides for the general priority of satisfaction of claims in insolvency and winding-up, more clarity is necessary to these rules to eliminate any ambiguities arising in practice.	To ensure a transparent and predictable law it is suggested to establish clear rules for ranking of priority claims. Also, the law should recognize rights	Section 8.1

³⁴⁵ *Supra* note 11, UNCITRAL Insolvency Guide, Recommendation 1-5 page 14.

No.	Title	Issue	Recommendations for reforms	Report reference
			<p>and claims arising under law other than the insolvency law, whether domestic or foreign, except to the extent of any express limitation set forth in the insolvency law.³⁴⁶</p> <p>Transparent and predictable law should recognize all of the existing creditors' rights and establish clear rules for ranking of priority claims</p>	
3.	Transfer of Loans			
3.1	NPL sales facility/NPL	Although the recent amendment to the Sale of Credit Facilities Act, has meant that issues regarding the transfer of collateral in the context of a sale of a credit facility/NPL are relatively straightforward, the current legal regime in Cyprus on issues relating to secrecy in the context of sale/transfer of credit facilities/NPLs, remains rather unclear as the law is relatively untested.	It is imperative to amend the relevant applicable laws to clarify the position in relation to consents obtained at the time of execution of the transaction documents and/or to provide that no such consent is required in the context of transfer/sale of credit facilities/NPLs.	Section 10

³⁴⁶ *Supra note 11*, UNCITRAL Insolvency Guide, Recommendation 1-5 page 14.

2. GLOSSARY

CBC	shall mean the Central Bank of Cyprus (i.e. <i>Η Κεντρική Τράπεζα της Κύπρου (ΚΤΚ)</i>)
Companies Act	shall mean the Companies Act Cap 113, as amended (i.e. <i>Ο περί Εταιρειών Νόμος (ΚΕΦ.113)</i>)
Contract Act	shall mean the Contract Act Cap 149, as amended
DMS	shall mean the Deputy Ministry of Shipping i.e. <i>Υφυπουργείο Ναυτιλίας</i>
FCA Act	shall mean the Financial Collateral Act 43(I)/2004, as amended
IP	shall mean an intellectual property (i.e. <i>πνευματική ιδιοκτησία</i>)
Lands Office	shall mean the Cyprus Lands Office
Mortgage Act	shall mean the Transfer and Mortgage of Immovable Property Act of 1965 (9/1965), as amended
NPL	Non-performing loan
Registrar	shall mean the Registrar of Cyprus Companies and Official Receiver, i.e. <i>Τμήμα Εφόρου Εταιρειών και Επίσημου Παραλήπτη</i>
Sale of Credit Facilities Act	shall mean the Sale of Credit Facilities and Related Matters Act 169(I) 2015, as amended

PART (A) LEGISLATIVE REVIEW

3. TYPE OF CLAIMS:

3.1 Unsecured claims

Unsecured claims are all debts/claims that are not secured by any form of collateral/security. Claims based on promissory notes, bonds in customary form, bills of exchange, cheques and court judgments are per se not secured claims. All of the aforesaid instruments can however be secured through the creation of any one of the securities analysed below.

3.2 Secured claims

3.2.1 Types of security

Generally, Cypriot law recognizes the following types of security:

- (a) mortgage over immovable property;
- (b) pledge over movable property;
- (c) fixed and floating charges over immovable or movable property; and
- (d) guarantee.

3.2.2 Immovable

- (a) Mortgage on land plots
- (b) Mortgage on premises and buildings, including buildings under construction

The most common type of security taken over immovable property (real estate) is a mortgage, which is also one of the most widely used forms of security in Cyprus.

The creation, registration and enforcement of a mortgage are governed by the Mortgage Act.

According to the Mortgage Act,³⁴⁷ the term "immovable property" has the meaning attributed to it by section 2 of the Immovable Property (Tenure, Registration and Valuation) Act (Cap. 224), and includes, *inter alia*, land, buildings, including buildings under construction, and other erections.

3.2.3 Movables

- (a) Pledge of Movables

By virtue of the Contract Act,³⁴⁸ a pledge is "*the bailment of goods as security for payment of a debt or performance of a promise*". Pledges on movable property are not a common security in Cyprus, with the exception of a pledge over share certificates which is referenced in paragraph 3.2.3(b) below, since pledges require possession of the asset. Charges are more popular forms of security over movables because they

³⁴⁷ Section 2 of the Mortgage Act.

³⁴⁸ Section 130 of the Contract Act, Cap. 149.

enable the grantor of the security to continue to deal with the asset. A movable pledge or pledge over share certificates grants the pledgee the right to possession of the pledged assets but not any right of ownership.

(b) Pledge over shares

A pledge over shares/share certificates is a common type of security.

Except for dematerialised shares listed with the Cyprus Stock Exchange, for which a special procedure applies for the creation and registration of a pledge over such shares, the creation of a pledge over share certificates presupposes delivery of the pledged share certificates to the pledgee. Furthermore, section 138(1) and (2) of the Contract Act provides specific requirements in order for a pledge over share certificates to be valid and enforceable.

In particular the contract of pledge must be:

- (i) expressed in writing; and
- (ii) signed at the end by the pledgor; and
- (iii) made in the presence of at least two witnesses competent to contract.

In addition to the foregoing, a notice of such pledge, together with a certified copy of the contract of pledge, is given by the pledgee to the company, and the company must make a memorandum of such pledge in the register of shareholders against the shares in respect of which the notice has been given. The company must thereafter deliver to the pledgee a certificate that a memorandum of such pledge has been made in the register of the company's shareholders.

(c) Fixed or Floating charge

Charges can be either fixed or floating and do not grant any proprietary right or interest on the asset/property charged. Both charges are created by contract.

A fixed charge is given over particular assets/property of a company to secure the repayment of a debt and is limited to that particular asset/property. The debtor/chargor is not allowed to deal with that asset/property in the ordinary course of business.

A floating charge is a charge over the overall assets of a company. A floating charge hovers over the company's assets until an event of default, in accordance with the terms of the document creating the floating charge, occurs and/or until the company goes into insolvency, at which time the floating charge "crystallises" and attaches to the existing assets at the time of crystallisation.

Fixed and floating charges are very common securities in practice.

(d) Charge on a ship or any share in a ship

The Merchant Shipping Act³⁴⁹ provides for the creation of a mortgage on a ship or any share in a ship. The instrument creating the mortgage must be accompanied by a deed of covenants covering the terms and provisions under which the mortgage is granted.

³⁴⁹ The Merchant Shipping (Registration of Ships, Sales and Mortgages) Act of 1963 (45/1963).

3.2.4 Personal Guarantee

Guarantees are regulated by the Contract Act. It is a common form of security *in personam* and, even though under the Contract Act is not mandatory for a guarantee to be in writing, such guarantees are created through the execution of relevant written agreements. The Contract Act contains provisions whereby the guarantor is discharged from liability, for example if any variance is made without the guarantor's consent, in the terms of the contract between the principal and the creditor. Thus the person in whose favour the guarantee is granted should be careful not to take any action which could result in the discharge of the guarantor.

The provision of guarantees, corporate guarantees by members of a group of companies or personal guarantees by directors and/or shareholders, is one of the most common forms of security.

It should be noted that to the extent that the guarantees are provided by natural persons, the Guarantors Act³⁵⁰ may apply. By virtue of the provisions of section 4 of the Guarantors Act, the contract of guarantee must be written.

3.3 Rights

3.3.1 Receivables pledge

The receivables pledge (charge) is a form of security created by contract, through an assignment of receivables or a charge and assignment of receivables.

In the event the charge takes the form only of an assignment of receivables, such charge is not registrable with the Registrar. In order for the charge to be registrable with the Registrar it should take the form of a charge and assignment.

3.3.2 Charge over credit institution accounts

A charge over credit institution accounts is created contractually and is very common in Cyprus. It can be granted in favour of a third party. Commonly a charge/lien over credit institution accounts is granted in favour of the account holder credit institution as lender. The document creating the charge/lien in favour of a credit institution includes provisions allowing the credit institution to set off the credit and debit accounts which the customer holds with the credit institution for paying off a debt owed to the credit institution.

3.3.3 Pledge over IP rights (intellectual property (i.e. πνευματική ιδιοκτησία))

A charge over IP rights may take various forms, the most common being an assignment or a charge and assignment, or floating charge. Except for the Copyright Act³⁵¹ which provides that the copyright is transferable by assignment agreement; by disposition of property upon death or by the operation of law, as a movable property, there is no other piece of legislation regulating charges over IP rights. It is not a common security in Cyprus in general, except where the security provider's line of business relates to the development and exploitation of IP rights.

3.4 Assets not capable of being pledged

Ahead of addressing the issue under this subsection, it should be noted that a company registered in Cyprus may only grant security if the Memorandum and Articles of Association of such company

³⁵⁰ The Protection of a Specific Category of Guarantors Act of 2003 (197(I)/2003), as amended.

³⁵¹ The Copyright and Neighboring Rights Act of 1976 (59/1976).

allow provision of the required security and always subject to compliance with the Articles of Association. Further, issues of financial assistance as well as, in exceptional cases, issues of fraudulent preference should, where applicable, be examined. Except for restrictions on the creation of a charge over wages, in general there are no restrictions on the type of assets that are capable of being charged.

3.5 Bank guarantee

Bank guarantees are not regulated by law and even though they are not uncommon in commercial transactions, such as in the development industry and trade, they are not a common form of security in the lending market.

3.6 Claims under financial collateral regulations

Financial collateral arrangements in Cyprus are governed by the FCA Act that transposed Directive 2002/47/EC (the "**Financial Collateral Directive**") into local law.

3.6.1 Covered arrangements

The FCA Act applies to financial collateral arrangements which satisfy the requirement referred to in section 3.6.2 herein below and to financial collateral which consists of cash or financial instruments, credit claims or a combination thereof. Furthermore, the FCA Act applies to financial collateral already provided, if that provision is evidenced in writing and to financial collateral arrangements, provided that such arrangement is evidenced in writing or in a legally equivalent manner.

The definition of the terms "financial collateral arrangements", "cash" and "financial instruments" under the FCA Act is almost identical to the definition of such terms under the Directive. "Credit claims" are defined under the FCA Act as pecuniary claims deriving from an agreement by virtue of which a credit institution (i.e. a credit institution as is defined under the Credit Institutions Act³⁵² or an institution listed in Article 2 of Directive 2006/48/EC, as amended), grants credit in the form of a loan.

The FCA Act does not apply to credit claims where the debtor is a consumer within the meaning of the Credit Agreements for Consumers Act of 2010 (as amended), or where the debtor is a small or micro enterprise as such are defined in Articles 1 and 2 of the Annex of the Commission Recommendations of 6 May 2003, except where the collateral taker and the collateral provider over such credit claims are one of the institutions referenced in section 3.6.2 herein below.

It should be noted that in accordance with the FCA Act, the sections of the FCA Act dealing with enforcement of financial collateral arrangements, the right of use of financial collateral under a security financial collateral arrangement, recognition of title transfer financial collateral arrangements and recognition of close-out netting provisions, do not apply to any restriction on enforcement of a financial collateral arrangement or to any restriction on the outcome of security financial collateral arrangements, close-out netting or set-off arrangements that are imposed by virtue of provisions of Cyprus law that are transposing into local law Title IV, Chapter V or VI of Directive 2014/59/EU or to any similar restriction that is imposed by virtue of ancillary powers under Cyprus law, that aim to facilitate the smooth resolution of an insurance undertaking or a central counterparty, settlement agent or clearing house, which are subject to safeguards at least equivalent to those under Title IV, Chapter VII of Directive 2014/59/EU.

³⁵² The Business of Credit Institutions Act 66(I)/1997, as amended.

3.6.2 Covered market participants

Under the FCA Act, the collateral taker and the collateral provider must each belong to any one of the following categories:

- (a) a public authority in Cyprus or elsewhere, excluding publicly guaranteed undertakings, unless they fall under paragraphs (b) to (e) herein below, including, inter alia:
 - (i) a public sector body charged with or intervening in the management of public debt;
 - (ii) a public sector body authorised to hold accounts for customers;
- (b) the CBC, a central bank of another member state, European Central Bank, Bank for International Settlements, a multilateral development bank as defined in the Directives to banks for Calculation of Capital Requirements and Large Financial Exposures of 2006 to 2010, the International Monetary Fund and the European Investment Bank;
- (c) a financial institution subject to prudential supervision, including:
 - (i) a credit institution as defined under the Business of Credit Institutions Act 66(I)/1997, as amended, and/or an institution listed in Article 2 of Directive 2006/48/EC, as amended;
 - (ii) an investment firm as defined in the Investment Services, exercise of Investment Activities, the Operation of Regulated Markets and Other Related Matters Act of 144(I)/2007, as amended;
 - (iii) a financial institution, as such is defined under the Business of Credit Institutions Act 66(I)/1997, as amended;
 - (iv) an insurance undertaking, as defined in the Insurance Services and Other Related Matters Act 35(I)/2002, as amended;
 - (v) an undertaking for collective investment in transferable securities (UCITS), as such is defined in the UCITS Act 78(I)/2012, as amended;
 - (vi) a UCITS management company, as such is defined in the UCITS Act 78(I)/2012, as amended;
- (d) a central counterparty, settlement agent or clearing house, as such are defined respectively in the Settlement Finality in Payment Systems and Securities Settlement Systems Act 8(I)/2003, as amended;
- (e) in other similar institutions subject to supervision and that operate in the futures, options and derivatives markets to the extent not covered by the Settlement Finality in Payment Systems and Securities Settlement Systems Act 8(I)/2003, as amended, and a legal person that acts as trustee or as an agent in the name of one or more persons, which include any bondholders or holders of other forms of secured loans or an institution falling within any one of the categories referred to in paragraphs (a) to (d) herein before;
- (f) a legal person, including unincorporated firms and partnerships, provided that

the other party falls within any one of the categories referred to in paragraphs (a) to (e) herein before.

We have not traced any case law in relation to the FCA Act as at the date of this report and in practice the FCA Act is not widely used by the market.

4. RANKING AND PRIORITY OF CLAIMS

4.1 Unsecured claims

In general, unsecured claims are junior to secured claims. Unsecured claims rank *pari passu* amongst them, both in and outside liquidation/winding up.

4.2 Secured claims

4.2.1 Priority in time

The ranking of the same security interests over the same asset is governed by the principle of time priority. In particular, mortgages over the same immovable property situated in Cyprus rank according to the time order of registration with the Lands Office. Mortgages over the same ship flying a Cyprus flag or over shares of such ship rank according to the time order of registration with the DMS. Charges over the same assets created by a Cyprus registered company rank according to the time of registration with the Registrar.

With regard to pledges, since pledges require physical possession of the asset, it is, in principle, not possible to create more than one valid pledge at the same time.

4.2.2 Possibility of contractual assignment of a priority ranking

Under Cyprus law, there is nothing to prohibit the contractual assignment of a priority ranking. However, if such contractual arrangement is not accompanied by analogous deregistration and registrations, where possible, such arrangement is binding only on the parties thereto and may not be enforceable against other creditors and/or the liquidator.

4.3 General priority of satisfaction of claims in insolvency and winding-up

Under the Companies Act and subject to the exception referred to in section 8.1, the order of priority of satisfaction of claims in liquidation and winding up is as follows:

4.3.1 Costs and expenses of the liquidation or winding-up;

4.3.2 Preferential debts. The categories of debts which qualify as preferential are:

- (a) all local rates due from the company at the relevant date, and having become due and payable within twelve months next before that date;
- (b) all Government taxes and duties due from the company at the relevant date and having become due and payable within twelve months before that date and, in the case of assessed taxes, not exceeding in the whole one year's assessment;
- (c) any salary owed to an employee and any sum withheld by the employer from the employee's salary for the payment of any obligations of the employee or otherwise, that the employer has not paid;
- (d) any other sum or benefit of the employee that arises as a result of an agreement

or employment relationship, including any sum owed to a recognized union that arises from the employment relationship between the employer and the employee or otherwise, that the employer has not paid;

- (e) every amount of compensation which the company is obliged to pay to an employee, on account of bodily harm suffered by the employee as a result of an accident caused by his employment and during his employment with the company;
- (f) all sums owed to an employee other than an employee of a private company who is a shareholder thereof, for any leave to which he is entitled as a result of his employment only for a period of employment of one year.

Preferential debts rank equally among themselves and are paid in full, unless the assets are insufficient in which case they shall abate in equal proportions.

Comparing the legislation of other European countries, the UK, unlike Cyprus, abolished Crown preference in 2002 through Enterprise Act on the grounds of hardship to the general body of creditors compared with insignificant benefits in terms of government revenues. The changes, contained in the Enterprise Act 2002, abolished the Crown's preferential claim, a change which was intended to benefit unsecured creditors, many of whom are small businesses.

4.3.3 Secured claims

If certain criteria are met, preferential claims under section 4.3.2 will be satisfied before secured claims. If a memorandum (notice) has been imposed or registered on an immovable property (for example by tax authorities) and upon sale of such immovable property where a secured creditor may have registered a mortgage, such preferential claims will be satisfied in priority. If no such memorandum has been registered on a property, then any such claim, even if listed in Companies Law as having priority, will be paid if there is any surplus following sale of the property and satisfaction of the secured creditor. The foregoing applies also for costs and expenses of the liquidation, for which there cannot be a memo registered on a property, hence they will be satisfied first out of any surplus following satisfaction of the secured creditor's claim.

4.3.4 Unsecured claims proven in the course of the liquidation or winding up.

Unsecured claims, proven as aforesaid, rank equally among them and if the assets are insufficient, they shall abate in equal proportions.

4.4 Subordinated claims

Contractual subordination of claims is effected through the conclusion of an agreement between the creditors and the borrower. Agreements of this nature are fairly common in finance transactions where the creditors, in particular the credit institutions involved, are non-Cypriot entities.

Contractual subordination of claims is binding on the parties thereto and may not be enforceable against other creditors and/or the liquidator, not party to the agreement.

The execution of such agreements does not affect the rankings of securities as analysed above. It is merely a contractual arrangement.

5. REGISTRATION AND PERFECTION WITH REGISTRY SYSTEM

5.1 General

Where the person providing the charge is a Cyprus company, in addition to registrations with the Registrar analysed under section below, particulars of the charge are recorded in the corporate register of the company, an internal document maintained by the company.

5.2 Registration

5.2.1 Registration with a public authority

(a) Lands Office (i.e. Κτηματολογικό Γραφείο)

Mortgages over immovable property situated in Cyprus are perfected through filing with the appropriate District Lands Office of the prescribed forms duly filled in and signed and registration thereof and payment of the prescribed fees.

(b) Registrar

Certain charges created by a company registered in Cyprus are registrable with the Registrar. In particular, the Companies Act³⁵³ provides that, subject to the provisions herein below, the following charges are registrable:

- (i) a charge for the purpose of securing any issue of debentures;
- (ii) a charge on uncalled share capital of the company;
- (iii) a charge on book debts of the company;
- (iv) a floating charge on the undertaking or property of the company;
- (v) a charge on calls made but not paid;
- (vi) a charge on a ship or any share in a ship;
- (vii) a charge on goodwill, on a patent or a licence under a patent, on a trade mark or on a copyright or a license under a copyright;
- (viii) a charge on any other movable property created or evidenced by an instrument, where the company retains possession of such property;
- (ix) a charge on immovable property, wherever situated, or any interest therein.

Provided that, the foregoing shall not apply to:

- (x) pledge of shares in companies and all the rights emanating from it; and
- (xi) agreements for the provision of financial collateral within the meaning of the FCA Act, as may be amended and apply from time to time.

³⁵³ Sub-section (2) of section 90 of the Companies Act.

Even though agreements for the pledge of shares/share certificates and agreement falling within the ambit of the FCA Act are exempt from registration, as a matter of good practice, especially since the Registrar accepts registration thereof, and taking into account that non registration has not been judicially tested, such charges continue to be registered with the Registrar.

The registration with the Registrar is effected through submission of the prescribed form, duly filled in and signed, accompanied with the document creating the charge and payment of the prescribed fee.

(c) DMS (i.e. *Υφυπουργείο Ναυτιλίας* - Deputy Ministry of Shipping)

Mortgages over ships or any share in a ship flying Cyprus flag are registered with the DMS in the form prescribed in the Merchant Shipping Act.

As mentioned above, pursuant to section 90 of the Companies Act, if the ship on which a mortgage is created belongs to a Cyprus company, the mortgage must be registered with the Registrar as a charge.

5.2.2 Consequences of absence of registration with the public authority

Failure to register a charge registrable under the Companies Act³⁵⁴ renders such charge void against the liquidator and any creditor of the company (no third party effect).

Failure to register a mortgage over immovable property situated in Cyprus with the appropriate District Lands Office or a mortgage over a ship or any share in ship with the DMS, affects the validity and enforceability of the security.

5.3 Possession principle

The possession principle is relevant to pledges where possession of the pledged asset is a prerequisite for the existence of a valid pledge.

5.4 Exemptions from perfection requirements for financial collateral

Under the FCA Act, the creation, validity, perfection, enforceability or admissibility in evidence of a financial collateral arrangement or the provision of financial collateral under a financial collateral arrangement is not dependent on the performance of any formal act.

In the event where credit claims are provided as financial collateral and provided that certain specific requirements of the FCA Act have been complied with, the creation, validity, perfection, enforceability or admissibility in evidence of such financial collateral is not dependent on the performance of any formal act such as the registration or notification of the debtor of the credit claim provided as financial collateral, unless such formal act such as registration or notification is required for purposes of priority, enforceability or admissibility in evidence of the said financial collateral against the debtor or third parties.

³⁵⁴ Section 90(2) of the Companies Act.

6. ENFORCEMENT PROCEEDINGS

6.1 Obtaining of information on a debtor's assets

Obtaining information on debtors' assets may be made in Cyprus in two following ways:

Firstly, but not commonly, by obtaining a court order ordering a defendant to disclose, under oath, information about the value and location of his/her assets. This procedure presupposes that the claimant has instituted court proceedings against the debtor and in the context of such proceedings the claimant requested the issue of a freezing order.

Secondly, an alternative way of obtaining information about a debtor's assets is through the public registers, which contain information about different types of assets belonging to legal entities.

The main registers are the following:

- (a) The register of the Lands Office. A claimant may apply to the aforesaid office enquiring whether a debtor has any immovable property registered on his/her name within the territory of the Republic of Cyprus. Searching the above mentioned register requires the existence of pending court proceedings or a court judgement. Such searches are not carried out on-line, but require the submission of an application in hard copy, together with payment of all the prescribed fees, and the Lands Office will provide the claimant with the results of such searches, in the form of a certificate.
- (b) The register of the DMS which contains information of owners of Cyprus flag vessels provided that the name of the vessel is known to the creditor. Searching the register of the DMS requires the submission of an application in hard copy, and the applicant must attend the DMS in person and search through the relevant register for the information required.
- (c) The register of the Road Transport Department. A claimant may apply to the aforesaid department enquiring whether a defendant has any motor vehicles registered on his/her name. Searching the abovementioned register requires the existence of pending court proceedings or a court judgement. Such searches are not carried out on-line, but require the submission of an application in hard copy, together with payment of all the prescribed fees, and the Road Transport Department will provide the claimant with the results of such searches, in the form of a statement of registered vehicles.
- (d) The Office of the Registrar of Industrial Designs administers Cypriot trademarks, patents, copyrights and industrial rights. An online search at the aforesaid register is possible either with the name of the trademark, patent, copyright or industrial right.

Identified issues:

Over the years, enforcement measures have proven to be ineffective due to the fact that strategic defaulters/debtors cannot be easily located or alienate their assets in an effort to defraud creditors and hinder the enforcement process. As indicated in this paragraph 6.1, creditors wishing to obtain information on debtors' assets must search through a number of different registries, most of which do not allow online searches, something which causes delays and generally makes the whole process difficult.

Recommendations for reform:

A single registry searchable through the ID or registration number of a specific debtor, as applicable, could be introduced, which creditors could easily access in their effort to locate debtors' assets for the purposes of enforcement. However, implementation of any such measure should carefully consider other issues which may arise, such as for example, issues of protection of

personal data, in order to ensure that it serves the rights of the creditors without however becoming abusive.

6.2 Judicial enforcement

Secured creditors may resort to court for the purposes of enforcing their claims even where such claim is technically capable of being enforced out of court, although this is not common in practice. For example, as explained below, a creditor having as security a pledge over share certificates, may resort to court for the purposes of enforcing such pledge, even where it has the ability to enforce out of court. As far as unsecured creditors are concerned, in the absence of any agreement between the debtor and the creditor, enforcement through court is the only available route.

6.2.1 Court hearing

Commonly, documents creating a security include provisions for the out-of-court enforcement of such security and/or the appointment of a receiver, and in certain instances such as pledges over share certificates it is common practice for the documents required to enforce a pledge in default to be duly signed and delivered to the pledgee at the time of signing of the document creating such pledge. Despite the foregoing, nothing precludes a secured creditor from filing a court action seeking enforcement to reinforce such proceedings and avoid any possible challenges/disputes of the debtor, although as mentioned this is not common in practice.

Furthermore, even in cases of out of court enforcement, where the debtor considers that such enforcement was not lawful or that the process followed by the creditor was not correct and wishes to resort to court for the purposes of filing an objection, he is free to do so.

(a) Proceedings at first instance

All unsecured claims may be pursued through court proceedings, which commence with the filing of a law suit against the debtor. It is common practice in Cyprus for a demand letter to be sent prior to the commencement of court proceedings. If the debtor does not appear and defend the claim in Court, the proceedings are rather quick and straightforward.

Following the issue of a judgment in favour of a creditor, such creditor may proceed with the enforcement thereof, by, *inter alia*, issuing a writ of movables, instituting garnishee proceedings, registering a memorandum over immovable property registered in Cyprus, registering a charging order over securities, such as shares, warrants etc., held by the debtor. Enforcement proceedings for unsecured claims are relatively quick, but in most cases prove ineffective, mainly due to the unavailability of sufficient assets or property, because such assets may either be secured or non-existent.

Identified issues:

If a debtor appears and defends an unsecured claim then proceedings may last four to seven years until the issue of a final judgment at first instance. The reason for such delays is the fact that defendants abuse the current court system and take advantage of its deficiencies which are, among other matters, the heavy workload of the courts, inefficient and obsolete civil procedure rules, the lack of electronic case administration and generally the lack of electronic means, the inexcusable postponement of trials etc.

Recommendations for reform:

In order to resolve the above problems, it is imperative for the legal system to be

reformed in full through the amendment of the Civil Procedure Rules, the modernisation of the courts, the increase of the number of judges, the digitalisation of the court proceedings etc. Market participants acknowledge the problems causing the delays and suggest, among other matters, the appointment of more judges and the digitalisation of the court proceedings.

It would be also helpful to build safeguards into the process to discourage grantors of security from making unfounded claims. That can be achieved with procedural mechanisms, such as adding the costs of the proceedings to the secured obligation in the event that they are unsuccessful or requiring affidavits from grantors of security as a prerequisite to launching such proceedings. In addition, it can be permitted to seek damages against grantors that bring frivolous proceedings or fail to comply with their obligations and to add these damages to the secured obligation.³⁵⁵ It is suggested to introduce damages to the person who fails to comply with its obligations under the provisions on enforcement.³⁵⁶

(b) Appeal proceedings

It should be noted that an aggrieved party has the right to file an appeal within a prescribed time period. Filing of such an appeal does not result in an automatic stay of enforcement, since the interested party must specifically apply for a stay. If a defendant launches an appeal, a further period of two to five years is required until the issue of a judgment by the Supreme Court. In an attempt to decrease the time that is required until the issue of a judgment by the Supreme Court, the Administrative Court was established in 2015 and commenced its operation in January 2016, in order to adjudicate administrative disputes which were adjudicated up to then by the Supreme Court.

6.2.2 Arbitral hearing

Subject to what is stated in the following paragraph, a submission to arbitration must be contractually agreed. If the parties do not agree to submit to arbitration, then arbitration is not an option. In general, arbitration proceedings are quicker than court proceedings, however the costs may be higher.

Cooperative banks/institutions are allowed by the Cooperative Societies Act³⁵⁷ to elect whether to submit a dispute to arbitration or to the courts. From our experience, arbitration proceedings instituted by cooperative banks/institutions are relatively quick and most of the debtors appear and accept/acknowledge their debts, without further hearings. If a debtor appears and defends the arbitration proceedings, the parties will be requested to submit their pleadings and evidence to prove their allegations. Even then, the proceedings are much quicker than court proceedings. It should be noted that once a cooperative bank/institution obtains an arbitral award, it should apply to the district courts in order to have such arbitral award registered. Once registered, an arbitral award may be enforced as any other judgment. Although a creditor needs to apply to the district court, the procedure is relatively straightforward since the objections that could be raised by the debtor are limited.

Although submission to the arbitration could help to decongest the courts from their workload, arbitration is a relatively recent introduction in Cyprus, hence not a preferred method of dispute

³⁵⁵ *Supra* note 7, UNCITRAL Legislative Guide, para. 20 page 280.

³⁵⁶ *Supra* note 7, UNCITRAL Legislative Guide, Recommendation 136 page 311.

³⁵⁷ The Cooperative Societies Act of 1985.

resolution between the parties. Market participants note that arbitration and dispute resolution procedures could be strengthened and promoted in order to encourage the parties to resolve the matters via this route and thus reduce the workload of the courts.

However, once an arbitral award is obtained, it has to be registered with the courts in order to be enforced, which could cause delays since a debtor is allowed to file an objection to such registration, and even if such objection is unfounded, the court will have no choice but to examine the substance of the application and the objection and deliver a judgment.

6.3 Extrajudicial (out-of-court) enforcement

6.3.1 Enforcement of unsecured claims

Out of court enforcement, in the strict sense, of unsecured claims is not legally possible except with the cooperation of the debtor. Typically unsecured claims must therefore be enforced through a court procedure.

6.3.2 Enforcement of secured claims

As mentioned above, depending on the nature of the specific security put in place, it is possible to enforce such security out of court for the purpose of satisfying the secured claim. All types of securities, except for guarantees and assignments where the third party debtor does not cooperate, can be enforced out of court provided the underlying document creating such security contains relevant provisions and mechanisms.

As explained in paragraph 6.3.2(b) herein below, enforcement of pledges over share certificates may take place out of court through use of the various documents that are required to effect and complete the transfer of the shares covered by the pledge over share certificates which are handed over to the pledgee at the time of execution of the document creating the pledge.

Enforcement of a mortgage through the new and simplified procedure introduced with the amendment of the Mortgage Act in 2014, as explained in paragraph 6.3.2(a) herein below, also takes place out of court.

Where out of court enforcement of a particular security is possible, creditors will usually elect to proceed out of court and will not opt to resort to court except where absolutely necessary.

Furthermore, enforcement of an assignment or charge and assignment over receivables can take place out of court. However, this presupposes that both the assignor/chargor as well as the third party debtor cooperates. In particular, even if notice of the assignment or of the charge and assignment is given by the assignee to the third party debtor, requesting such third party debtor to make any payments with regard to the assigned receivable to the assignee instead of the assignor/chargor, in the event that the assignor/chargor advises or instructs the third party debtor not to make such payments to the assignee/chargee but the assignor/chargor instead, a third party debtor may elect to comply with such instructions of the assignor/chargor, in order not to be in breach of his contractual obligations towards the assignor/chargor under the contract between the assignor/chargor and that third party debtor since the third party debtor is not contractually bound by the assignment or the charge and assignment.

With regard to a charge over bank accounts, where the charged bank account is with the same credit institution that provides the facility, the relevant charge can be enforced without any further steps, provided that the instrument creating the charge is properly drafted and contains provisions allowing the bank to set off credit and debit accounts which the debtor holds with the bank towards payment of the debt.

Identified issues:

With regard to the enforcement of a charge and assignment, non-cooperation by the third party debtor as explained above will hinder the enforcement of a charge and assignment over receivables. The same problem may occur with regard to an assignment or a charge and assignment where the charged bank account is maintained at a bank other than the lender/chargee.

Recommendations for reform:

This problem could be handled through introduction of a new piece of legislation that would explicitly provide that the third party debtor or bank other than the lender/chargee bank, upon receipt of notice of assignment or charge and assignment and subject to the occurrence of a default under the underlying secured obligation, is bound to pay the assigned/charged receivables directly to the assignee/charge.

(a) Enforcement by way of public auction sale (immovable property)

Prior to the amendment of the Mortgage Act in 2014, mortgagees had the option to apply to the court and obtain a court judgment ordering, *inter alia*, the sale of the mortgaged property or to apply directly to the appropriate District Lands Office for the sale of the mortgaged property. Most mortgagees were electing to proceed and obtain a Court judgment against the debtor in order to avoid any disputes during the sale procedures. From our experience, the procedures followed by the appropriate District Lands Office were lengthy and it commonly took between 10 – 12 years from the time the procedure was initiated before the District Lands Office for a public auction to be fixed and the sale completed.

Following the financial crisis in Cyprus, the Mortgage Act was amended in 2014 in an effort to introduce more simplified and quicker procedures aiming to assist the creditors in enforcing their securities and satisfying their claims.

The amendments effected to the Mortgage Act have indeed simplified the procedure and abridged the time period that elapses from commencement of the procedure for sale of a mortgaged property until an auction is fixed.

However, practice has shown that the debtors took advantage and/or abused the rights afforded to them by the amended Mortgage Act. In an effort to make the system more efficient the Mortgage Act was further amended in July 2018.

Although the newly amended Mortgage Act has expanded the objections available to the debtors in relation to the contents and/or due service of the various notices required, it has restricted/limited the right of the debtors to file unsubstantiated appeals against notices or actions provided and/or taken by the secured creditors.

Furthermore, the new amended Mortgage Act provides for the possibility of electronic auctions at the creditors' election.

Identified issues:

The Mortgage Act, as amended, has simplified the procedure on enforcement by way of public auction, since the mortgagees are simply required/obliged to serve the mortgagors with various notices as these are specified in the Mortgage Act, requesting payment or settlement of the debt and notifying the mortgagor that failure to comply may result in the sale of the mortgaged property. Market participants highlighted that the obligations imposed on the mortgagees by the Mortgage Act, i.e. service of various notices on the mortgagors and/or any other

party, may cause delays or even freeze the whole process since in most cases the recipients of such notices cannot be found hence service proves difficult or impossible.

Recommendations for reform:

The law should specify that notification of public auction should be provided in a manner that will ensure that the information is known to all interested parties.³⁵⁸ Notices should be given in a way to avoid the notification procedure becoming unwieldy. Effective notification should include various forms of electronic communication and use of relevant public registries to address the issue related to the difficulty of serving proper notice.³⁵⁹

Since the amendment of the Mortgage Act, although a number of properties were put in auction, the number of properties actually sold during such auctions is still limited. It is worth noting that from statistics revealed from the CBC for the year 2017 only 3.2% of the properties for which notices of sale were sent, were sold. This can be attributed in part to the financial crisis in Cyprus which resulted in a depressed real estate market. Given the fact that the Mortgage Act has been recently amended, it remains to be seen if in practice the latest amendments will facilitate the procedure and eliminate the abuse and/or the delays caused by the debtors.

- (b) Enforcement by way of private sale (immovable property, pledge over shares, charge etc.)

Irrespective of what is stated in paragraph (a) above in relation to public auctions, the Mortgage Act provides that if the first attempt to sell a mortgaged property through public auction fails, the creditor has the option to proceed with the sale of the mortgaged property either by auction or through private sale.

The documents creating the security, whether those are pledges over share certificates, fixed or floating charges etc., customarily allow for the private sale of the charged property.

For clarity, there is nothing to preclude the parties to the documents creating the charge to agree that sale of the charged property will be through a public auction.

- (i) As far as pledges over share certificates are concerned, in addition to the share certificate, all documents that are required to effect and complete the transfer of the shares covered by the pledge over share certificate, such as instruments of transfer, letters of resignation etc., are handed over to the pledgee, duly executed but undated, at the time of execution of the document creating the pledge thus the pledgee may enforce the pledge by dating and utilising those documents.
- (ii) On sale of a property subject to a security, in particular through a private sale, the lender even though not bound to sell at the best possible price, should be careful not to sell at an undervalue since in such a case, if there are insufficient funds to cover the entire claim, such sale an undervalue may result in claims against the lender.

³⁵⁸ *Supra note 11*, UNCITRAL Insolvency Guide, Recommendation 56 page 112.

³⁵⁹ *Ibid*, para. 70 page 61.

The appointment of a receiver is possible under Cyprus law, either by the secured creditor obtaining a court order for the appointment of a receiver or manager of the property of the Cyprus company or by appointment under any powers contained in the instrument creating the charge. Powers to appoint receivers are customarily found in floating charges. The receiver, once appointed, in general manages the affairs and the assets of the chargor and should exercise such powers in line with the provisions of the Companies Act. Subject to the foregoing, the aim of a receiver is to protect the interests of the creditor that has appointed him and may proceed with the sale of such assets as are necessary to repay the secured debt or even the whole company.

- (i) As concerns mortgages over ships registered with the DMS, the Merchant Shipping Act provides that the document creating the mortgage must include, *inter alia*, the powers exercisable by the mortgagee, including, subject to the below proviso, power to take possession of the ship, assume its management and sell the ship by private sale. However, no power to take possession of the ship and assume its management or sell it by private sale shall be exercised by a mortgagee unless the entire ship is mortgaged.
- (ii) Further to the above, although the enforcement procedure as provided in the legislation for fixed and floating charges on assets is relatively clearly defined and simple, it is not unusual for a debtor to challenge the enforcement through lengthy, costly and inefficient court proceedings, which, as explained above, may from our experience last four to seven years until the issue of a final judgment at first instance thus causing delays in the enforcement of the security and increases in the costs of the receivership.

Identified issues:

Certain obstacles, identified in discussions with market participants, may delay the appointment of receivers/managers and the overall enforcement of a floating charge. This includes: (a) the non-cooperation of the directors of the company who fail to prepare and submit the statement of affairs of the company to the receiver/manager; (b) the holders of the memorandum (creditors who have registered a court judgment over the immovable property of a debtor) blocking a sale of a company's immovable property; and (c) the requirement by the Tax Authorities for the settlement of all outstanding taxes of the company before issuing a tax clearance.

Market participants emphasized that the legal framework on the appointment of the receivers is outdated.

Recommendations for reform:

We suggest that the Companies Act be reviewed and amended in order to provide clarity on the powers of the receivers and the procedure to be followed in exercising their duties, thus avoiding having to resort to court for clarification on issues or seeking an order in relation to the exercise of his duties, such as inclusion of provisions allowing the receiver to take in his possession and dispose of at a fair market price assets of the debtor to repay the debt, inclusion of provisions on the remuneration of the receiver without the need to apply to the Court, extension of certain periods prescribed by the law within which the receiver must fulfil certain obligations thus abolition of the need to apply to the Court in order to get extension of time, something

which is time consuming and may delay the enforcement process.

Enforcement of secured claims can, subject to certain provisions of the Companies Law, be enforced despite commencement of liquidation, as further explained in paragraph 8.1.

6.3.3 Enforcement of personal guarantee

A personal guarantee cannot be enforced out of court unless the guarantor cooperates with the lender's demands.

6.3.4 Exemption for enforcement requirements for financial collateral

Under the FCA Act, on the occurrence of an enforcement event, a collateral taker must be in a position to realise any financial instruments or cash provided as financial collateral under a security financial collateral arrangement, as follows:

- (a) financial instruments by sale or appropriation or by setting off their value against, or applying their value in discharge of, the relevant financial obligations. Appropriation is only possible if:
 - (i) it has been agreed by the parties in the security financial collateral arrangement; and
 - (ii) the parties have agreed in the security financial collateral arrangement on the valuation of the financial instruments and the credit claims.
- (b) cash by setting off the amount against or applying it in discharge of the relevant financial obligations;
- (c) credit claims by sale or appropriation and thereafter by setting off their value against, or applying their value in discharge of, the relevant financial obligations.

Furthermore, under the FCA Act, subject to the terms agreed in the security financial collateral arrangement, the realisation of financial collateral in the manner referred to herein before can be effected without any requirement:

- to provide prior notice of the intention to realize;
- that the terms of realization be approved by any court, public officer or other person;
- that realization be conducted by public auction or in any other prescribed manner; or
- that any additional time period must have elapsed,

(the "**Exempted Requirements**").

The enforcement of a financial collateral arrangement in accordance with its relevant terms is possible notwithstanding the commencement or continuation of winding up proceedings or reorganisation measures in respect of the collateral provider or collateral taker. The foregoing is without prejudice to any requirements under Cyprus law to the effect that the realisation or valuation of the financial collateral and the calculation of the relevant financial obligations be conducted in a commercially reasonable manner.

6.4 Bank guarantee

As explained above, a bank guarantee is not common as a security in finance transactions. As a general rule, a properly drafted and unambiguous bank guarantee is irrevocable and will allow the beneficiary thereof to recover thereunder within its validity period, subject to complying with any conditions and providing the required notice. Therefore, the involvement of the courts is rarely necessary.

6.5 Enforcement costs

With regards to enforcement through court proceedings, the legal costs are calculated according to the scales provided under the Civil Procedure Rules, which are directly related to the amount of the claim. Such costs also include out of pocket expenses such as stamp duties, etc.

Out of court enforcement costs may include costs of lawyers, receivers and certain costs that may be payable to various governmental bodies that may be involved in the enforcement process, such as for example fees payable to the Land Registry in relation to the enforcement process under the Mortgage Act.

Recently, the Supreme Court approved the increase of legal fees and costs in court procedures which may prohibit debtors from raising unsubstantiated defences and/or objections or appeals. This may also deter small claim creditors from filing law suits, which may help decongest the courts, since law suits relating to small claims constitute a substantial portion of the actions filed before the Courts. From unofficial sources, it appears that the number of law suits filed over the last six months has been reduced.

With regard to costs of advisors and/or receivers, those are negotiated between the relevant parties. From our experience, in the negotiations of such costs, the form of the security, the amount of the claim and the complications that may arise, are taken into account.

7. PROCEDURAL APPEAL

7.1 Appeal in judicial enforcement of secured claims

Any debtor is free to appear and object to the court proceedings instituted against him for the enforcement of a secured claim. The fact that a claim is secured does not necessarily exclude a debtor from defending such claim.

While in the past, credit institutions commonly applied to the court and requested issuance of summary judgments, and such judgments were issued by the courts more readily where the court was satisfied that, *prima facie*, without going into the substance of the case, the debtor's defence was not valid. Nowadays, the courts tend to be more reluctant to issue such judgments and may give the debtor the chance to be heard on the substance of the claim. The reason for the court's reluctance to issue summary judgements is mainly the fact that it was proven through the years that credit institutions were overcharging accounts, thus debtors, in most cases, had a valid defence and had the right to be heard on the substance.

7.2 Appeal in out-of-court enforcement of secured claims

Any person, showing good cause, may apply to the court for the removal or replacement of a receiver on the allegation that he was in breach of duty or guilty of any misconduct or even that the interests of the general creditors are better served if he is removed or replaced, or for the issue of a court order prohibiting the receiver from dealing with the company's business.

7.3 Appeal in insolvency and winding-up proceedings

The types of winding up proceedings are analysed in section 8 below.

As far as liquidation proceedings are concerned, the debtor company against whom such proceedings have been commenced must be served with a petition for liquidation, and is free to appear in court and contest the issue of an order for its liquidation.

If no court judgment was issued prior to filing of the applications for liquidation and the debtor company disputes the claim, then the court has the power to stay the proceedings and/or dismiss the application since courts adjudicating on liquidation proceedings do not examine the substance/validity of the claim. If an application is stayed or dismissed as aforesaid, the creditor may resort to court for obtaining a judgement in substance, through separate court proceedings.

If the debtor company does not appear in court and provided that all the requirements for the liquidations are complied with and no interested parties appear and object, the proceedings should be concluded in less than 6 months. If contested though, subject to what has been stated above, it is likely for the proceedings to last from 6 – 18 months until a judgment is issued on the application for the liquidation of the company.

8. IMPACT OF INSOLVENCY AND WINDING-UP PROCEEDINGS ON ENFORCEMENT

Identified issues:

Although the Companies Act contains certain provisions with regard to the impact of insolvency on enforcement, the position and rights of the secured creditors and in particular their rights to enforce their securities once the liquidation and winding up have commenced, is still not entirely clear.

Recommendations for reform:

An amendment of relevant laws such as, inter alia, the Companies Act, could be introduced whereby more clarity in relation to the position and rights of the secured creditors and in particular their rights to enforce their securities once the liquidation and winding up have commenced, could be given.³⁶⁰

8.1 Exemptions to security enforcement from insolvency

Subject to certain provisions of the Companies Act, a secured creditor can enforce its security notwithstanding the commencement of liquidation or winding up proceedings. However, following an application to the Court by the liquidator, where the Court is satisfied that the disposal of any property of a company, which is subject to security in favour of a secured creditor may lead to a favourable liquidation of the company's assets, the Court may issue an order by which the secured property will come under the liquidator's management for the disposal thereof or the exercise of his powers and authorities in relation thereto.

Preferential claims will be satisfied first where a memorandum (notice) has been imposed or registered on an immovable property, for example by tax authorities, and upon sale of such immovable property by a secured creditor who has registered a mortgage, such preferential claims will be satisfied in priority. If no such memorandum has been registered on a property, then any such preferential claim, even if listed in the Companies Act as having priority, will be paid if there is any surplus following sale of the mortgaged property and satisfaction of the secured creditor who had registered the mortgage. The foregoing applies also for costs and expenses of the liquidation, for which there cannot be a memorandum registered on a property, hence they will be satisfied first out of any surplus following satisfaction of the secured creditor's claim.

As will be analysed in the following sub-sections of this section 8, there are a number of provisions in the Companies Act dealing with the effects of insolvency and liquidation and winding-up proceedings

³⁶⁰ *Supra* note 7, UNCITRAL Legislative Guide, para. 4 page 423.

on enforcement and on antecedent and other transactions, some of which are applicable in every mode of winding up, whether liquidation proceedings (mandatory) or winding up proceedings (voluntary), as indicated herein below.

8.2 Examinership

In 2015, as part of a new insolvency framework, Cyprus introduced the proceedings of examinership, through amendments to the Companies Act.

The examinership procedure under the Companies Act is very similar to the concept of examinership under Irish law. It is a court-led debt restructuring and corporate rescue procedure for insolvent companies or companies that are likely to be insolvent, that are however viable, with the purpose of facilitating such viable companies facing financial difficulties to survive as a "going concern".

The process involves the appointment, on application to the court, of a licensed insolvency practitioner as examiner, whose role is to prepare proposals for a compromise and /or scheme of arrangement of the company with its creditors. The application for the appointment of an examiner must be accompanied by an independent expert's report on which the court will rely in order to decide whether there is a reasonable prospect of survival of the company as a going concern.

Once the order of the court for the appointment of an examiner is granted, the company in question is placed under the protection of the court for a period of four (4) months from the date that the application for the appointment of an examiner is made, which can be extended for an additional sixty (60) days, on application of the examiner. Before the end of the foregoing period, the examiner's proposals for a compromise and/or scheme of arrangement must be formulated and approved by the company's creditors.

It is important to note that during the entire period in which the company remains under the protection of the court, the company is protected from any creditor action. For example, creditors cannot apply for the liquidation of the company, cannot apply for the appointment of a receiver or take any steps for the enforcement of any judgement against the company.

Identified issues:

The concept of examinership is relatively new and has not been tested in practice yet, since many debtors are reluctant to use it. Therefore it remains to be seen how useful and widely used this process will be. Given the congestion and delays in the Cyprus courts, hearings may take a long time to arrange and by the time an application for the appointment of an examiner is heard, most, if not the entirety, of the period allowed by the law for the completion of the process may have elapsed.

In addition, the potentially high costs related to examinership, such as fees and other costs of lawyers and examiners, may prevent debtors from electing to follow this procedure.

Furthermore, there is no secondary legislation currently in place in Cyprus that would aid in the practical application of this process nor any best practice directives like the ones enacted in Ireland for the independent experts or any codes of practice in relation to insolvency practitioners, as a safety mechanism to deter biased behaviours and protect creditors' interests. The establishment of such secondary legislation and/or best practice directives should be considered as a means to assist in the practical application of the examinership procedure.

If not applied correctly, examinership may be used as a tool for abuse by allowing companies with no real prospect of survival to be put "on life support" and enjoy protection from creditors for as long as permitted by the law.

Recommendations for reform:

It is advisable to specify additional qualifications required for the appointment of insolvency practitioners as examiners, to establish a mechanism for selection and appointment of examiners, to specify powers and functions and to provide for remuneration, liability, removal and replacement of

examiners.³⁶¹ These issues are not addressed by the Companies Law or the Insolvency Practitioners Law and Regulations.

The Insolvency Practitioners Law sets the minimum standards of qualification and regulation for the role of the insolvency practitioner and restricts certain activities to persons meeting those standards or to the Official Receiver. Such restricted activities are acting as a liquidator, provisional liquidator, receiver, administrator or examiner under the Companies Law or as a trustee in bankruptcy proceedings against a natural person.³⁶² An examiner must be member of a recognised professional body. Insolvency Practitioners have the responsibility to participate in appropriate programmes of continuing education to maintain their theoretical knowledge, professional skills and values at a high level.³⁶³

Regarding the fees of the examiner (and lawyers) a balance should be struck³⁶⁴ between strict requirements for an appointment of a qualified person, which may significantly add to the costs of the proceedings, and requirements that would be too low, to guarantee the quality of the service required.³⁶⁵ An appointment system which encourages a measure of competition among examiners on fees would therefore be needed.

8.3 Pre-insolvency proceedings

The Companies Act contains provisions related to company arrangements and reorganisations and compromises with creditors and members.³⁶⁶ Recently, this procedure is being used by financially troubled companies in order to restructure problematic debts and avoid going into liquidation or winding up proceedings.

The relevant sections of the Companies Act regarding arrangements and reorganisations do not provide for an automatic stay of legal proceedings of enforcement of claims by creditors.

Under the Companies Act,³⁶⁷ where a compromise or arrangement is proposed between a company and its creditors or between the company and its members or any class of them, the company or any creditor or member, or in the case of a company being wound up, the liquidator may apply to the court for an order convening a meeting of the creditors or the members of the company, in whatever way the court directs.

Subject to the sanction of the court, any compromise or arrangement approved by a simple majority in value of the creditors or simple majority in number of votes of members, as the case may be, present and voting at the meeting, will be binding on all the creditors or members and on the company, and in case of a company being wound up, on the liquidator and contributories³⁶⁸ of the company.

Furthermore, in order for it to be binding, any order of the court sanctioning a compromise or arrangement must be delivered to the Register of Cyprus Companies for registration and every copy of such order must be annexed to every copy of the memorandum of the company issued after the order has been made or in case of a company that has no memorandum, a copy of every order must be attached to every copy of the instrument comprising or defining the constitution of the company.

³⁶¹ *Supra* note 11, UNCITRAL Insolvency Guide, Recommendations 115-125 pages 188-189.

³⁶² <https://www.neocleous.com/articles/news/licensing-of-insolvency-practitioners>.

³⁶³ <http://www.lawyersincyprus.com/article/examinership-and-insolvency-new-law-in-cyprus>.

³⁶⁴ *Ibid.*, para. 37 page 174.

³⁶⁵ *Ibid.*

³⁶⁶ Sections 198 to 201 of the Companies Act.

³⁶⁷ Section 198 of the Companies Act.

³⁶⁸ Under the Companies Act the term "contributory" means every person liable to contribute to the assets of a company in the event its being wound up, and for the purposes of all proceedings for determining, and all proceedings prior to the final determination of, the persons who are to be deemed contributories, includes any person alleged to be a contributory.

Identified issues:

Until the amendment of the Companies Act in 2015, the required majority was a majority in number representing three-fourths in value of creditors or members present and voting. The rationale behind the amendment reducing this to a simple majority was to make it easier to bind creditors or members who disagree and avoid liquidation or winding up. This in essence allows for a reorganisation plan to be "imposed" by some creditors or members despite the objection of others.

The only safeguard measure in place appears to be the requirement for any compromise or arrangement to be sanctioned by the court, however given the absence of an experienced and established insolvency profession and specialised insolvency courts and the accompanying regulatory framework and related infrastructure, the whole procedure carries the danger of abuse to the detriment of some creditors' interests.

Recommendations for reform:

The Companies Act should identify the matters on which a vote of creditors is required and establish the voting requirements applicable in each case.³⁶⁹ The Companies Act provides simply that the court must sanction any compromise or arrangement in order for such to be binding.

In order to reach an agreement with its creditors, legislative provisions could be introduced to enable a debtor to ask the court to appoint a "mediator", a possibility which exists within some European jurisdictions such as France. The mediator would have no particular powers, but could request, subject to satisfaction of certain conditions, the court to impose a limited stay of execution against all creditors if, in his or her judgement, a stay would make a conclusion of agreement easier. This would require an amendment to the Companies Act to allow for an option of a standstill or moratorium to conclude an agreement. Practically, the procedure would end when agreement is reached either with all creditors or (subject to court approval) with the main creditors.³⁷⁰

8.4 Liquidation proceedings (mandatory)

The Companies Act provides that a company may be liquidated (wound-up) by the court, *inter alia*, where the company is unable to pay its debts.

The procedure is initiated by presenting a petition to the court, by, *inter alia*, any creditor (including a contingent or prospective creditor), the company, a contributory or the examiner.

Under the Companies Act, at any time after the presentation of a petition for the liquidation of a company, and before a liquidation (winding-up) order is made, the company or any creditor or contributory, may: (a) where any action or proceeding against the company is pending in any District Court or the Supreme Court apply to the court in which the action or proceeding is pending for a stay of proceedings therein; and (b) where any other action or proceeding is pending against the company, apply to the court having jurisdiction to liquidate (wind-up) the company to restrain further proceedings in the action or proceeding, and the court to which application is so made, as the case may be, stay or restrain the proceedings accordingly on such terms as it thinks fit.

Furthermore, in a liquidation by the court, any disposition of the property of the company, including actionable rights and any transfer of shares or alteration in the status of the members of the company, made after the commencement of the liquidation, shall be void unless the court orders otherwise.

The Companies Act also provides that where a company is being liquidated by the court, any attachment, sequestration, distress or execution put in force against the estate or effects of the company after the commencement of the liquidation is void. When a liquidation order has been made or a provisional liquidator has been appointed, no action or proceeding shall continue or commence

³⁶⁹ *Supra* note 11, UNCITRAL Insolvency Guide, para. 95 page 196.

³⁷⁰ *Ibid.*, para 32 page 30.

against the company except following permission of the court and subject to such terms as the court may impose.

Furthermore, the Companies Act extends the 'fraudulent preference' provisions of the Bankruptcy Act (for natural persons) to companies in liquidation, either by way of mandatory liquidation proceedings or voluntary winding-up proceedings.

To that effect, any transfer, charge, mortgage, delivery of goods, payment, execution or other actions relating to property, made or done by or against a company within six months before the commencement of its liquidation/winding-up which, had it been made or done by or against an individual within six months before the presentation of a bankruptcy petition on which he is adjudged bankrupt, would be deemed in his bankruptcy a fraudulent preference, shall in the event of the company being liquidated/wound up be deemed a fraudulent preference of its creditors and be invalid accordingly.

For determining the foregoing six month period, any time period during which the company was under the protection of the court during an examinership procedure, as analysed above, will not be taken into consideration. In addition to the foregoing, when a company is in liquidation/winding up, any floating charge over the undertaking or property of the company created within twelve months of the commencement of the liquidation/winding-up is void, unless it is proven that the company immediately after the creation of the charge was solvent, except to any amount paid to the company at the time of or subsequently to the creation of, and in consideration for, the charge, together with interest on that amount at the rate of 5% per annum or such other rate as may for the time being be prescribed by order of the Accountant-General. The foregoing applies in every mode of winding up, thus both in liquidation as well as in winding-up proceedings as described in section 8.5 herein below.

In accordance with the Companies Act, where a creditor has initiated enforcement against the goods (which includes all chattels personal) or immovable property of a company or has attached any debt due to the company, and the company is subsequently liquidated/wound up, it shall not be entitled to retain the benefit of the enforcement or attachment against the liquidator in the liquidation/winding-up of the company unless that creditor has completed the enforcement or attachment before the commencement of the liquidation/winding-up.

8.5 Winding-up proceedings (voluntary)

Winding up proceedings may be initiated by a company that is solvent by passing a special resolution of its members resolving that the company be wound up voluntarily and appointing a liquidator for the purpose of winding up the company's affairs, discharging the company's liabilities and distributing the remaining assets, if any, among the members (Members' voluntary winding up).

Ahead of convening a meeting of the members and passing the foregoing resolution, the directors of the company are obliged by law to make a statutory declaration of solvency to confirm that the company is able to pay its debts within 12 months from the commencement of the winding-up. Therefore, under the law all creditors of the company must be paid in full within 12 months from the commencement of the winding-up.

Where the company is not solvent and therefore unable to make the above-mentioned statutory declaration of solvency, the company, in addition to convening a meeting of its members, must arrange to also convene a meeting of its creditors in order for the directors of the company to present to the creditors a full statement of the position of the company's affairs together with a list of the creditors of the company and the estimated amount of their claims and to give the creditors the opportunity to nominate a person to be appointed as the liquidator (Creditors' voluntary winding up).

After the commencement of winding up proceedings as aforesaid, any transfer of shares, not being a transfer made to or with the approval of the liquidator, and any alteration in the status of the members of the company, shall be void.

We refer to the specific provisions of the Companies Act referenced in section 8.4 herein before, relating to the effects/impact of insolvency and winding up on antecedent and other transactions, that

are applicable to every mode of winding-up.

8.6 Financial collateral: close-out netting and treatment in insolvency procedure

- (a) According to the FCA Act, a close-out netting provision can take effect in accordance with its terms:
 - (i) notwithstanding the commencement or continuation of winding up proceedings or reorganization measures in respect of the collateral provider or the collateral taker or both; or
 - (ii) notwithstanding any assignment, judicial or other attachment or other disposition of or in respect of such rights.
- (b) In accordance with the FCA Act, a financial collateral arrangement, as well as the provision of financial collateral under such arrangement, may not be declared invalid or void or be reversed on the sole basis that the financial collateral arrangement has come into existence, or the financial collateral has been provided (i) on the day of the commencement of winding up proceedings or reorganization measures; or (ii) in a prescribed period prior to, and defined by reference to, the commencement of the proceedings or measures referred to in the immediately preceding paragraph (i) herein before or by reference to the making of an order or decree or the taking of any other action or occurrence of any other event in the course of such proceedings or measures.
- (c) In the event where a financial collateral arrangement or a relevant financial obligation has come into existence, or financial collateral has been provided on the day of, but after the moment of the commencement of, winding up proceedings or reorganization measures, such financial collateral arrangement is legally enforceable and binding on third parties if the collateral taker can prove that he was not aware, nor should have been aware, of the commencement of such proceedings or measures.

Subject to what has been referred to under this section 8.6 in relation to the treatment of financial collateral in insolvency proceedings, the FCA Act does not affect the general rules of Chapter V of the Companies Law (which deals with the winding up and liquidation of Cyprus companies) in relation to the avoidance of transactions entered into during the prescribed periods referred to in paragraph B (ii) and paragraph C (a) herein before.

9. FINANCIAL (CONSENSUAL) RESTRUCTURING AND OTHER WORK-OUTS

The CBC issued the CBC Directive,³⁷¹ for the application by all authorised credit institutions (the "ACIs") of efficient and effective measures for the management of arrears and the attainment of fair and sustainable restructurings of credit facilities of debtors in financial difficulties, being either physical or legal persons.

The CBC Directive also creates a Code of Conduct for the Handling of Borrowers in Financial Difficulties setting out specific rules on the handling of arrears and the conducting of restructuring programmes, on the basis of mutual co-operation between debtor and lender, which aims to provide a common ground for dealing with eligible debtors, including micro or small enterprises.³⁷²

Further to the above, a fundamental part of the Cyprus government's strategy to assist the country to recover from the financial crisis and return to stability and economic growth was the enactment of a new insolvency framework, applicable to both natural and legal persons. The new insolvency

³⁷¹ The Directive on Arrears Management of 2015.

³⁷² As these are defined in the European Commission Recommendation of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises (2003/361/EC).

framework comprises a package of six pieces of legislation³⁷³ and is in line with the terms of the Memorandum of Understanding between the Cyprus government, the IMF, the ECB and the EC program, as agreed in 2013 during the banking crisis.

The Insolvency Service pointed that recent statistics of the CBC show several re-defaults in respect of previously restructured debts, whether restructured by negotiation or mediation. This leads to the conclusion that the debtors are either unable to pay the amount of the monthly instalments even after restructuring, or they are strategic defaulters taking advantage of the fact that court enforcement, which may be the next step, is slow and inefficient.

9.1 Standstill

Under the CBC Directive, where debtors have various debts with multiple creditors, the ACIs, when formulating a restructuring plan, should consider the interests of all creditors, secured or unsecured, and are recommended to incorporate in their policies international best practices in this respect, such as the "Eight Principles" approved by INSOL International in 2000 for multi-creditor workouts. Those principles provide, *inter alia*, that all relevant creditors should be prepared to cooperate with each other, to give sufficient, though limited time (a "standstill period") for information about the debtor to be obtained and evaluated, and for proposals for resolving the debtor's financial difficulties to be formulated and assessed and that, during the standstill period, all relevant creditors should agree to refrain from taking any steps to enforce their claims against the debtor and the debtor should not take any action that might adversely affect the prospective return to relevant creditors (either collectively or individually) as compared with the position at the standstill commencement date.

9.2 Other arrangements

All the acts and/or directives that have been analysed above address all arrangements relating to restructuring of debts of physical or legal persons.

10. TRANSFER OF LOANS (NPL SALE)

10.1 General regulatory requirements and obstacles for security transfer

10.1.1 General on the transfer of credit facilities

In general, the purchase/acquisition/transfer of credit facilities granted to, *inter alia*, micro or small enterprises (as these are defined in the European Commission Recommendation of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises (2003/361/EC), including, *inter alia*, the purchase/acquisition/transfer of NPLs, together with related collateral, is regulated by the Sale of Credit Facilities Act. In particular, persons, other than credit institutions duly licensed/authorised by the CBC, credit institutions duly licensed/authorised and supervised by the competent authority of another Member State of the EU that have the right to provide services or to establish a branch in Cyprus and financial institutions, which are subsidiaries of a credit institutions incorporated in a Member State that provide services or do business in Cyprus through a branch established in Cyprus, pursuant to the provisions of the Credit Institutions Act, intending to engage in the purchase of credit facilities where the total balance of such credit facilities does not exceed EUR 1,000,000, must incorporate a credit acquiring company (the "CAC"), obtain a relevant license by the CBC (the "Licence") and follow, *inter alia*, the regulatory requirements briefly described under paragraph 10.1.2 below.

³⁷³ The Personal Plans Repayment Act, the Bankruptcy (Amendment) Act of 2015, the Companies (Amendment) (No. 2) Act of 2015, concerning the mechanism for corporate debt restructuring, the Companies (Amendment) (No. 3) Act of 2015, relating to liquidation, the Council on Insolvency Act of 2015 and the Council on Insolvency Regulations of 2015.

Irrespective of what is stated above, for the sale of credit facilities where the creditor or the judgement creditor is a credit institution, a financial institution or a CAC, the requirements in sections 18 and 19 of the Sale of Credit Facilities Act, briefly described under paragraph 10.1.2 below, must be followed. Furthermore, the purchase/acquisition of credit facilities/NPLs of enterprises other than micro or small enterprises does not require incorporation of a CAC or obtaining the License.

It is noted that (i) credit institutions duly licensed/authorised by the CBC, (ii) credit institutions duly licensed/authorised and supervised by the competent authority of another Member State of the EU that has the right to provide services or to establish a branch in Cyprus and (iii) financial institutions, which are subsidiaries of a credit institutions incorporated in a Member State that provide services or do business in Cyprus through a branch established in Cyprus, pursuant to the provisions of the Credit Institutions Act, provided that their license/authorisation does not prohibit their engagement in activities of acquiring/buying of credit facilities/NPLs, are exempted from the requirement of obtaining the License.

It should be further noted that credit facilities that (i) are granted by credit institutions duly licensed/authorised by the CBC, including their branches, to legal persons not registered in Cyprus, or (ii) relate to business and/or investments outside Cyprus, or (iii) their basic collateral includes mortgage on immovable property and/or charge on assets outside Cyprus, or (iv) are governed by the law of a country other than Cyprus, do not fall within the ambit of the Sale of Credit Facilities Act.

10.1.2 Regulatory requirements and obstacles for the transfer of collateral

Under the provisions of the Sale of Credit Facilities Act, a credit or financial institution or a CAC, prior to selling the whole or part of its credit facilities/NPLs, together with the securities attached thereto, must either (i) notify its intention to sell or dispose the whole or part of its portfolio of credit facilities, including NPLs, together with the attached securities through relevant publication in the Official Gazette of the Republic of Cyprus and three daily newspapers, or (ii) call the borrowers/debtors and their guarantors to submit, within prescribed period, an offer to purchase the credit facility/NPL under sale.

Subject to the above and in accordance to the provisions of the Sale of Credit Facilities Act, any credit facility/NPL, that is transferred to the purchaser, is deemed to be transferred to that purchaser at the time of such transfer and all rights and obligations are automatically transferred and continue to be valid between the debtor and the purchaser. The "time of transfer" under the Sale of Credit Facilities Act means the time which is determined in the agreement between the transferor/assignor and the purchaser as the time of transfer of the credit facilities.

Further to the foregoing, the Sale of Credit Facilities Act, as recently amended, provides that: *"From the time of transfer the purchaser of credit facilities replaces the transferor/assignor in relation to all the rights and obligations concerning any collateral in a way that any collateral which is obtained by the transferor/assignor for purposes of securing repayment of the credit facility, is transferred to the purchaser, held and is at his disposal as collateral/security for the repayment of the credit facility transferred: Provided that, for the purposes of this section, collaterals include and any contracts of guarantee and any encumbrance: Provided further that, irrespective of the requirements of any other law or any directions issues under any other law, the transfer of collaterals from the transferor/assignor to the purchaser is made without the payment of any costs". Furthermore, "The purchaser of credit facilities has the same rights, the same order of priority, and is subject to the same obligations, in relation to contracts of credit facilities and collaterals transferred to him, as the transferor/assignor".*

With regards to the possession of documents, books, goods or assets, the Sale of Credit Facilities Act provides that: *"The possession of any documents, books, goods or other assets*

which are held by the transferor/assignor in respect of credit facilities being transferred, is deemed to be transferred to the purchaser at the time of the transfer together with all related rights and obligations of the transferor/assignor in relation to such documents, books, goods or other assets and in anticipation of any such transfer, the transferor/assignor is deemed to hold any such document, book, good or other asset on trust or as bailee, as appropriate, exclusively for the benefit of the purchaser".

In addition to the above, "All documents, books, records and assumptions/admissions which constitute evidence by law or otherwise, for or against the transferor/assignor, with respect to any matter, constitute evidence for or against the purchaser, during and after the time of transfer".

We note that the Mortgage Act, provides that following the sale/transfer of a loan/credit facility secured with mortgage over immovable property situated in Cyprus, the mortgagor will retain his rights against the buyer of the loan and the buyer of the loan its obligations towards the mortgagor including, without limitation, under the contract and in particular will retain the right to restructure its credit facility and its recourse to the mediation procedure in accordance to the provisions of the Credit Institutions Act and the Establishment and Operation of the Unified Body of Out-of-court Dispute Resolution of a Financial Nature Act of 2010, respectively.

In addition to the above, in the event that together with the sale of a portfolio of credit facilities/NPLs, the purchaser shall also acquire the operations of a department or part of the business of such credit or financial institution or a CAC, including the necessary resources i.e. employees to be moved under the employment of the purchaser, the provisions of the Safeguarding and Protection of Employees Rights in the Event of the Transfer of Undertakings, Businesses or Parts Thereof Act of 2000, as amended, (TUBE), may apply.

The procedure under the Sale of Credit Facilities Act, especially as recently amended, is rather straightforward; therefore, unless abused by debtors we cannot see any substantial obstacle preventing the transfer of collateral in the context of a sale of a credit facility/NPL. It should be noted, however, that the Sale of Credit Facilities Act is a recent enactment, and the amendments thereto even more recent, and has not been tested yet. As a matter of fact, no loans/NPLs have been sold/ transferred up to the date of this report. So far only Hellenic Bank has engaged the services of APS Cyprus for the management of the bank's NPLs and real estate portfolio, whilst the bank has retained the ownership of the portfolio.

10.2 Issues relating to collateral transfer

10.2.1 Form of transfer (notices, consents)

As noted in section 10.1 above, the Sale of Credit Facilities Act, as recently amended provides for the automatic transfer of the collateral relating to the transferred/sold credit facility/NPL without the payment of any cost. Since it is still not explicitly provided that no recordings should be made following such automatic transfer, even though through the amendments introduced such recordings appear not to be required, it is advisable, to the extent that a security is recorded with any public body in Cyprus e.g. the Registrar, the Lands Office, the DMS, to effect the relevant notifications, in order to avoid any possible disputes and/or irregularities, especially in light of the fact that as mentioned herein above, that the Sale of Credit Facilities Act is a recent enactment, and the amendments thereto even more recent and has not been tested yet.

Further to the above:

- (a) the Mortgage Act provides that a mortgagee may, unless the mortgage agreement contains provisions to the contrary, transfer the mortgage created in his favour to any third party. Such transfer is recorded with the appropriate Lands Office and upon such registration all rights, duties, powers and privileges of the mortgagee are transferred to the transferee thereof. The transfer of a mortgage registered as aforesaid does not affect the priority of the mortgage.
- (b) the Merchant Shipping Act provides that a mortgage over a ship may be transferred and such transfer is effected through a prescribed form and submission thereof with the DMS.

Regarding assignments provided as security of a credit facility, on transfer of such credit facility/NPL, notifications should be sent to the assignor, who has provided such security, if such assignor differs from the debtor whereas pledges should be notified to the company whose shares are pledged and relevant recordings effected in the register of members.

In accordance to the provisions of the Sale of Credit Facilities Act, the credit or financial institution or CAC, shall inform the borrower/debtor, the latest within five (5) working days from the transfer, that the credit facility agreement and related collateral have been transferred to another person. In addition, the foregoing act provides that each credit or financial institution or CAC which is a credit facility/NPL purchaser, shall provide the borrower/debtor with all relevant contact details of the persons responsible for the handling of the credit facilities/NPLs transferred and of the new account numbers.

Identified issues:

In our view, the issue of whether any recordings/registrations/notifications should be made following automatic transfer of the collateral relating to the transferred/sold credit facility/NPL should be clarified, either through further amendment of the Sale of Credit Facilities Act or other relevant applicable laws.

Recommendations for reform:

It would be reasonable and helpful that the law regulates the impact of a transfer of an encumbered asset on the effectiveness of registration, so as to explicitly provide whether any recordings/registrations/notifications should be effected following transfer of credit facilities/NPLs.³⁷⁴

10.2.2 Compliance with banking secrecy, data protection, requirement for license and permits

The Credit Institutions Act imposes an obligation of secrecy to credit institutions in relation to bank accounts maintained with them. The foregoing act contains explicit exemptions to the secrecy obligation, that include, *inter alia*, (a) consent by the customer, or (b) where processing of information is necessary for reasons of public interest, or (c) for the protection of the interests of the credit institution, or (d) where the information is supplied for the purpose of maintaining and operating a central information register, set up under the provisions of the Credit Institutions Act, to which only licensed/authorised credit institutions and companies that engage in activities, including, *inter alia*, portfolio management and advice thereof may participate and have access.

³⁷⁴ *Supra* note 7, UNCITRAL Legislative Guide, Recommendation 62 page 104.

Except for secrecy obligations on the CBC, the Sale of Credit Facilities Act does not contain any secrecy provisions or provisions on data transfer; neither does the Credit Institutions Act contain explicit provisions extending secrecy to purchasers of credit facilities/NPLs. Needless to say that to the extent that the purchaser is a credit institution falling within the ambit of the Credit Institutions Act, the secrecy provisions therein apply.

From our experience, credit institutions tend to obtain, at the time the various transaction documents are executed, the consent of debtors for the disclosure of their personal and other data, however the validity of such consent has not been judicially tested in the context of sale of credit facilities/NPLs or transfer of securities.

It should be noted that any processing of personal data of any physical persons should be made subject to and in accordance with the new European Regulation on Data Protection which came into force in May 2018, known as the GDPR.

Identified issues:

The current legal regime in Cyprus is rather unclear on issues relating to banking secrecy in the context of sale/transfer of credit facilities/NPLs.

Recommendations for reform:

It is imperative to amend the relevant applicable laws, as referenced above, to clarify the position in relation to consents obtained at the time of execution of the transaction documents and/or to provide that no such consent is required in the context of transfer/sale of credit facilities/NPLs.

10.2.3 Taking over by NPL purchaser of any existing enforcement procedure

Following its recent amendment, the Sale of Credit Facilities Act provides that *"any legal procedure, including, without limitation, any law suit, arbitration, foreclosure of immovable property or other procedure, and any actionable right or order or judgment which at the time of transfer of the credit facilities is pending or subsists for or against the transferor/assignor in relation to the credit facilities being transferred is not terminated or interrupted or adversely affected in any way due to the transfer of the credit facilities, but can be filed or continued or recognised or enforced by or against the purchaser of the credit facilities, who automatically replaces/substitutes the transferor/assignor in such legal procedure at the time of transfer of the credit facilities"* and that *"irrespective of the provisions of any other law, in the event where any procedure is pending before the court or district lands office, the replacement and/or substitution of the transferor/assignor by the purchaser, for the purposes of the pending procedure, is done through filing by the transferor/assignor of relevant notification to the court registrar or district lands office, as appropriate, and such notification bears no cost."*

It should be noted that the foregoing provisions do not apply to any criminal or administrative procedure or right to commence such procedure or any order or decision in respect thereof, which are not affected in any way by the sale of the credit facility and may be filed, continued or enforced by or against the transferor/assignor.

Furthermore, the Sale of Credit Facilities Act provides that *"Where in any document, whenever made or executed, any reference to the transferor/assignor is contained or implied, then, to the extent that such document relates to any right or obligation being transferred to the purchaser of the credit facilities, such reference is read, interpreted and applies as a reference to the purchaser at and following the time of the transfer, unless where the context requires otherwise."*

11. DEVELOPMENTS IN LEGISLATION AND PRACTICE ON ENFORCEMENT OF CLAIMS

11.1 Legislative acts

There are currently no proposals for legal reform regarding enforcement of claims.

11.2 Court practice

The Minister of Justice of Cyprus and the Supreme Court have decided to set up Commercial Courts which shall have jurisdiction over matters including claims arising from contracts, including, among other, finance contracts, or disputes between companies, the purchase or sale of goods, the exploitation of oil or gas, the purchase or exchange of shares, intellectual property and insurance affairs. This would cover enforcement of contracts and security but not insolvency proceedings. The claims or the amounts in dispute must not be less than EUR 2,000,000. However, no relevant law has been passed. If this proposal is indeed implemented, this may assist the decongestion of the courts, facilitating quicker justice. We would propose that in the mid to long term as part of the reform that all commercial enforcement and insolvency cases are administered by the Commercial Courts to ensure that the same are handled by specialist judges.

PART (B) INSTITUTIONAL FRAMEWORK REVIEW

12. INSTITUTIONAL FRAMEWORK REVIEW

12.1 Courts

As highlighted in our analysis, lack of adequate number of judges, heavy workload of the court, inefficient and obsolete civil procedure rules, lack of electronic case administration and generally lack of electronic means, result in general to repeated postponement of trials thus lead up to long delays. The foregoing are taken advantage by debtors thus resulting to inefficiency in the enforcement of securities where resorting to court proceedings is either imperative or opted by the creditor.

Market participants acknowledge the problems causing the delays and suggest, as a minimum, the appointment of more judges and the computerisation of the court proceedings.

In order to achieve speedy and efficient enforcement of security through court proceedings, the whole system should be reformed and modernised.

At present the judges are appointed through an interview, provided that they meet certain requirements. They do not become specialised ahead of being appointed but rather obtain any such specialisation through years of service in particular courts, i.e. family courts, labour courts etc. The School for Judges has already been established and through such school judges receive training in various fields of the law.

The Ministry of Justice and the Supreme Court have appointed international experts who are considering (and have to certain extent already implemented) the following reforms:

- (a) Reform of the courts,
- (b) Reform of the Civil Procedure Rules,
- (c) Establishment of a School for Judges.

12.2 Competent bodies of registry system

12.2.1 Registrar

While filing the prescribed forms for registration of a registrable security with the Registrar, as well as involvement of the Registrar to the extent required in the course of enforcement proceedings depends entirely on the creditor, completion of the relevant proceedings thereafter such as issuance of certificate of registration of a charge that requires prior examination of all submitted information/documentation by the Registrar is delayed due to heavy workload as well as the attitude of civil servants.

Even though the Office of the Registrar has been modernized through computerisation to a great extent, the involvement of employees who are assigned with the duty of examining submitted information/documentation is necessary, therefore such computerisation has not managed to eliminate the delays.

There is a need for an operational review of this institution with an aim of improving the overall efficiency of the Registrar. Employees of the Registrar should be more qualified and undergo frequent training and education so as to become more efficient and productive.

12.2.2 Lands Office

Throughout the years, the Lands Office was overloaded with work and understaffed, therefore

the pile of work increased by the day, resulting in substantial, inexcusable delays.

The fact that the Lands Office has been modernized through computerization did not result to elimination of the above, or to speedier procedures. In particular, following the financial crisis a great number of experienced employees left the Lands Office, thus not only the number of employees was reduced, but the level of experience has also reduced and the delays could not be handled. Notwithstanding the above and the delays associated with the enforcement of securities registrable with the Lands Office, the Lands Office truly and completely reflects the legal status of the lands situated in Cyprus.

In order for the Lands Office Department to be more efficient and productive it is imperative that the state hires new employees, adequately qualified and trained, to fill the gap that was created due to the early retirement of employees as a result of the financial crisis.

12.2.3 DMS (i.e. Υφυπουργείο Ναυτιλίας- Deputy Ministry of Shipping)

As opposed to Courts and the other competent bodies of the registry system, the Deputy Ministry of Shipping where mortgages over ships are registered is considered by market participants as one of the efficient public bodies. Even though it cannot be said that it is perfect and no delays are encountered, where no other body is involved, the procedures are in general completed within reasonable time.

SOURCES

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2. Business of Credit Institutions Act 66(I)/1997 (i.e. Ο Περί Εργασιών Πιστωτικών Ιδρυμάτων Νόμος) (Official Cyprus Government Gazette, as amended ΔΙΟΡΘ./Ι(Ι)/317/22.8.97, 74(I)/1999, 94(I)/2000, 119(I)/2003, 4(I)/2004, 151(I)/2004, 231(I)/2004, 235(I)/2004, 20(I)/2005, 80(I)/2008, 100(I)/2009, 123(I)/2009, 27(I)/2011, 104(I)/2011, 107(I)/2012, 14(I)/2013, 87(I)/2013, 102(I)/2013, 141(I)/2013, 5(I)/2015, 26(I)/2015, 35(I)/2015, 71(I)/2015, 93(I)/2015, 109(I)/2015, 152(I)/2015, 168(I)/2015, 21(I)/2016, 5(I)/2017, 38(I)/2017, 169(I)/2017, 28(I)/2018, 89(I)/2018);
3. Companies Act Cap 113 (i.e. Ο περί Εταιρειών Νόμος (ΚΕΦ.113)) (Official Cyprus Government Gazette, as amended 9/1968, 76/1977, 17/1979, 105/1985, 198/1986, 19/1990, 46(I)/1992, 96(I)/1992, 41(I)/1994, 15(I)/1995, 21(I)/1997, ANAK.2331, 82(I)/1999, 149(I)/1999, 2(I)/2000, 135(I)/2000, 151(I)/2000, 76(I)/2001, 70(I)/2003, 167(I)/2003, 92(I)/2004, 24(I)/2005, 129(I)/2005, 130(I)/2005, 98(I)/2006, 124(I)/2006, 70(I)/2007, 71(I)/2007, 131(I)/2007, 186(I)/2007, 87(I)/2008, 41(I)/2009, 49(I)/2009, 99(I)/2009, 42(I)/2010, 60(I)/2010, 88(I)/2010, 53(I)/2011, 117(I)/2011, 145(I)/2011, 157(I)/2011, 198(I)/2011, 64(I)/2012, 98(I)/2012, 190(I)/2012, 203(I)/2012, 6(I)/2013, 90(I)/2013, 74(I)/2014, 75(I)/2014, 18(I)/2015, 62(I)/2015, 63(I)/2015, 89(I)/2015, 120(I)/2015, 40(I)/2016, 90(I)/2016, 97(I)/2016, 17(I)/2017, 33(I)/2017, 51(I)/2017, 37(I)/2018, 83(I)/2018);
4. Contract Act Cap 149 (i.e. Ο περί Συμβάσεων Νόμος (ΚΕΦ.149)) (Official Cyprus Government Gazette, as amended 22(I)/1995, ANAK.3374, 99(I)/2013);
5. Cooperative Societies Act of 1985 (Ο περί Συνεργατικών Εταιρειών Νόμος) (Official Cyprus Government Gazette, as amended 22/1985, 68/1987, 190/1989, 8(I)/1992, 22(I)/1992, 140(I)/1999, 140(I)/2000, 171(I)/2000, 8(I)/2001, 123(I)/2003, 124(I)/2003, 144(I)/2003, 5(I)/2004, 170(I)/2004, 230(I)/2004, 23(I)/2005, 49(I)/2005, 76(I)/2005, 29(I)/2007, 37(I)/2007, 177(I)/2007, 104(I)/2009, 124(I)/2009, 85(I)/2010, 118(I)/2011, 130(I)/2012, 204(I)/2012, 214(I)/2012, 15(I)/2013, 39(I)/2013, 88(I)/2013, 107(I)/2013, 185(I)/2013, 23(I)/2014, 122(I)/2014, 107(I)/2015, 138(I)/2016, 84(I)/2018);
6. Copyright and Neighboring Rights Act of 1976 (59/1976) (i.e. Ο περί του Δικαιώματος Πνευματικής Ιδιοκτησίας και Συγγενικών Δικαιωμάτων Νόμος) (Official Cyprus Government Gazette, as amended 63/1977, 18(I)/1993, 54(I)/1999, 12(I)/2001, 128(I)/2002, 128(I)/2004, 123(I)/2006, 181(I)/2007, 207(I)/2012, 196(I)/2014, 123(I)/2015, 66(I)/2017);
7. Establishment and Operation of the Unified Body of Out-of-court Dispute Resolution of a Financial Nature Act (84(I)/2010) (i.e. Ο περί της Σύστασης και Λειτουργίας του Ενιαίου Φορέα Εξώδικης Επίλυσης Διαφορών Χρηματοοικονομικής Φύσεως Νόμος) (Official Cyprus Government Gazette, as amended 125(I)/2014, 126(I)/2014, 125(I)/2015, 80(I)/2017, 174(I)/2017, ΔΙΟΡΘ. Ε.Ε. Παρ. Ι(Ι), Αρ. 4632, 15.12.2017, 75(I)/2018);
8. Financial Collateral Act (Ο Περί των Συμφωνιών Παροχής Χρηματοοικονομικής Εξασφάλισης Νόμος) (Official Cyprus Government Gazette, as amended 43(I)/2004,

100(I)/2011, 17(I)/2016, 145(I)/2017);

9. Insurance Services and Other Related Matters Act 35(I)/2002 (i.e. *Ο περί της Ασκήσεως Ασφαλιστικών Εργασιών και Άλλων Συναφών Θεμάτων Νόμος*) (Official Cyprus Government Gazette, as amended 141(I)/2003, 165(I)/2003, 69(I)/2004, 70(I)/2004, 136(I)/2004, 152(I)/2004, 153(I)/2004, 240(I)/2004, 17(I)/2005, 26(I)/2008, 105(I)/2009, 50(I)/2011, 132(I)/2013, 38(I)/2016);
10. Investment Services, exercise of Investment Activities, the Operation of Regulated Markets and Other Related Matters Act of 144(I)/2007 (i.e. *Ο περί Επενδυτικών Υπηρεσιών και Δραστηριοτήτων και Ρυθμιζόμενων Αγορών Νόμος*) (Official Cyprus Government Gazette, as amended 106(I)/2009, 141(I)/2012, 154(I)/2012, 193(I)/2014, 8(I)/2016, 87(I)/2017);
11. Merchant Shipping (Registration of Ships, Sales and Mortgages) Act of 1963 (45/1963) (i.e. *Ο περί Εμπορικής Ναυτιλίας (Νηολόγησις, Πώλησις και Υποθήκευσις Πλοίων) Νόμος*) (Official Cyprus Government Gazette, as amended 32/1965 82/1968 62/1973 102/1973 42/1979 25/1980 14/1982 57/1986 64/1987 28(I)/1995 37(I)/1996 138(I)/2003 169(I)/2004 108(I)/2005);
12. Personal Plans Repayment Act 65(I)/2015 (i.e. *Ο περί Αφερεγγυότητας Φυσικών Προσώπων (Προσωπικά Σχέδια Αποπληρωμής και Διάταγμα Απαλλαγής Οφειλών) Νόμος*) (Official Cyprus Government Gazette, as amended 36(I)/2018, 85(I)/2018);
13. Protection of a Specific Category of Guarantors Act of 2003 (197(I)/2003) (i.e. *Ο περί της Προστασίας Ορισμένης Κατηγορίας Εγγυητών Νόμος*) (Official Cyprus Government Gazette, as amended 8(I)/2004, 7(I)/2006, 58(I)/2015);
14. Safeguarding and Protection of Employees Rights in the Event of the Transfer of Undertakings, Businesses or Parts Thereof Act of 2000 104(I)/2000 (*Ο Περί της Διατήρησης και Διασφάλισης των Δικαιωμάτων των Εργοδοτούμενων κατά τη Μεταβίβαση Επιχειρήσεων, Εγκαταστάσεων ή Τμημάτων Επιχειρήσεων ή Εγκαταστάσεων, Νόμος*) (Official Cyprus Government Gazette, as amended 39(I)/2003);
15. Sale of Credit Facilities and Related Matters Act (i.e. *Ο περί Αγοραπωλησίας Πιστωτικών Διευκολύνσεων και για Συναφή Θέματα Νόμος*) (Official Cyprus Government Gazette, as amended 169(I)/2015 86(I)/2018);
16. Settlement Finality in Payment Systems and Securities Settlement Systems Act 8(I)/2003 *Ο περί του Αμετάκλητου του Διακανονισμού στα Συστήματα Πληρωμών και στα Συστήματα Διακανονισμού Αξιογράφων Νόμος* (Official Cyprus Government Gazette, as amended 118(I)/2006, 99(I)/2011, 145(I)/2012, 79(I)/2016, 55(I)/2017);
17. Transfer and Mortgage of Immovable Property Act of 1965 (i.e. *Ο περί Μεταβιβάσεως και Υποθηκέυσεως Ακινήτων Νόμος*) (Official Cyprus Government Gazette, as amended 9/1965, 51/1970, 3/1978, 6/1981, 181(I)/2002, 59(I)/2006, 122(I)/2007, 52(I)/2008, 26(I)/2010, 120(I)/2011, 142(I)/2014, 197(I)/2014, 4(I)/2015, 27(I)/2015, 32(I)/2015, 42(I)/2015, 46(I)/2015, 53(I)/2015, 75(I)/2015, 76(I)/2015, 133(I)/2015, 139(I)/2015, ΔΙΟΡΘ. Παρ. Ι(Ι), Ε.Ε. 4531 198(I)/2015, 87(I)/2018);
18. UCITS Act 78(I)/2012 (*Ο περί των Ανοικτού Τύπου Οργανισμών Συλλογικών Επενδύσεων Νόμος*) (Official Cyprus Government Gazette, as amended 88(I)/2015, 52(I)/2016);

19. Directive of the Central Bank of Cyprus on Arrears Management of 2015 (i.e. *η περί της Διαχείρισης Καθυστερήσεων Οδηγία*). URL: <https://www.centralbank.cy/el/legal-framework/licensing-supervision/regulations-directives/directives-regulations-and-guidelines-which-govern-the-operation-of-banks/directive-on-arrears-management-of-2015>.

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2. Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements;
3. Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (recast);
4. Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms;
5. Report of the Supreme Court on the operational needs of the Courts and other related issues of 2016. URL: [http://www.supremecourt.gov.cy/judicial/sc.nsf/All/1D32C3471C6EED0FC225811A003F4E36/\\$file/REPORT%20OF%20THE%20SUPREME%20COURT%20OF%20CYPRUS%202016%20COVER%20AND%20INSIDE%20PAGES.en.pdf](http://www.supremecourt.gov.cy/judicial/sc.nsf/All/1D32C3471C6EED0FC225811A003F4E36/$file/REPORT%20OF%20THE%20SUPREME%20COURT%20OF%20CYPRUS%202016%20COVER%20AND%20INSIDE%20PAGES.en.pdf);
6. Report relating to the Functional Review Of The Courts System Of Cyprus, Technical Assistance Project 2017 – 2018, IPA, Ireland;
7. The World Bank Group Flagship Report. Doing Business 2018. Economy Profile Cyprus. URL: <http://www.doingbusiness.org/en/data/exploreconomies/cyprus>.

ANNEX - LIST OF MARKET PARTICIPANTS

I.	Governmental authorities	Address details
1.	Central Bank of Cyprus	80, Kennedy Avenue, Nicosia, Cyprus
2.	House of Representatives	House of Representatives, 1402 Nicosia, Cyprus
3.	Ministry of Justice	125 Athalassas Avenue, 1461 Strovolos, Nicosia, Cyprus
4.	Ministry of Energy, Commerce, Industry and Tourism	6, Andreas Araouzos street, Nicosia, Cyprus
5.	Ministry of Interior	Michael Karaoli 1095, Nicosia, Cyprus
6.	Registrar of Cyprus Companies	Corner Makarios Avenue & Karpenisiou street, Xenios Building, 1427 Nicosia, Cyprus
7.	Lands offices and Survey	29 Michalakopoulou, 1075 Nicosia, Cyprus
8.	The Financial Ombudsman of the Republic of Cyprus	13 Lordou Vyronos Avenue, 1096, Nicosia, Cyprus
9.	Supreme Court of Cyprus	Charalambos Mouskos Street, 1404 Nicosia, Cyprus
10.	District Courts of Cyprus	Charalambos Mouskos Street, 1404 Nicosia, Cyprus
11.	Attorney General	1 Appeli, Agioi Omologites, Nicosia, Cyprus
II.	Associations	Address details
1.	Cyprus Bar Association	Florinis 11, Nicosia, Cyprus
2.	Licensed Insolvency Practitioners (Insolvency Service)	Corner Gerasimou Markora and Mixalopoulou 19, 2 nd Floor, Office 201, 1075 Nicosia, Cyprus
III.	Banks	Address details
1.	Bank of Cyprus Public Company Limited	51 Stassinou Street, Ayia Paraskevi, Nicosia, Cyprus
2.	Hellenic Bank Public Company Limited	Corner Limassol Ave & 200 Athalassas Ave., 2025, Strovolos, Nicosia, Cyprus
3.	Alpha Bank Cyprus Limited	3 Lemesou Avenue, 2112, Nicosia, Cyprus
4.	Eurobank Cyprus Limited	41 Archbishop Makarios Avenue, Nicosia
5.	RCB Bank Limited	2, Amathuntos Street, Limassol, Cyprus
6.	USB Bank Public Limited Company	83 Digeni Akrita Avenue, 1070, Nicosia, Cyprus

7.	Societe Generale Bank Cyprus Limited	Corner of 88 Digenis Akritas Ave and 36 Kypranoros Str., 1061, Nicosia, Cyprus
8.	Cooperative Central Bank Limited	8 Grigori Afxentiou Str., 1096, Nicosia, Cyprus.
9.	Housing Finance Corporation	Corner Prodromou & 2 Lefkonos Str., 2064, Strovolos, Nicosia, Cyprus
IV.	Financial advisors	Address details
1.	PWC	PWC Central, 43 Demostheni Severi Avenue, 1080, Nicosia, Cyprus
2.	Deloitte	24 Spyrou Kyprianou Avenue, Nicosia, Cyprus
3.	KPMG	Address: 14 Esperidon Street, Nicosia, Cyprus
4.	Ernst & Young	Jean Nouvel Tower, 6 Stasinou Street, Nicosia, Cyprus

E GREECE

1. EXECUTIVE SUMMARY

This study aims to review the current state of affairs with regard to the enforcement of creditor claims in Greece. The study was conducted by Karatzas & Partners Law Firm under the auspices of the European Bank for Reconstruction and Development and is a part of a wider research project conducted in five selected jurisdictions: Albania, Croatia, Cyprus, Greece and Ukraine.

The objective of this report is a) to comprehensively present the current legal framework of the creation of security rights and the enforcement thereof in a commercial context; and b) to identify the problematic areas and to present suggestions on their improvement, taking into account the input from selected market participants listed in the Annex hereto. Compared with other countries such as the UK which allow for out of court enforcement, the Greek enforcement system is heavily reliant on judicial intervention, subject to the exemption of financial collateral consisting of cash, financial instruments or receivables under the Collateral Law, which grants the creditor an appropriation right over the asset. An intermediate solution is provided in LD 1923, according to which the enforcement procedure can commence without an Enforcement Title, but the assets are still liquidated through public auction procedures requiring judicial intervention.

The enforcement process is public auction driven, subject to the exemption of security over financial collateral granted by virtue of the Collateral Law described above and security over claims where the creditor is entitled to collect the claim amounts. As a general remark, the efficiency of the legal framework could be considerably improved by the adoption of targeted regulatory initiatives such as the establishment of electronic databases for the registration of security and the facilitation of the non-judicial enforcement of movable assets, subject to appropriate safeguards both as per the legal nature of the parties and the sale process, with a view to make the creation of security and the enforcement and sales process more time- and cost-efficient.

The World Bank Group report, Doing Business in 2019, based on the average of Greece's economy's distance to frontier (DTF) scores benchmarked to June 2018, highlights areas for legislative improvement in the area of enforcement, particularly in terms of reducing the timeframe for enforcement of contracts (estimated at 1580 days) and associated enforcement costs (estimated at 14.4% of the claim). There is also room for improvement in the timeline for resolving insolvency, which reportedly takes an average 3.5 years with a cost of 9% to the insolvency estate.

Assessment of the Key Determinants set out in this study is supported by various responses from market participants, including governmental authorities, associations, foreign and state- owned banks and financial advisors which expressed similar concerns as to cost, speed and simplicity of the enforcement process. A list of the contributing participants and stakeholders is annexed to this report.

In the below table we highlight the main issues with respect to the security and enforcement framework, based on our review of the legal framework and the feedback received from local stakeholders and market participants. A more detailed analysis of the issues and recommendations is found in the Report, which is divided into Part (A) - a Legislative Review, which contains an analysis of existing legislative provisions regulating claims enforcement and recommendations for improvement; and Part (B) - an Institutional Framework Review, which provides an analysis of the institutions involved in the enforcement process in Greece and, where applicable, suggestions for reform.

We note that the recommendations in this report are in line with the objectives of the Commission's Proposal for a Directive of the European Parliament and of the Council on credit servicers, credit purchasers and the recovery of collateral Directive which aim to: (1) to increase the efficiency of debt recovery procedures through the availability of a distinct common accelerated extrajudicial collateral enforcement, (2) to encourage the development of secondary markets for NPLs and exposures. To be noted that the above mentioned are not yet adopted.

The cut-off date for the legislative review was 30 November 2018.

No.	Title	Issue	Recommendations for reforms	Report reference
1	Security and registration			
1.1	Mortgage	The mortgage over immovables is widely considered to be one of the most important forms of security. However, excessive notary public fees, with respect to the granting of a mortgage, deter banks (with the exception of bondholders) from taking fully perfected mortgage security. At the moment, this type of security is mainly used as security for bond loans (since the relevant fees are limited to a specific amount in accordance with the Greek Law 3156/2003), as well as for mortgages on industrial properties pursuant to Greek Law 4112/1929.	The law defining the fees of the notaries public should be amended so that mortgages are either not subject to percentage based fees but rather to maximum defined fees or a qualifying percentage scale of fees with maximum amounts. Further details can be found under point 2.2 of this Executive Summary. Upon such an amendment, this important type of security could be utilized as security with respect to overdraft accounts and other loan agreements. This would bring Greece in line with EU practice.	Sections 3.2.1(a), 5.1
1.2	Floating charge	Whereas the floating charge facilitates the creation of a pledge over a group of movable assets of the borrower, several assets of significant value may not be used as collateral due to their legal nature (e.g. administrative permits, which as per their nature cannot be transferred separately from the business).	It would be particularly useful to introduce a new type of security, creating a pledge over a business as a whole instead of its separate components, as is currently the case. Such security, which is in line with best practices and UNCITRAL recommendations, would require a form of a notarial deed, in case the business includes immovable assets, and would be registered with General Commercial Registry ("G.E.MI."). This security would capture on a dynamic basis, among the assets of the business, any administrative permits required for operation of the business, which currently cannot be sold and transferred separately. For the purposes of enforcement, the creditors would be able to either sell the business as a whole (without its debt),	Section 3.2.1(e)

No.	Title	Issue	Recommendations for reforms	Report reference
			<p>thereby maximizing the purchase price, or to undertake the management of the business and satisfy their claims from the proceeds, as in the case of a preferential ship mortgage.</p> <p>Such a business pledge concept is recognized across many European jurisdictions.</p> <p>The creation of a security over the business as a whole in its entirety will serve other purposes than the creation of a floating charge over receivables or inventory, as the enforcement will entail the sale of business as a going concern, whereas a floating or fixed charge entails the collection of the relevant receivables or the sale of the inventory.</p>	
1.3	Receivables pledge	<p>In cases of security granted by means of pledges over receivables, the market participants have highlighted that it is not possible to find out whether another pledge has been created over the same receivables in favour of other creditors.</p> <p>If the claim's debtor is a legal entity incorporated under public law, Legislative Decree 496/1974 sets out specific prerequisites for the lawful service of documents to the competent authority, hindering the facilitation of the service procedure. In particular, in order for the pledgor to conduct a legal service on these legal entities, the former is obliged to perform multiple services in a specific sequence, while, as noted by market participants, neither the identification of the competent addressees nor the compliance with the exact service procedure is a simple exercise.</p>	<p>It is advisable to establish a publicly searchable electronic registry for security rights, if possible, and to register assignments and pledges over claims at a general electronic registry. This recommendation has been also supported by market participants.</p> <p>Creditors would then be able to search the registry and find out whether the receivables have been pledged to another creditor, prior to the acceptance of the relevant collateral. Please also refer to <i>Recommendations for reform</i> under 3.2.1(b). With direct electronic registration and electronic search of relevant information the whole process of registration and search of information is becoming easier and faster.</p> <p>Several jurisdictions in the region such as Bulgaria, the Czech Republic and the Slovak Republic started reforming their legal frameworks based on modern principles. In Bulgaria (Central Register of Pledges), in Czech Republic (Cadastral Register), and in Slovak Republic (Central Notarial Registry of Liens). In particular, an electronic registration system means that: 'notices are stored in electronic form in a computer database; registrants and searchers have immediate access to the registry record by</p>	Section 3.2.1(h)(i)

No.	Title	Issue	Recommendations for reforms	Report reference
			<p>electronic or similar means, including the Internet and electronic data interchange; the system is programmed to minimize the risk of entry of incomplete or irrelevant information; the system is programmed to facilitate speedy and complete retrieval of information and to minimize the practical consequences of human error'.</p> <p>Another recommendation would be the amendment of the law as regards the legal entities incorporated under public law, so that the service towards these entities is done by a court bailiff under the same manner as the service towards the Greek State (Article 145 of Greek Law 4270/2014), and, thus, introducing a more simple, efficient, and less costly service process.</p>	
1.4	Financial collateral	Limited scope of application of the Collateral Law as regards the covered financial instruments and the covered market participants.	<p>On the basis of the Greek business model, which is mainly structured on non-listed companies and self-employed individuals, we consider that the scope of law set out in Article 1 of the Collateral Law should be extended beyond the scope of the collateral directive, so that it covers both listed securities in regulated capital markets and non-listed title securities and cases where the security provider is a natural person.</p> <p>Altogether, security should be available over more types of assets and between all types of entities as covered by the Financial Collateral Directive.</p>	Section 3.4
2	Registration issues			
2.1	Obtaining information on a debtor's assets	Market participants have noted that lack of digitized and online registries for all kinds of assets affect the ability to locate debtor information.	Digitized and online data bases regarding assets could be established, for example for the registration of vehicles and other movables data bases, as well as a unified online system for bank accounts of natural and legal entities. As to the assets of natural persons we note that a reasonable precaution for the protection of their personal data would be to authorize lawyers to enter any asset registries with special codes.	Section 6.1

No.	Title	Issue	Recommendations for reforms	Report reference
2.2	Excessive public notary fees for granting a mortgage	Market participants have pointed out that public notary fees required for granting a mortgage are excessive. This is why in practice creditors use mortgage pre-notation instead of a mortgage. Although mortgage pre-notation is a useful tool to secure a claim in a genuine dispute, as used in practice it overloads judges with clerical work, which in case of a mortgage could be done by a notary public. This issue has not been raised with respect to pledges, since in practice these types of security can be created by means of a private document with a certified date and the parties prefer not to enter into notarial deeds and, thus, the public notary fees do not constitute an impediment.	<p>The law defining the fees of the notaries public should be amended so that mortgages are not subject to percentage based fees but rather to maximum defined fees. If the law is amended in accordance with the above, mortgages would then be utilized as properly registered security as regards overdraft accounts and other loan agreements, whereas at the moment they are used mainly as security for bond loans, since such fees are limited to a specific amount in accordance with the Bond Loan Law, as well as for the mortgages pursuant to Greek Law 4112/1929.</p> <p>Generally, it is advisable that costs of taking, maintaining and enforcing security are low because high costs of security are a barrier to external investment and efficiency of the credit market.</p>	Section 5.1
2.3	Inefficiency of the registration process of pledge agreements	<p>All market participants identified issues with regard to the need for the simplification and greater efficiency of the registration process for pledge agreements, deriving from the lack of an electronic pledge registry and the obligation to register the pledge at the competent pledge registry, depending on the seat of the pledgor at the time of pledge registration. This registration scheme not only results in higher registration fees but also complicates any relevant due diligence by the creditors.</p> <p>The majority of market participants have noted that the fees of the public registries and the cadastres (i.e. the local municipal registries) are excessive. Based on our experience, this indeed is a factor impeding the granting of security in</p>	<p>The establishment of a general electronic registry, where the use of the Taxpayer ID would allow creditors to obtain a general overview of the assets of the debtor across the country. Electronic registrations are usually cheaper than paper-based registrations, and electronic searches are in principle free of charge.</p> <p>The registration process could be simplified and become at the same time less expensive and more transparent, if all relevant registrations were made via the electronic system G.E.MI., instead of the competent pledge registries. By utilizing the G.E.MI. electronic system for this purpose, the registrations could take place and be visible online on the same day. In order to safeguard the electronic procedure, any registration (including modifications or releases) should require the consent of the pledgee, except for cases of modification or release on the basis of a court decision. Non-Greek legal entities should be able to become G.E.MI. members and acquire a G.E.MI. number and</p>	Section 5.2

No.	Title	Issue	Recommendations for reforms	Report reference
		Greek transactions. More specifically, percentage based fees for the registration of security, with the exception of bond loans, lead to most large financing transactions being structured as bond loans to get round this issue, which can result in complex structures.	<p>access to G.E.MI.'s system for the purposes of such registrations. In order to expedite the procedure, G.E.MI. should not be obliged to check the legality of the registrations.</p> <p>Another recommendation would be the amendment of the law defining the fees of public registries and the cadastres, so that the registration of a non-possessory pledge or a floating charge of Greek Law 2844/2000 is not subject to percentage based fees, calculated on the basis of the amount of the claim of the security, but rather to fixed charges. Such amendment would allow the use of such securities with regard to loan agreements and revolving credit facilities.</p>	
3	Enforcement			
3.1	Obstacle to locate debtors who are natural persons after the change of the address	Market participants have highlighted that with regard to debtors who are natural persons, the most common obstacle to locating them (which is necessary for service of court and extra-judicial documents in the context of the enforcement procedure) occurs when they change their address without notifying the bank of their new one. With regard to legal entities, service of court and extra-judicial documents upon them can be made only if legally appointed management exists. Otherwise, service cannot be lawfully made. Another identified issue refers to service of legal documents on persons of unknown residence, which is a time-consuming process.	With regard to service on persons of unknown residence, electronic service through an on-line system may simplify the procedure.	Section 6.9
3.2	Judicial enforcement	Market participants have highlighted that significant impediments are: 1. complex civil procedure mechanisms;	1. The implementation of the process of electronic auction was recently introduced and its administration, conducted by an independent administrative authority under the guarantee of the state, will greatly facilitate the enforcement proceedings	Section 6.2

No.	Title	Issue	Recommendations for reforms	Report reference
		<ul style="list-style-type: none"> 2. overlapping legislation, legislation "open" to interpretation, rulings contradicting each other; 3. Judges with lack of specialization; 4. court's inefficiency in responding in a timely manner to various petitions, lawsuits, applications etc., and 5. in cases where the debtor of pledged claims is the state, the latter is not obliged to pay if the pledgee does not provide a tax and insurance clearance certificate of the pledgor; this is particular burdensome for the pledgee, since the pledgor might have already gone bankrupt. 	<p>currently in force. This view has been supported by the market participants and is confirmed by the experience from electronic auctions so far. Other recommendations on behalf of the market participants are amendments in the enforcement in order for the procedure to become more simple and flexible.</p> <ul style="list-style-type: none"> 2. Specialisation of judges in commercial matters such as enforcement to deal more effectively with enforcement cases and seminar based training for such judges regarding complex financial issues; 3. Hiring additional court personnel to alleviate the work burden on judges; and 4. Amendment of the tax legislation, so that in the case of payment of a pledged claim made by the Greek State or the legal entities incorporated under public law, the tax clearance and public insurance certificates are required solely for the pledgee and not for the debtor, who may be declared bankrupt (between the issuance of the loan and the payment of the claim), particularly in case of significant delay in the payment of the pledged claims by the Greek State and the legal entities incorporated under public law. Another recommendation would be the introduction of provisions similar to those of Articles 448 and 463 of the GCC, according to which the Greek State or legal entities incorporated under public law, would pay the pledgee, but would be able to set-off any tax or social security claims against counterclaims existing at the time of the notification of the pledge. 	
3.3	Pledge enforcement	Although significant steps have been made with regards to non-judicial enforcement in the context of the Collateral Law on financial	A recommendation would be, in the case of a debtor which is a legal entity, to enable the creditor to sell the pledged movable asset without running a public auction or acquiring a relevant	Section 6.7.3

No.	Title	Issue	Recommendations for reforms	Report reference
		collateral, more progress should be made to facilitate non-judicial enforcement of movable assets pledged pursuant to the general provisions of the GCC.	enforceable title or court permission, subject to appropriate safeguards. If the sale does not take place in a commercially acceptable way, it would still be valid (in order not to affect any third parties involved and decrease the purchasers' interest and/or price paid), but the debtor would be able to ask for compensation in the event of damage or financial loss. This suggested process could be restricted to being only available to a regulated creditor (e.g. a credit institution), which would more trustworthy with regards to both the conduct of the sale and payment of any compensation.	
3.4	Enforcement costs	Market participants have noted that enforcement costs and expenses are high. Moreover, the actual collection depends on the financial situation of the debtor as well as the Greek economy.	<p>Generally, flexibility in timing and method of disposition is recommended in the enforcement process, because this reduces the costs of enforcement.</p> <p>Market participants have suggested that the fees should be reduced. Rather than percentage-based fees and expenses, the costs should be fixed. Percentage-based fees depend on the value of the secured claims and not on the value of the asset. Thus, a creditor, who wishes to secure the total amount of its claim via an encumbrance on all available assets of the debtor may have to pay several times high percentage-based fees. The reduced fixed fees regarding bond loans were provided for in order to facilitate the growth of the relevant market, which was new at that time.</p>	Section 6.9
3.5	Inefficiency in the work of the courts	Market participants have noted that the court procedure is not efficient in terms of speed, mainly due to court workload and auctions bottleneck. In addition to the long backlog created due to systemic deficiencies it is worth noting that Greek Courts remain closed during Greek court holidays – for several months per year – for a long period thus creating further delays and impediments to the enforcement of	The issuance of court decisions may be expedited through the simplification of proceedings, the delay in which is caused to a great extent by debtors who abuse their rights through the exercise of multiple motions and appeals throughout the enforcement process. Further details can be found under point 3.7 below.	Section 6.9

No.	Title	Issue	Recommendations for reforms	Report reference
		debt claims, lack of bidding interest, strikes and prevention of auction conduct. Other noted forms of delay are: delays caused by unpredictable reasons relating to various parties involved in the process (strikes by lawyers, notaries public, court bailiffs).		
3.6	Time-consuming mandatory auction procedures for immovable assets	Mandatory auction procedures for immovable assets may remain pending for several years, something which in turn delays the satisfaction of already adjudicated claims. This is partially due to the financial crisis, which has reduced interest in and affected the value of immovable assets, but also due to the formalities linked to the determination of the auction price. Currently, the determination of a new price following an unsuccessful auction requires a court decision which is very time-consuming.	In case of cancellation of the first auction due to the non-appearance of interested bidders, the offer price could be reduced automatically. Our suggestion would be to expedite the procedure by the auction price dropping automatically by a certain rate of the offer price at the preceding auction (e.g. 10%) following each unsuccessful auction, without the need for a court decision.	Section 6.9
3.7	Inefficiency of enforcement proceedings and abusing of appeal rights	Market participants have noted that enforcement proceedings are subject to various motions and appeals that may delay or annul the procedure and that debtors may abuse appeal rights provided to them by law via these appeals.	<p>Changes in legislation or court regulation are required to prevent appeal rights being used primarily for purposes of delaying the enforcement process, for example by tightening of the requirements for the issuance of an interlocutory injunction and suspension/regulation of the situation.</p> <p>Unnecessary appeals particularly where the debtor is a legal person, may be prevented by following the principle of due process. Procedures should be adopted to ensure the efficiency of the court which should be organized so that all interested parties are dealt with fairly, in a timely manner, objectively, and as part of an efficient, transparent system.</p> <p>It is considered that insolvency law should prescribe that a party in interest may appeal from any order of the court in the insolvency proceedings that affects its rights, obligations or</p>	Section 0

No.	Title	Issue	Recommendations for reforms	Report reference
			interests, but time limit for appeal should be shorter. Although appeals do not suspend insolvency proceedings, in some cases the courts have power to do so.	
3.8	Lack of specialization of judges in commercial and insolvency cases	There are no specialist commercial or financial courts, but there are special commercial sections in the ordinary procedure of the First Instance and Appeal Courts. However, due to the fact that judges serve at this specific department for only two (2) to four (4) years, judges in commercial and insolvency cases lack specialization and in certain cases knowledge and understanding of basic accounting and financial matters. Moreover, there is no practice of appointing one judge to deal with all enforcement questions relating to a particular debtor.	<p>Judges should be appointed to a special department of a court for a longer period and be able to participate in relevant seminars before their appointment to the specific department as well as throughout their service there.</p> <p>An example for this is the maritime section of the Court of Piraeus, where the specialization of judges has led to an improvement in term of both timing and substance. Moreover, appointing one judge to deal with enforcement questions relating to a particular debtor would be useful, in order for the judge to be able to handle more easily related cases.</p> <p>There is a trend towards and recognition of the importance of specialised commercial courts across the EU.</p> <p>The plan of EU is to introduce an expedited procedure for cross-border commercial cases and to establish specialized courts or chambers for cross-border commercial matters in each Member State. The study of the EU Parliament's Committee on Legal Affairs on Building Competence in Commercial Law in the Member States, recommends the introduction of a European expedited procedure for cross-border commercial cases and furthermore the setting-up of a European Commercial Court.</p>	Section 12.2

2. GLOSSARY

Bond Loan Law	shall mean Greek Law 3156/2003
Collateral Directive	shall mean Directive 2002/47/EC
Collateral Law	shall mean Greek Law 3301/2004
Data Protection Law	shall mean Greek Law 2472/1997
Financial Collateral Law	shall mean Greek Law 3301/2004 and Directive 2002/47/EC
G.E.MI.	shall mean the General Commercial Registry
GBC	shall mean Greek Bankruptcy Code
GCC	shall mean Greek Civil Code
GCPC	shall mean Greek Code of Civil Procedure
GDPR	shall mean Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC (General Data Protection Regulation)
GSL	shall mean Greek Law 3156/2003
HDP A	shall mean the Hellenic Data Protection Authority
LD 1923	shall mean Legislative Decree of 17 July-13 August 1923
NPL	Non-Performing loan
NPL Law	shall mean Greek Law 4354/2015
RAC	shall mean the "Receivables Acquisition Company"
RMC	shall mean the "Receivables Management Company"

PART (A) LEGISLATIVE REVIEW

3. TYPE OF CLAIMS

3.1 Unsecured claims

If no specific security has been granted by the parties with regards to a claim, the claim is unsecured. However, it may still benefit from a general privilege with regards to the distribution of proceeds in the context of enforcement or insolvency, by virtue of law, as analysed below under section 4 below.

3.2 Secured claims

3.2.1 Types of security

(a) Immovables

(i) Mortgage on land plots, premises and buildings (GCC)

This type of security is created over immovable assets of the debtor or over the immovable assets of a third party who allows the encumbrance of its property (owner of the asset) in favour of the debtor. A mortgage extends to the whole of the mortgaged property as well as to its (immovable and movable) components (e.g. buildings and other structures) and (movable) accessories³⁷⁵ thereof. If a movable asset, being a component or an accessory of the mortgaged immovable property has been separated from the immovable asset and has been transferred to a third party, the mortgagee (creditor) is not entitled to claim the movable item back from the third party.

Titles conferring the right to acquire a mortgage are the law, a Court decision and the private agreement (see below section 5.1).

Furthermore, as regards buildings under construction, it shall be noted that in case a building is constructed after the registration/perfection of the mortgage on the land plot, the mortgage will be constituted on that building as well, in accordance with the above analysis.

The cost of the registration of mortgage is defined at approximately 0.75% of the secured amount. Moreover, the creation of a mortgage by virtue of a notarial deed, which is the most common case in practice, entails significant percentage-based notarial fees, varying from to 0.80% of the secured amount for the part of the secured amount up to EUR 120,000 to 0.10% for the part of the amount exceeding EUR 20,000,000 and, other than in cases of loans granted by banking institutions and bond loans, stamp duty (2.4% or 3.6% of the secured amount, as the case may be).

Percentage based fees for the registration of security, with the exception of bond loans, lead to most large financing transactions being structured as bond loans to get round this issue, which can result in complex structures and consequently greater costs for market parties.

³⁷⁵ Specifically with regard to the accessories, please note that they may be subject to a different right *in rem*. Therefore, the mortgage shall extend to the accessories of the immovable asset under the condition that the owner of the mortgaged property has the ownership of the accessory as well.

(ii) Pre-notation of mortgage (GCC)

A pre-notation of mortgage constitutes a type of "provisional mortgage", which may be converted into a (final) mortgage, provided that: a) the secured claim is recognized by a final Court decision; and b) the creditor converts the pre-notation of mortgage into a (final) mortgage within a ninety (90)-day period, starting from the issuance date of the final Court decision adjudicating the claim. In that case, the mortgage is deemed as created from the date of the registration/perfection of the pre-notation of mortgage ("retroactive effect").

A creditor can acquire a pre-notation of mortgage on the basis of a Court decision or a payment order (see below section 5.1).

The cost of the registration of mortgage pre-notation is defined at approximately 0.75% of the secured amount. This is why many financial institutions rely in practice on a mortgage pre-notation rather than a notarised mortgage which entails significant fees (see paragraph (i) above).

Public notary fees required for granting a mortgage are excessive. This is why in practice creditors use mortgage pre-notation instead of mortgage. Although mortgage pre-notation is a useful tool to secure a claim in a genuine dispute, as used in practice it overloads judges with clerical work, which in respect of a mortgage could be done by a notary public

(iii) Mortgage on industrial properties (Greek Law 4112/1929)

In case an industrial company or any other person (including individuals acting in their profession) using permanent (mechanical or other) establishment(s) receives a loan or other credit, with respect to which a mortgage on its industrial property is constituted, the mortgage can be extended to any and all machinery entered/inserted into the industrial company, together with its facilities and other building extension(s), forming a single industrial unit, irrespective of whether they are entered/inserted therein prior to or following the registration/perfection of the mortgage. Such mortgage can be created only by virtue of an agreement between the parties and not by the law or by a Court decision.

Importantly, the attachment of the mortgaged items on the property results in the extinction of any third party's rights thereon (except for in case of machinery etc. which is leased by the debtor), so that any alienation or transfer of ownership of these items is not permitted by law, without the consent of the mortgagee, prior to the full payment of the amount of the loan or credit.

(iv) Mortgage in favour of banks (LD 1923)

A mortgage in favour of Greek Banks and Banks within the EU³⁷⁶ pursuant to the LD 1923 can be created by virtue of an agreement, in order to secure a) any claim which arose prior to the creation of the mortgage; or b) any claim deriving from a loan or the opening of a credit which arises at the same time as the creation of the mortgage. The LD 1923 contains specific provisions for the facilitation of the enforcement procedure, which are presented below in section 6.7.2.

³⁷⁶ The legislative decree refers to Greek Credit Institutions and confers special rights regarding taking of security (pledge and mortgages). As this legislation is very old (1923) it is to be supported that non Greek EU banks can enjoy the privileges of such presidential decree on the grounds of the EU principle of equality.

(v) Sale and leaseback (Greek Law 1665/1986)

Sale and leaseback of immovable assets is a type of regulated financial leasing activity that may be carried out between licensed credit institutions or licensed financial leasing companies and companies. Such agreements provide the lessee with, for a specific time-period, the use of the immovable asset upon payment of rent to the lessor. Upon the end of the aforementioned period, the lessee is entitled either to purchase the asset or to renew the lease agreement for an additional time-period. The minimum period of the lease agreement is defined by law at ten (10) years.

(vi) Public policy restrictions with regards to immovable assets located at the frontier

The creation of a mortgage in favour of non-EU entities over immovable assets which are located in specific areas characterized as frontier areas is subject to obtaining the permission of a special state committee. The same applies for a pledge over the shares of a company owning such immovable assets.

(b) Movables

(i) Movable pledge (GCC)

This type of security may be created on the movable assets of the debtor or over the movable assets of a third party who allows the encumbrance of its property in favour of the debtor. The creation of the right of pledge requires a) an agreement between the pledgor (debtor or a third party, owner of the pledged asset) and the pledgee (creditor) (for the required document form, see below section 5.1) and b) delivery of the movable item by the pledgor to the creditor or, following its consent, to a third party.

For the protection of creditors acting in good faith, in case the movable item does not belong to the pledgor, a right of pledge is still acquired by the creditor provided that: a) the owner of the movable item had entrusted its possession or holding to the pledgor on the basis of a legal relationship; b) the pledgee was acting in good faith at the time of the delivery of the item; and c) physical delivery of the item took place, under the meaning that the pledgee acquired the holding of the item as well.

(ii) Non-possessionary pledge (Greek Law 2844/2000)

A pledge on a movable asset or group of assets may be created without delivery of those assets provided that the relevant agreement is registered in a public register created by the law for this purpose. In the case of a non-possessionary pledge, the pledgor continues to hold and use the pledged asset.

The non-possessionary pledge provisions apply provided that: a) both the debtor and the creditor are companies or professionals (merchandisers, self-employed individuals etc.); and b) the security is provided for business purposes or in order to cover the professionals' needs. Money, bills of security, household items, as well as movables that can be subject to a right of mortgage (ships, floating craft, aircraft) are excluded from this type of security. The registration of the agreement in the public registry constitutes a condition for the creation of the pledge. If such registration does not occur, the non-possessionary pledge will not be validly created even between the contracting parties. The cost of the

registration of the non-possessory pledge is defined at approximately 0.75% of the secured amount.³⁷⁷

(c) Title retention (GCC)

According to this special form of security, the seller retains the ownership of the asset which was sold and delivered to the purchaser until full payment of the purchase price. Upon fulfilment of the payment condition mentioned above, the purchaser acquires the ownership of the item.

The parties may opt to register this agreement in the public registry of Greek Law 2844/2000, in which case the seller is better protected against any further transfer of the asset by the purchaser. If so, the specific conditions set out in Greek Law 2844/2000 on a) the contracting parties, b) the type of the secured claims, and c) the nature of the pledged items, as described in the section (b)(ii) above, are applicable as well.

(d) Financial leasing (Greek Law 1665/1986)

Financial leasing for movable assets is a type of regulated financial leasing activity that may be carried out between licensed credit institutions or licensed financial leasing companies and companies or self-employed professionals. Such agreements provide the lessee, for a specific time-period, with the use of the movable asset upon payment of rent to the lessor. Upon the end of the aforementioned period, the lessee is entitled either to purchase the asset or to renew the lease agreement for an additional time-period. The minimum period of the lease agreement is defined by law as being three (3) years and, specifically with regard to the aircraft, five (5) years.

(e) Floating charge (Greek Law 2844/2000)

This type of security is created provided that the conditions as regards a) the contracting parties, b) the type of the secured claims, and c) the nature of the pledged items mentioned above, in section (b)(ii) above are met. The floating charge may be constituted upon a group of movable assets, including inventory, or upon a group of claims (usually business receivables, including future ones).

Under a floating charge, the pledgor can deal with and dispose of the pledged assets, provided that it replaces them.

However, such disposal must take place for business purposes or in order to cover professional needs. Among other obligations, the pledgor must notify the pledgee on a quarterly basis about the items forming the group of assets, must allow the conduct of a scheduled or unscheduled inspection conducted by the pledgee, and must replace, without undue delay, the disposed items with other items of similar value. The parties may agree on different types of floating charge, for instance they may agree that the pledgor may not be obliged to replace the disposed items, but rather that security covers the remaining assets. Upon the crystallization of the security, the pledgor can no longer dispose of the group's assets.

³⁷⁷ According to Bond Loan Law on convertible bond loans, the amount required for the each registration regarding the creation of a right *in rem* amounts to the sum of EUR 100.

Identified issue:

While the floating charge facilitates the creation of a pledge over a group of movable assets of the borrower, several assets of significant value may not be used as collateral due to their legal nature (e.g. administrative permits, which as per their nature cannot be transferred separately from the business or perishable goods with very short expiry dates which can be difficult to realise in a sufficiently short time frame).

Recommendations for reform:

In our opinion, it would be particularly useful to introduce a new type of security, creating a pledge over a business as a whole instead of its separate components, as is currently the case. Such security would require a notarial deed if the business includes immovable assets, and would be registered with General Commercial Registry ("G.E.M.I."). This security would capture, among the assets of the business, any administrative permits required for operation of the business, which currently cannot be sold and transferred separately. For the purposes of enforcement, the creditors would be able to either sell the business as a whole (without its debt), thereby maximizing the purchase price, or to undertake the management of the business and satisfy their claims from the proceeds, as in the case of a preferential ship mortgage (see the section (g)(iv) below).

We consider that the introduction of a new type of security will not adversely affect the parties as they would have the flexibility to choose the type of security they would like to grant. The creation of a security over the business as a whole in its entirety will serve other purposes than the creation of a floating charge over receivables or inventory, as the enforcement will entail the sale of business as a going concern, whereas a floating or fixed charge entails the collection of the relevant receivables or the sale of the inventory.

Generally, it is recommended that States adopt the concept of an all-asset security right.³⁷⁸ In that case law should provide that a security right may encumber any type of asset, including parts of assets, undivided rights in assets and any exceptions to these rules should be limited and described in a clear and specific way.³⁷⁹

(f) Pledge on movables in favour of banks (LD 1923)

The pledge on movable assets in favour of Greek Banks and Banks within the EU³⁸⁰ pursuant to the LD 1923 may secure a) any claim which arose prior to the creation of the pledge; or b) any claim deriving from a loan or the opening of a credit which arises at the same time as the creation of the pledge. The creation of a pledge requires an a) execution of an agreement (for the required document form see below section 5.1) and b) delivery of the pledged item.

The LD 1923 contains specific provisions for the facilitation of the enforcement procedure, which are presented below in section.

³⁷⁸ *Supra* note 7, UNCITRAL Legislative Guide, par. 70, page 83.

³⁷⁹ *Ibid.* Recommendation 17, page 98.

³⁸⁰ The legislative decree refers to Greek Credit Institutions and confers special rights regarding taking of security (pledge and mortgages). As this legislation is very old (1923) it is to be assumed that non Greek EU banks can enjoy the privileges of such presidential decree on the grounds of the EU principal of equality.

(g) Pledge over shares of non-listed and listed *sociétés anonymes*

(i) Non-listed *sociétés anonymes*

Bearer shares (GCC, LD 1923): the pledge thereon is governed by the provisions applicable to the pledge over movables. In particular, the creation of the right of pledge requires a) an agreement between the pledgor and the pledgee (for the required document form, see below section 5.1) and b) delivery of the share title by the pledgor to the creditor. Exceptionally, in cases of a pledge in favour of banks and/or *société anonymes*, the agreement between the pledgor and the pledgee shall be in written form, but not in the specific document form mentioned above.

Registered shares (GCC, Greek Law 1818/1951): similarly, the creation of a right of pledge on registered shares requires a) an agreement between the pledgor and the pledgee (for the required document form, see below section 5.1) and b) delivery of the share title by the pledgor to the creditor. In case of restricted nominal shares, the prior consent of the competent body, i.e. the Board of Directors or the General Meeting of the Shareholders is required for the valid creation of the pledge. Moreover, the creation of a pledge must also be registered in the company's register of shareholders. The aforementioned registration does not constitute a condition for the creation of the pledge, but rather authorizes the pledgee *vis-a-vis* the company. Moreover, the share title is annotated with regards to the pledge.

The pledge in practice can be subject to 2nd or 3rd ranking security, because the share title can also be "delivered" to the pledgee by virtue of an agreement of the parties that the share title will remain in the possession of a third person (e.g. an escrow agent) or of one of the pledgees acting for all of them. In case of multiple pledges, ranking priority depends on time of creation of each one of them.

As for the cases of a pledge in favour of banks and/or *société anonymes*, we refer to the above analysis with regard to the bearer shares.

(ii) Listed *sociétés anonymes* (GCC, LD 1923)

Dematerialized shares (Greek Law 2396/1996): the creation of a pledge on dematerialized shares requires a) an agreement between the pledgor and the pledgee (for the required document form, see below section 5.1), b) the service of the pledge agreement by a Court Bailiff to "the Central Securities Depository" (in Greek *KAA*), and c) its registration in the System of Dematerialized Titles (in Greek *SAT*). As regards the formal requirements of the agreement, we refer to our analysis on bearer shares and the abovementioned exception.

In all above cases, upon creation of the pledge, whereas the pledgee is entitled to enjoy all the monetary rights deriving from the share (e.g. collection of the dividends), the voting rights are to be exercised by the pledgor, unless otherwise agreed.

(iii) Pledge over companies' participation rights (excluding *sociétés anonymes*) (GCC)

Provided that the portions of participation are transferrable, either by law (Limited Liability Company (in Greek *EPE*) and Private Company (in Greek *IKE*)) or pursuant to specific provision of the company's Articles of Association or upon consent provided by all the company's members, the pledge over these

rights is created upon an agreement between the pledgor and the pledgee (for the required document form, see below section 5.1).

(iv) Ship mortgage (common and preferred)

Common ship mortgage (GCC, Code of Private Maritime Law): The mortgage may be constituted on a ship, a ship under construction (provided that it is registered) or an undivided part thereof, including its components and accessories. The title conferring the mortgage may be a unilateral declaration of the ship owner (for the required document form, see below section 5.1), upon its registration in the Ship Registry.

Preferred ship mortgage (Code of Private Maritime Law, Legislative Decree no 3899/1958): The mortgage may be constituted on a ship or a ship under construction (provided that it is registered), provided its capacity is equal to or higher than five-hundred (500) tones, entitling the creditor to undertake the management of the ship (or sale of the ship freely or through mandatory auction), from the moment when the creditor's claim becomes due and payable. Upon taking over the management of the ship, the creditor uses its proceeds in order to satisfy its claim. The title conferring the mortgage is an agreement between the debtor and the creditor (for the required document form, see below section 5.1), upon its registration in the Ship Registry.

The main difference between the two types of security above is that preferred mortgage grants the creditor the ability to manage the ship and/or aircraft up from the moment when the creditor's claim becomes due and payable and use the relevant proceeds to satisfy its claim, instead of proceeding with a public auction.

(v) Aircraft mortgage (Greek Civil Law, Code of Aviation Law)

Common aircraft mortgage: The mortgage may be constituted on an aircraft, an aircraft under construction (provided that it is registered), including its accessories, and the aircraft engine. The title conferring the mortgage may be a unilateral declaration of the owner (for the required document form, see below section 5.1), upon its registration with the Aircraft Registry.

Preferred aircraft mortgage: The mortgage may be constituted on an aircraft, an aircraft under construction (provided that it is registered), including its accessories, provided its maximum take-off weight exceeds five thousand seven hundred kilograms, entitling the creditor to undertake the management of the aircraft, from the moment when the creditor's claim becomes due and payable. The title conferring the mortgage is an agreement between the debtor and the creditor (for the required document form, see below section 5.1), upon its registration in the Aircraft Registry.

(h) Rights

(i) Receivables pledge (GCC)

A pledge may be constituted in regard to monetary and transferable claims, provided that a) the pledge contract is incorporated in a specific form (see below section 5.1) and b) the pledgor notifies the pledge to the claim's debtor (i.e. the third party debtor which owes the relevant receivable to the pledgor).³⁸¹

³⁸¹ In practice, in order for the contracting parties to avoid the notification of the pledge of receivables to the claim's debtor,

Although no specific requirement is set out, such notification is ordinarily conducted by the service of a copy of the pledge contract by a Court Bailiff. Following the creation of the pledge, the pledgor is entitled to freely dispose of the pledged receivable, provided that such disposal may not impair the rights of the pledgee.

Identified issue:

A pledge over receivables is a common/important form of security on the Greek market. Nevertheless cases of security granted by means of pledges over receivables, market participants have highlighted that it is not possible to be informed on whether another pledge has been created over the same receivable in favour of other creditors which reduces the attractiveness and value of this form of security.

Recommendations for reform:

It is advisable to establish an electronic registry for security rights, if possible.³⁸² With direct electronic registration and electronic search of relevant information the whole process of registration and search of information becomes easier and faster.³⁸³ Market participants suggested registering assignments and pledges over claims at a general electronic registry. The creditors would then be able to search the registry and find out whether the receivables have been pledged to another creditor, prior to the acceptance of the relevant collateral. Please also refer to *Recommendations for reform* under (b) above. Several jurisdictions in the region such as Bulgaria, the Czech Republic, the Slovak Republic, and Ukraine started reforming their legal frameworks based on modern principles. In Bulgaria the Central Register of Pledges, in Czech Republic the Cadastral Register, and in Slovak Republic the Central Notarial Registry of Liens, for example, are all electronic registers

In particular, electronic registration system means that: "notices are stored in electronic form in a computer database; registrants and searchers have immediate access to the registry record by electronic or similar means, including the Internet and electronic data interchange; the system is programmed to minimize the risk of entry of incomplete or irrelevant information; the system is programmed to facilitate speedy and complete retrieval of information and to minimize the practical consequences of human error".³⁸⁴

Identified issue:

If the claim's debtor is a legal entity incorporated under public law, Legislative Decree 496/1974 sets out specific prerequisites for the lawful service of documents to the competent authority, hindering the facilitation of the service procedure. In particular, in order for the pledgor to conduct a legal service on

they may agree the assignment of the claim to the creditor. In the latter case, the notification of the assignment to the claim's debtor is not a condition for its validity, but is required for the protection of the claim's debtor and other third parties. Therefore, the creditor may further assign the claim or collect it, in case the claim is offered to it. In the event the debtor does not fulfil its obligations, the creditor may then proceed with notification of the assignment to the claim's debtor and request the fulfilment of the obligation deriving from the claim. It shall be noted that up until the notification of the assignment, the assignee does not acquire any right in regard to the debtor and third parties. On the contrary, in accordance with Greek Law 2844/2000, the notification of the pledge to the claim's debtor does not constitute a condition for the exercise of its rights towards the debtor. The same applies also according to the specific provision of Collateral Law on financial collateral.

³⁸² *Supra* note 7, UNCITRAL Legislative Guide, para. 82 page 31.

³⁸³ *Supra* note 7, UNCITRAL Legislative Guide, para. 84, page 32.

³⁸⁴ *Supra* note 7, UNCITRAL Legislative Guide, Recommendation 54., j), page 179.

these legal entities, the former is obliged to perform multiple services in a specific sequence, while, as noted by market participants, neither the identification of the competent addressees nor the compliance with the exact service procedure is a simple exercise.

Recommendations for reform:

Amending the law as regards the legal entities incorporated under public law, so that the service towards these entities is done by a court bailiff under the same manner as the service towards the Greek State (Article 145 of Greek Law 4270/2014), and, thus, introducing a simpler, efficient, and less costly service process.

(ii) Pledge on business claims (Greek Law 2844/2000)

A pledge on business claims or group of claims may be created upon execution of the relevant agreement and registration of the agreement in the pledge registry of the registered seat or the place of residence of the pledgor. The pledgee shall inform the claim's debtor on the publication of the creation of the pledge.

(iii) Pledge on claims in favour of banks (LD 1923)

A pledge on claims in favour of Greek Banks and Banks within the EU³⁸⁵ pursuant to the LD 1923 may secure: a) any claim which arose prior to the creation of the pledge; or b) any claim deriving from a loan or the opening of a credit which arises at the same time as the creation of the pledge. The creation of the pledge requires the execution of an agreement (for the required document form see below 5.1). In case of a nominal claim of the debtor against a third party, the pledge on the claim constitutes an assignment of the relevant claim to the Bank. In the latter case, the Bank acquires the right to hold the claim upon service of copy of the agreement on the third party.

The LD 1923 contains specific provisions for the facilitation of the enforcement procedure, which are presented below in section 6.7.2

(iv) Title security (GCC)

The term "title security" is used to describe the assignment of a claim, by virtue of which a claim is transferred towards the assignee, not in order to form part of its property, but rather in order to either secure a claim of the assignee towards the assignor or to transfer the administration of the relevant claim to the assignee. In the latter form, in principle the assignment is granted in order for the assignee to collect the outstanding amount on behalf of the assignor.

(v) Pledge over bank account (LD 1923)

A pledge over a bank account is constituted by a written agreement between the pledgor and the pledgee. This type of security over a debtor's bank account allows the pledgee to collect the amount of the debtor's bank deposit. Security over bank accounts is widely used in Greece. In practice, usually the parties agree that the debtor retains control over the pledged account until occurrence of an event of default. Depending on the circumstances, the parties may also

³⁸⁵ The legislative decree refers to Greek Credit Institutions and confers special rights regarding taking of security (pledge and mortgages). As this legislation is very old (1923) it is to be assumed that non-Greek EU banks can enjoy the privileges of such presidential decree on the grounds of the EU principal of equality.

agree that the debtor will only be allowed to use the amounts credited in the pledged bank account for specific purposes.

- (vi) Pledge over IP rights (GCC, Greek Law 4072/2012, Greek Law 1739/1987)

The pledge over IP rights is governed by the general provisions for the creation of pledge over rights, and, thus, requires a) that the pledge contract is incorporated in a specific form (see below section 5.1) and b) its registration in the competent register.

- (i) Personal guarantee (GCC)

The personal guarantee is the most common type of personal security. It does not grant the creditor a certain type of priority in the enforcement process over a specific asset, but rather entitles the creditor to request the fulfilment of the debtor's obligation by the guarantor. According to the applicable legal provisions, the guarantor has the ability to refuse payment of the debt until the creditor has distrained the principal debtor's property and that step did not yield results. Nonetheless, in practice, the guarantor is requested to waive its plea of distraint.

3.3 Financial guarantee

The letter of guarantee constitutes another type of personal security. By the letter of guarantee, an individual or an entity undertakes the obligation towards the creditor of a third party (recipient of the letter of guarantee), following the order of a third party, that it will proceed to the payment of a certain obligation immediately upon such demand (on demand letter of guarantee), or in view of specific conditions, upon fulfilment of certain formalities by the recipient of the letter of guarantee. In principle, the letters of guarantee are granted by a bank. The different nature of the letter of guarantee and the personal guarantee described above is that the letter of guarantee is a standalone agreement separate from the secured claim. Thus, upon presentation of all the required documents to the issuer, the latter is obliged to honour its obligations, without examining the underlying agreement between the beneficiary and the third party.

3.4 Claims under financial collateral regulations (Greek Law 3301/2004)

3.4.1 Covered arrangements

The Collateral Law transposing into Greek legislation the Collateral Directive on financial collateral arrangements, both as amended and in force (the "**Financial Collateral Law**") creates security rights which benefit from an appropriation right over the asset on which the security has been granted, provided the parties specifically agree to that in the relevant arrangements.

The Financial Collateral Law lays down the regime applicable to financial collateral arrangements and to financial collateral. For the purpose of the Greek Collateral Law the term "financial collateral arrangement" means "a title transfer financial collateral arrangement or a security financial collateral arrangement notwithstanding whether these are covered by a master agreement or general terms and conditions".

The financial collateral to be provided must consist of cash, financial instruments (including listed shares -but excluding non-listed shares- or other listed securities) or credit claims (monetary claims deriving from an agreement, by virtue of which the credit institution grants credit in the form of a loan or any other monetary claims of the collateral provider against third parties or against the same collateral taker). The financial collateral arrangement itself as well as the provision of the financial collateral under such arrangement must be evidenced in writing or in a legally equivalent manner (as opposed to pledges or assignments perfected under the

GCC, for which a notarial deed or an agreement bearing a certain date is required). The evidencing of the provision of the financial collateral must allow for the identification of the financial collateral to which it applies. The Financial Collateral Law prevails over all previous laws in its field of application, including all general and specific insolvency law provisions. This means that the Financial Collateral Law disapplies, among others, all insolvency rules related to moratorium on enforcement and transaction avoidance (this is also provided for by articles 26 para 6 and 46 para 2 of the Greek Bankruptcy Code, respectively).

The Financial Collateral Law eliminates all risks of re-characterisation of title transfer collateral within its field of application. Up until today, no significant cases of judicial challenge regarding security granted pursuant to the Financial Collateral Law before the Greek Courts have been reported.

3.4.2 Covered market participants

The collateral taker and the collateral provider must each belong to one of the following categories:

- (a) a public authority (excluding publicly guaranteed undertakings unless they fall under points (b) to (e)) including: (i) public sector bodies of Member States charged with or intervening in the management of public debt, and (ii) public sector bodies of Member States authorised to hold accounts for customers;
- (b) the Bank of Greece, the European Central Bank, the Bank for International Settlements, a multilateral development bank as referred to in Part E, paragraph 6 of the Act no. 2588/2007 of the Governor of the Bank of Greece and in Annex VI, Part 1, Section 4 of Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (recast), the International Monetary Fund and the European Investment Bank;
- (c) financial institution subject to prudential supervision including: (i) credit institutions; (ii) investment firms; (iii) financial institutions; (iv) insurance undertakings; (v) an undertaking for collective investment in transferable securities ("UCITS"); (vi) management companies;
- (d) a central counterparty, settlement agent or clearing house, including similar institutions regulated under national law acting in the futures, options and derivatives markets to the extent not covered by that Directive, and a person, other than a natural person, who acts in a trust or representative capacity on behalf of any one or more persons that includes any bondholders or holders of other forms of securitised debt or any institution as defined in points (a) to (d);
- (e) a person other than a natural person, including unincorporated firms and partnerships, provided that the other party is an institution as defined in points (a) to (d):³⁸⁶

³⁸⁶ Importantly, the Collateral Directive provided that Member States may exclude from the scope of this Directive financial collateral arrangements where one of the parties is a person mentioned in paragraph (e). Greece has not exercised the aforementioned right and opted for the inclusion of category (e).

Identified issues:

Limited scope of application of the Collateral Law as regards the covered financial instruments and the covered market participants.

Recommendations for reform:

On the basis of the Greek business model, which is mainly structured on non-listed companies and self-employed individuals, we consider that the scope of law set out in Article 1 of the Collateral Law should be extended beyond the scope of the collateral directive, so that it covers both listed securities in regulated capital markets and non-listed title securities and cases where the security provider is an entity which is not covered by the Collateral Directive.

Altogether, security should be available over more types of assets and between all types of persons.³⁸⁷ We note however that the Collateral Directive should not be expanded to cover consumers, who are subject to different policy considerations.

3.5 Security agent structure

Greek law lacks rules and procedures accommodating the role of a security agent in syndicated loans and requires the incorporation of "parallel debt" concept to enable banks to service syndicated creditors in matters of security administration. The "parallel debt" concept has been used in practice in a limited number of major transactions (such as the financing of motorways through project finance) and is accepted by legal practitioners, with no relevant issues having arisen to date. However, this structure is complex and has not been used for smaller financing transactions. The Bond Loan Law solved this issue within its scope of application, as it provides that security for the bond loan is taken in the name of the bondholders' agent and on behalf of bondholders. Since the introduction of the Bond Loan Law syndicated bank loans have been granted in the form of bond loans. However, the issue remained in relation to other types of claims of creditors, such as claims from derivatives. A further step forward was made through Greek Law 4548/2018 (the "**New Company Law**"), which will replace the Bond Loan Law upon its entry into force on 1 January 2019. This provides that the bondholders' agent can also take security on behalf of creditors related to the bond loan, such as creditors from hedging transactions.

4. RANKING AND PRIORITY OF CLAIMS

4.1 General privileges

- (a) claims for hospitalization and interment costs of the individual against whom execution was forced, his/her spouse and children, if such costs arose during the last twelve (12) months prior to the mandatory auction or the declaration of bankruptcy and compensation claims due to disability of more than 80% (with the exception of moral damages), provided such claims arose prior to the day of the auction or the declaration of bankruptcy;
- (b) costs for the nourishment of the individual debtor, his/her spouse and children, if such costs arose during the last six (6) months prior to the auction date or declaration of bankruptcy;
- (c) claims arising from employment relationships, as well as claims by lawyers paid by means of a fixed periodic remuneration regarding their fees and expenses for the provision of services (provided such claims relate to services provided during the two (2) years preceding the first

³⁸⁷ *Supra* note 5, EBRD Core Principles para.7 page 2.

auction date or the declaration of bankruptcy). Claims for termination compensation of employees and lawyers regardless of the date they were created. Claims by the state for VAT and other taxes, along with any relevant surcharges and interest. Claims of social security funds, compensation claims in case of death of a person who was responsible for alimony and compensation claims due to disability of more than 67%, provided such claims became due prior to the day of the auction or the declaration of bankruptcy;

- (d) claims by farmers or farming partnerships arising from sale of agricultural goods if such costs arose during the last twenty-four (24) months prior to the auction date;
- (e) claims of the state, prefectures and municipalities arising from any cause, along with any relevant surcharges and interest;
- (f) claims by the collective guarantees fund (if the debtor is or was an investment services company in the meaning of Greek Law 2396/1996), that arose two years prior to the day of the auction or the declaration of bankruptcy.

4.2 Special privileges

Claims with a privilege over a specific movable or immovable asset or amount of money and specifically:

- (a) Claims which arose due to expenses for the preservation of the asset;
- (b) Claims secured by virtue of a pledge, mortgage or mortgage pre-notation;
- (c) Claims which arose due to expenses for the production or collection of fruits of the asset.

4.3 Unsecured claims

Any claims not enjoying a general or special privilege are characterized as "unsecured" claims.

4.4 Allocation of auction proceeds

At the beginning of 2018, the provisions of the Code of Civil Procedure relating to allocation of auction proceeds changed, resulting in a separate regime for claims with respect to security rights created after 17 January 2018.

4.4.1 Security rights created prior to 17 January 2018

The auction proceeds are allocated as set forth below, following deduction of the amount corresponding to enforcement expenses. In case of co-existence of creditors' claims of general privilege, claims of special privilege i.e. secured creditors and of non-privileged claims, 25% of the auction proceeds is allocated to creditors enjoying one or more general privileges, 65% of the auction proceeds is allocated to creditors enjoying one or more special privileges and the remaining 10% of the auction proceeds is allocated to unsecured creditors. The position of secured creditors is relatively disadvantageous when compared with other parts of the EU. For instance, many insolvency laws recognize the rights of secured creditors to have a first priority for satisfaction for their claims, either from the proceeds of sale of the specific encumbered assets or from general funds, subject to limited exceptions for payment of any court costs or insolvency practitioner fees.³⁸⁸ Where the insolvency law only affords secured creditors a limited first priority, it undermines the role of security and lead to uncertainty with respect to the recovery of secured credit. Thus, the use of such exceptions to the first priority rule for secured creditors is in general not recommended or should be reasonably limited, hence the reforms introduced for security rights created after 17 January 2018. In case of co-existence of special privilege claims and unsecured ones, an amount of 90% of the auction proceeds is

³⁸⁸ UNCITRAL Legislative Guide on Insolvency Law

allocated for the repayment of creditors enjoying special privileges, while the remaining 10% of the auction proceeds is allocated to non-privileged creditors. In case of co-existence of claims enjoying general privileges and unsecured claims, then 70% of the auction proceeds are allocated to the repayment of the first category of creditors. Finally, in case of co-existence of claims of general privileges and claims of special privileges, the first are allocated one third (1/3) of the auction proceeds and the latter the remaining two thirds (2/3). Claims falling under the same category are satisfied in the order set forth above and claims having the exact same ranking are satisfied proportionally. Priority of real security is determined by reference to priority of perfection of that security, so that any prior ranking security interests must be satisfied before any subsequent ranking security interests.

4.4.2 Security rights created after 17 January 2018

In case of claims arising after 17 January 2018, for which a security right is constituted over an asset which was not already burdened on that date, the auction proceeds are allocated as set forth below, (following deduction of the amount corresponding to enforcement expenses):

- (a) Claims arising prior to the date of the first auction relating to outstanding remuneration up to a maximum period of six (6) months from employment relationships and up to an amount equal to the minimum monthly remuneration applicable to employees older than twenty-five (25); years multiplied by 275%;
- (b) Special privileges claims under paragraphs (a) and (b) above;
- (c) General privileges claims and special privileges under paragraph (c) above; and
- (d) Unsecured claims.

In case of multiple general and special privilege claims, the claims falling under the same category are satisfied in the order set forth under sections 4.1 and 4.2 above and the claims having the exact same ranking are satisfied proportionally. Priority of real security is determined by reference to priority of perfection of that security, so that any prior ranking security interests must be satisfied before any subsequent ranking security interests. Following the satisfaction of the privileged claims, the unsecured creditors are proportionally satisfied from the remaining amount.

In the majority of cases, secured creditors are expected to receive more under the newly established regime in comparison with the previous one, as the claims falling within the definition as per the specific conditions set out by law with respect to claims arising from employment relationships of the new system, as described under (a) above, are not expected to be excessive as to significantly reduce the amount to be allocated to the secured creditors, who are satisfied in the second rank.

4.5 **Priority of satisfaction of claims in insolvency and winding-up**

In case of insolvency, the allocation of the liquidation proceeds follows the above structure, with the following exceptions:

- (a) the allocation of the proceeds takes place following deduction of not the enforcement expenses, but judicial expenses, expenses for the administration of the bankruptcy estate (including the remuneration of the bankruptcy trustee) and any group claims;³⁸⁹

³⁸⁹ Group claims include any claims created after the declaration of bankruptcy due to actions by the bankruptcy trustee and in general due to the bankruptcy procedure, such as:

- (b) claims arising from financing provided for the rescue or preservation of the debtor's business in the context of a rehabilitation or reorganization plan, or during the negotiations for the agreement on a rehabilitation plan (and maximum six (6) months before the filing of the rehabilitation application) have a super-privilege and are satisfied before the allocation of the liquidation proceeds.

The above deductions affect the level of satisfaction of secured claims, however, they are justified from the need to finance the bankruptcy procedure, to incentivize the financing for the rescue or preservation of the debtor's business and for safeguarding of a minimum protection for the employees (in which case a specific time limit applies).

4.6 Other ways of protection of secured creditors in the context of pre-insolvency and insolvency proceedings

Apart from the aforementioned priority ranking of secured claims, secured creditors are protected in the context of pre-insolvency and insolvency proceedings in the following ways:

- (a) The approval of a rehabilitation plan or of a special administration petition (in the context of the respective pre-insolvency proceedings) or of a reorganization plan (in the context of bankruptcy) requires the acceptance 60% of the overall creditors, 40% of which should be secured ones;
- (b) In case a secured creditor does not accept the rehabilitation petition, the court cannot validate such petition unless it is proven that the position of such creditor following rehabilitation will not be worse than its position in case of bankruptcy.³⁹⁰

4.7 Possibility of contractual assignment of a priority ranking – Subordinated claims

Under Greek law, the debtor cannot change the ranking of claims by means of an agreement with one or more of its creditors.

The creditors can contractually agree with each other on the ranking of their claims. However, such agreement is binding only between the parties and will have no effect against third parties involved in enforcement, such as the notary public who will allocate the auction proceeds to the creditors. This is why usually in case of the aforementioned agreements, the creditors appoint an agent who is authorized to receive payment on behalf of all the creditors and then allocates it based on the terms of the inter-creditor agreement.

Moreover, the agreement on the ranking of priority has been accepted with respect to mortgages, and Greek Law 2844/2000 regulating the creation of a pledge without delivery of the pledged asset to the pledgee, provides for the possibility of two or more pledgees to agree on the ranking of their pledges, by virtue of an agreement which is registered. Finally, pursuant to Greek Law 612/1968, several creditors with a mortgage can agree on the change of the mortgages' ranking, by virtue of a notarial deed and a relevant note in the mortgage registry.

-
- The claim of the creditor, who has filed for bankruptcy, to take over the fee pre-paid for the filing;
 - In case a bilateral agreement continues being performed following bankruptcy, following a relevant statement by the bankruptcy trustee, the claim of the debtor's counterparty's for the performance of the obligation of the debtor due;
 - Third party claims from contracts entered into by the bankruptcy trustee.;
 - Claims of employees who continue providing their services as a result of the continuation of business activity for wages and related benefits;
 - In the event of the revocation of the bilateral agreement, the claim of the debtor's counterparty, who has repaid the benefit received from the debtor, to also get back the relevant consideration.

In addition, group credits include, among other things, the remuneration of the bankruptcy trustee, claims from post-commencement of the bankruptcy financing procedure, the remuneration of the persons hired by the bankruptcy trustee to assist him with his work etc.

³⁹⁰ The same applies for unsecured creditors who have not accepted the rehabilitation petition.

5. REGISTRATION AND PERFECTION WITH THE REGISTRY SYSTEM

5.1 Form

Types of Security	Notarial deed	Private document with certified date	Simple private document	Declaration	Court decision	Payment order
Immovables						
Mortgage on land plots, premises and buildings	x				x	x
Pre-notation of mortgage					x	x
Mortgage on industrial properties	x					
Mortgage in favour of banks	x					
Sale and leaseback	x					
Movables						
Movables pledge	x	x				
Non-possessory pledge	x	x				
Title retention	x	x	x			
Financial leasing	x	x	x			
Floating charge	x	x				
Pledge in favour of banks	x	x	x			
Pledge over shares of non-listed and listed <i>sociétés anonymes</i>	x	x				
Pledge over company rights	x	x				
Ship mortgage (common and preferred)	x					
Common aircraft mortgage				x		
Preferred aircraft mortgage			x			

Types of Security	Notarial deed	Private document with certified date	Simple private document	Declaration	Court decision	Payment order
Rights						
Receivables Pledge	x	x				
Pledge on business claims			x			
Pledge in favour of banks	x		x			
Title security	x	x				
Pledge over bank accounts	x	x				
Pledge over IP rights	x	x				
Personal guarantee	x		x			
Financial guarantee			x			
Claims under financial collateral regulations			x			

Identified issue:

Market participants have pointed out that public notary fees required for granting a mortgage are excessive. This is why in practice creditors use mortgage pre-notation instead of mortgage. Although mortgage pre-notation is a useful tool to secure a claim in a genuine dispute, as used in practice it overloads judges with clerical work, which in case of mortgage could be done by a notary public. This issue has not been raised with respect to pledges, since in practice with respect to these types of security that can be created by means of a private document with a certified date, the parties prefer not to enter into notarial deeds entailing the notarial fees for the creation of the security, and, thus, the public notary fees do not constitute an impediment.

Recommendations for reform:

The law defining the fees of the notaries public should be amended so that the mortgages are not subject to percentage based fees but rather to maximum defined fees. If the law is amended in accordance with the above, the mortgages would then be utilized as properly registered security as regards overdraft accounts and other loan agreements, whereas at the moment they are used mainly as security for bond loans, since such fees are limited to a specific amount in accordance with the Bond Loan Law, as well as for the mortgages pursuant to Greek Law 4112/1929.

Generally, it is advisable that costs of taking, maintaining and enforcing security are low because high costs of security have a negative effect on the efficiency of credit market.³⁹¹ High fees for taking and enforcing security also deter external investors.

³⁹¹ *Supra* note 5, EBRD Core Principles para.6 page 2.

5.2 Registration

Types of Security	Land registry	Pledge registry	Ship registry	Aircraft registry	IP rights registry
Immovables					
Mortgage on land plots, premises and buildings	x				
Pre-notation of mortgage	x				
Mortgage on industrial properties	x				
Mortgage in favour of banks	x				
Sale and leaseback					
Movables					
Movables pledge					
Non-possessory pledge		x			
Title retention		x (optional)			
Financial leasing					
Floating charge		x			
Pledge in favour of banks					
Pledge over shares of non-listed and listed <i>sociétés anonymes</i>					
Pledge over company rights					
Ship mortgage (common and preferred)			x		
Common aircraft mortgage				x	
Preferred aircraft mortgage				x	
Rights					
Receivables Pledge					
Pledge on business claims		x			
Pledge in favour of banks					

Types of Security	Land registry	Pledge registry	Ship registry	Aircraft registry	IP rights registry
Title security					
Pledge over bank accounts					
Pledge over IP rights					x
Personal guarantee					
Financial guarantee					
Claims under financial collateral regulations					

Identified issues:

All market participants identified issues with regard to the need for the simplification and greater efficiency of the registration process of the pledge agreements, deriving from the lack of an electronic pledge registry and the obligation to register the pledge at the competent pledge registry, depending on the seat of the pledgor at the time of pledge registration. This registration scheme not only results in higher registration fees but also complicates any relevant due diligence by the creditors.

The majority of market participants have noted that the fees of the public registries and the cadastres (i.e. the local municipal registries) are excessive. Based on our experience, this indeed is a factor impeding the granting of security in Greek transactions. More specifically, percentage based fees for the registration of security, with the exception of bond loans, lead to most large financing transactions being structured as bond loans to get round this issue, which can result in complex structures.

Recommendations for reform:

Market participants suggested the establishment of a general electronic registry, where the use of the Taxpayer ID would allow the creditors to obtain a general overview of the assets of the debtor across the country. Electronic registrations are cheaper than paper-based registrations, and electronic searches are free of charge.³⁹²

Elaborating on the aforementioned suggestion, our view is that the registration process could be simplified and become at the same time less expensive and more transparent, if all relevant registrations were made via the electronic system of G.E.MI., instead of the competent pledge registries. By utilizing the G.E.MI. electronic system for this purpose, the registrations could take place and be visible online on the same day. In order to safeguard the electronic procedure, any registration (including modifications or releases) should require the consent of the pledgee, except for cases of modification or release on the basis of a court decision. Non-Greek legal entities should be able to become G.E.MI. members and acquire a G.E.MI. number and access to G.E.MI.'s system for the purposes of such registrations. In order to expedite the procedure, G.E.MI. should not be obliged to check the legality of the registrations.

Another recommendation would be the amendment of the law defining the fees of public registries and the cadastres, so that the registration of a non-possessory pledge or a floating charge of Greek Law 2844/2000 is not subject to percentage based fees, calculated on the basis of the amount of the claim of the security, but rather to fixed charges. Such amendment would allow the use of such

³⁹² *Supra* note 7, UNCITRAL Legislative Guide, para. 276 page 120.

securities with regard to loan agreements and revolving credit facilities.

6. ENFORCEMENT PROCEEDINGS

6.1 Obtaining information on a debtor's assets

There is no central registry or procedure where the creditors can obtain information on all the assets of the debtor. The only case where the creditors can obtain information through public records is with regard to immovable assets, from the land registries or cadastral offices where the debtor's assets are located, as well as with regard to ships and aircraft, from the relevant registries.

Moreover, creditors can acquire information from publicly available records on any insolvency or pre-insolvency procedures pending regarding the debtor.

Identified issue:

Market participants have noted that lack of digitized and online registries for all kinds of assets affect the ability to locate reliable information about the debtor.

Recommendations for reform:

It is recommended that digitized and online data bases regarding assets, for example registration of vehicles and other movables data bases, as well as a unified online system for bank accounts of natural and legal entities are developed. As to the assets of natural persons we suggest that a reasonable precaution for the protection of their personal data would be to authorize lawyers to enter any asset registries with special codes.

6.2 Judicial enforcement

According to the GCPC, in order to enforce against a debtor, a secured creditor must obtain an enforcement title, in the form of a final or provisionally enforceable Court decision, an arbitral award, the minutes of a Greek court which include a settlement agreement, a notarial deed, a Payment Order or foreign judgments or the equivalent which are declared as enforceable by the Greek courts. Nevertheless, in case of security granted under LD 1923, the enforcement procedure can commence without previously obtaining an Enforcement Title, under the fast-track procedure described below under 6.7.2.

Apart from the notarial deed, which is acquired extra judicially, all other aforementioned types of enforcement titles require judicial proceedings.

According to the GCPC, assets are mandatorily liquidated through public auction procedures. More specifically, three (3) working days after the enforcement title is served, a creditor seizes the secured property and initiates auction proceedings described as follows: The court bailiff issues a statement of seizure naming the property or the assets to be auctioned, the date, place and price of the auction and the Notary Public that will act as the Secretary of the Public Auction. The public auction takes place before a Notary Public who is appointed as the Secretary of the Public auction and who is responsible for the procedure of the public auction and the bidding procedure, the collection of the proceeds by the highest bidder etc. The auction shall take place within seven (7) months and in any case no later than eight (8) months after the seizure's completion. Electronic auctions apply from September 2017 onwards and currently constitute the exclusive type of auction in Greece, as physical auctions have been abolished. Up until today, the number of auctions has increased and they produce satisfying results.

Identified issues:

Market participants have highlighted that significant impediments are:

1. complex civil procedure mechanisms;
2. overlapping legislation, legislation "open" to interpretation, rulings contradicting each other;

3. judges with lack of specialization;
4. court's inefficiency in responding in a timely manner to various petitions, lawsuits, applications etc.; and
5. in cases where the debtor of pledged claims is the state, the latter is not obliged to pay if the pledgee does not provide a tax and insurance clearance certificate of the pledgor; this is particular burdensome for the pledgee, since the pledgor might have already gone bankrupt.

Recommendations for reforms:

1. It is recommended that the implementation of the process of electronic auction, which was recently introduced and its administration, conducted by an independent administrative authority under the guarantee of the state, will greatly facilitate the enforcement proceedings currently in force. This is confirmed by the experience from electronic auctions so far. Another recommendation is to introduce amendments to make the enforcement procedure more simple and flexible.
2. Specialisation of judges in commercial matters such as enforcement to deal more effectively with enforcement cases and seminar based training for such judges regarding complex financial issues. There are no specialist commercial or financial courts, but there are special commercial sections in the ordinary procedure of the First Instance and Appeal Courts which could be strengthened.
3. Additional court personnel should be hired to alleviate the work burden on judges.
4. Amendment of the tax legislation, so that in case the payment of a pledged claim made by the Greek State or the legal entities incorporated under public law, the tax clearance and public insurance certificates are required solely for the pledgee and not for the debtor, who may be declared bankrupt (between the issuance of the loan and the payment of the claim), particularly in case of significant delay in the payment of the pledged claims by the Greek State and the legal entities incorporated under public law. Another recommendation would be the introduction of provisions similar to those of Articles 448 and 463 of the GCC, according to which the Greek State or legal entities incorporated under public law, would pay the pledgee, but would be able to set-off any tax or social security claims against counterclaims existing at the time of the notification of the pledge.

6.3 Full hearing (Final or provisionally enforceable Court Decision/ Arbitral Award)

The generally applicable court procedure is the filing of a lawsuit on behalf of the creditor. The decision issued at first instance may be declared provisionally enforceable³⁹³ (either in whole or partially) by the Court. If not, the creditor will have to wait for the decision to become final upon the lapse of the time period available for appeal or, if an appeal is filed, the creditor will have to wait for the second-instance decision to be issued. The final (unappealable) court decision on such lawsuit is enforceable.

Until recently, the issuance of a final court decision in Greece was very time consuming. Regarding new lawsuits filed from 1 January 2016 and afterwards, following amendments to the GCPC which inter alia shortened the procedural deadlines of the cases brought before Court with the ordinary proceedings, the time needed for the final judgment is reduced. There is not enough precedent on the basis of the new provisions of the GCPC yet, therefore we are not aware of the time required for the issuance of a final decision under the new procedure, but we estimate that it will take about 1-2 years.

³⁹³ The declaration of a decision as provisionally enforceable is obligatory in certain cases (e.g. alimony claims, certain labour claims), it is forbidden in other cases (e.g. regarding claims for the payment of court expenses), while in all other cases it is at the discretion of the court, if the latter finds that it is necessary due to exceptional reasons or that any delay in enforcement may cause significant damage to the winning party.

If an agreement regarding recourse to arbitration exists, the creditor may seek to issue an arbitral award. The arbitral award constitutes an enforcement title.

6.4 Non full hearing (Payment order)

If the creditor can prove its claim through public or private documents (such as loan agreement, bank statements, invoices along with dispatch notes), then it can apply for a payment order, which is issued by the competent court without the presence of the debtor. The payment order is issued within approximately 3-4 months. The payment order constitutes an enforcement title.³⁹⁴ The creditor commences the enforcement procedures against the debtor by serving a copy thereof to the debtor by a court bailiff, together with a demand for immediate payment.

6.5 Title retention

Please see above under the section 3.2.1(c). In case the debtor does not fulfil its obligation to pay the purchase price within the agreed time period, it does not acquire ownership of the purchased asset and has no legal reason to keep the asset in his possession. The creditor, which is the sole owner of the asset, can seek to regain possession of the asset via a court decision.

6.6 Title security

In case of title security, the creditor following acquiring possession of the asset (in case of movable assets) shall proceed to a voluntary auction (provision of Article 1237 GCC apply mutatis mutandis).

6.7 Extrajudicial (out-of-court) enforcement

6.7.1 Enforcement by virtue of a notarial deed

According to Greek law, enforcement can take place out of court without prior court approval on the basis of notarial deeds, provided that they depict a claim which is certain, fixed and subject to enforcement.

6.7.2 Enforcement under LD 1923

Security rights created in favour of credit institutions under the LD 1923 such as share pledges, pledges of receivables and mortgages benefit from a fast-track out-of-court enforcement procedure (as opposed to the rules of the GCPC). More specifically, pursuant to the LD 1923, the enforcement procedure can commence without previously obtaining an Enforcement Title. Instead, for the purposes of enforcement the creditor only needs to submit a specific payment request by a court bailiff to the debtor. Non-listed shares must be subject to a public auction procedure without the requirement of seizure. Nevertheless, it is noted that the aforementioned does not constitute a fully extra judicial enforcement procedure, since with respect to auction, the general procedure entailed in the GCPC applies. Furthermore, in case of pledges (such as pledges over receivables or bank account pledges), the creditor is entitled to collect the respective amounts and apply such amounts for the purposes of satisfaction of the due claims against the debtor (while releasing any excess amounts).

Under the LD 1923, the enforcement proceedings can be initiated immediately at any time following all or any part of claims become due and payable by serving an enforcement writ. The auction takes place on the first Sunday following the lapse of eight days from the service of the enforceable writ before the notary appointed via the enforceable writ, without any seizure proceedings. Pursuant to the Greek Bond Law, the provisions of the LD 1923 apply (amongst other types of security) to pledges securing bond loans; moreover, it is stated that whereby the

³⁹⁴ Except in case of a payment order against a debtor with unknown residence or against a foreign resident, in which case enforcement cannot take place before the lapse of the time period available for appeal.

security was granted, the agreement can serve as the executable writ of enforcement.

6.7.3 Pledge enforcement

Under Article 1237 of the GCC once its monetary claim has become due and payable, a pledgee has the right to proceed with the realisation of the pledge. In case of the existence of an enforcement title, the pledgee may sell the assets through auction. In case of lack of an enforcement title, the pledgee may seek Court permission for sale of the assets. This involves a procedure before the Magistrates Court where the assets are located and the decision of the Court allowing the pledgee to proceed with the auction (without an enforcement title having to be issued) either within forty-eight (48) hours or within thirty (30) days at the latest. The decision is subject to a revocation in the case of change of circumstances or on appeal by the debtor. This procedure of appeal may also last between 1-2 years subject to availability of the court dockets.

Identified issue:

Although significant steps have been made with regards to non-judicial enforcement in the context of the Collateral Law on financial collateral, more progress should be made to capture movable assets pledged pursuant to the general provisions of GCC and allow these to be subject to extra-judicial enforcement.

Recommendations for reform:

A recommendation would be, in case of a debtor which is a legal entity, to enable the creditor to sell the pledged movable asset without running a public auction or acquiring a relevant enforceable title or court permission, subject to appropriate safeguards. If the sale does not take place in a commercially acceptable way, it would still be valid (in order not to affect any third parties involved and decrease the purchasers' interest and/or price paid), but the debtor would be able to ask for compensation in the event of damage or financial loss. This suggested process could be restricted to being only available to a regulated creditor (e.g. a credit institution), which would more trustworthy with regards to both the conduct of the sale and payment of any compensation.

The above recommendation could be applied to movable assets. With respect to immovables, we are of the opinion that an increase of out of court enforcement by creditors would be difficult from a political point of view.

6.8 Exemption for enforcement requirements for financial collateral

According to the Collateral Law and by way of derogation from any other provision, upon the occurrence of an enforcement event, the collateral-provider is entitled to satisfy his claim on any security provided under a financial collateral agreement as follows: (a) on financial instruments, by sale and transfer of financial instruments or the acquisition of their ownership by the collateral-provider; and price or value setting off with the relevant finance liabilities, (b) with respect to cash, by using it for the total or partial satisfaction of relevant financial obligations, (c) on receivables, by sale and assignment or acquisition of receivables by the collateral-taker and with the price or value being set off against the relevant financial liabilities. The acquisition of financial security of the collateral-taker under the foregoing paragraph is only possible, under the conditions that:

- (a) it is agreed by the contracting parties in the collateral security agreement and
- (b) the contracting parties have agreed in the collateral security agreement the method of valuation of financial instruments or claims.

6.9 Enforcement costs

The costs of enforcement proceedings depend on various factors, such as the amount of the claims for which enforcement is sought, the number of times that the public auction will be repeated, whether

legal remedies are filed against the enforcement actions, the number of creditors involved, etc. The costs include seizure, public auction and other costs and may relate to land registry fees, court bailiff fees, fees of the appointed expert who determined the value of the seized property, fees for publication of the enforcement actions in the Bulletin for Judicial Publications, public notary fees, lawyers' fees and judicial expenses. In particular the court bailiff fees for the attachment of an asset amount to EUR 660 and increase in case of multiple assets, while they amount to EUR 300 for the drafting of each excerpt of attachment report for the purposes of an auction (or the repetition of an auction). The public notaries fees for the conduct of an auction are percentage based, but are capped at EUR 120.

Identified issue:

Market participants have noted that enforcement costs and expenses are high. Moreover, it is noted that the actual collection depends on the financial situation of the debtor as well as the overall economic environment of the Greek market.

Recommendations for reform:

Generally, flexibility in timing and method of disposition is recommended in the enforcement process, because this reduces costs.³⁹⁵

Market participants have suggested that the fees should be reduced. Rather than percentage-based fees and expenses, the costs should be fixed or a qualifying percentage scale of fees with maximum amounts shall be introduced. Percentage-based fees depend on the value of the secured claims and not on the value of the asset. Thus, a creditor, who wishes to secure the total amount of its claim via an encumbrance on all available assets of the debtor, may have to pay several times the high percentage-based fees. The reduced fixed fees regarding bond loans were provided for in order to facilitate the growth of the relevant market, which was new at that time.

General identified issues regarding enforcement proceedings:

1. Market participants have highlighted that with regard to debtors who are natural persons, the most common obstacle to locating them (which is necessary for service of court and extra-judicial documents in the context of the enforcement procedure) occurs when they change their address without notifying the bank of their new one. With regard to legal entities, service of court and extra-judicial documents upon them can be made only if legally appointed management exists. Otherwise, service cannot be lawfully made. Another identified issue refers to service of legal documents on persons of unknown residence, which is a time-consuming process.
2. Market participants have noted that the procedure is not efficient in terms of speed, mainly due to court workload and auctions bottleneck. In addition to the long backlog created due to systemic deficiencies it is worth noting that Greek Courts remain closed during Greek court holidays –for several months per year – for a long period thus creating further delays and impediments to the enforcement of debt claims, lack of bidding interest, strikes and prevention of auction conduct. Other noted forms of delay are: delays caused by unpredictable reasons relating to various parties involved in the process (strikes by lawyers, notaries public, court bailiffs).
3. Time consuming court decisions regarding the offer price of the asset to be auctioned.
4. In addition to the above, market participants have noted that enforcement obstacles or claims, alleged by debtors and collateral providers put obstacles in the enforcement procedure as debtors raise objections with regard to claims that are not explicitly and clearly presented in the petition/lawsuit/payment order and/or set-off objections with claims they

³⁹⁵ *Supra* note 7, UNCITRAL Legislative Guide, para. 59, page 293.

have against the creditors.

General Recommendations regarding enforcement proceedings:

1. With regard to service on persons of unknown residence, electronic service through an on-line system may simplify the procedure. With regard to legal entities we suggest that legal service would be at the last known registered seat of the legal entity, together with the granting of a right to its shareholders to appoint new members of the Board of Directors; moreover, in order to safeguard the parties' rights, extra deadlines and publicity prerequisites could be defined. As an alternative we note that following a temporary management appointment, and provided that the legal entity would file a bankruptcy petition within a short period (for example thirty (30) days), the members of the temporary management would not be subject to civil, criminal and tax liability.
2. Market participants have suggested that the issuance of court decisions may be expedited through the simplification of proceedings.
3. Market participants have suggested that it would be more efficient for the offer price to be reduced automatically, in case of the cancellation of the first auction due to the non-appearance of interested bidders. It is noted that mandatory auction procedures for immovable assets may remain pending for several years, something which in turn delays the satisfaction of already adjudicated claims. This is partially due to the financial crisis, which has reduced interest in and affected the value of immovable assets, but also due to the formalities linked to the determination of the auction price. Currently, the determination of a new price following an unsuccessful auction requires a court decision. It would expedite the procedure if the auction price dropped automatically by a certain rate of the offer price at the preceding auction (e.g. 10%) following each unsuccessful auction, without the need of a court decision.

7. PROCEDURAL APPEAL

7.1 Appeal in judicial enforcement of secured claims

Please see below under the sections 8.6 and 8.7.

7.2 Appeal in out-of-court enforcement of secured claims

Please see below under the sections 8.6 and 8.7.

7.3 Appeal in insolvency and winding-up proceedings

Please see below under the sections 8.6 and 8.7.

Identified issues:

Market participants have noted that enforcement proceedings are subject to various motions and appeals that may delay or annul the procedure and that debtors may abuse appeal rights provided to them by law via these appeals.

Recommendations for reform:

Market participants have suggested that changes in legislation or court regulation are required to prevent appeal rights being used primarily for purposes of delaying the enforcement process, for example by tightening of the requirements for the issuance of an interlocutory injunction and suspension/regulation of the situation.

Unnecessary appeals particularly where the debtor is a legal person, may be prevented by following the principle of due process. Procedures should be adopted to ensure the efficiency of the court which should be organized so that all interested parties are dealt with fairly, in a timely manner, objectively, and as part of an efficient, transparent system.³⁹⁶

It is considered that insolvency law should prescribe that a party in interest may appeal from any order of the court in the insolvency proceedings that affects its rights, obligations or interests, but time limit for appeal should be shorter.³⁹⁷ Although appeals do not suspend insolvency proceedings, in some cases the courts have power to do so.³⁹⁸

It would make sense to restrict the number of cases when a party has an automatic right of appeal. For this purpose, it would be reasonable to include provisions which would require a permission in some instances in order to appeal, such as restriction related to the amount or value of the subject matter, or permission required in cases where the only issue in the appeal relates to costs or fees for hearing dates. It would also be reasonable to seek to reduce the number of cases in which the debtor may file an application before the court to request the suspension of the auction as well as to reduce duration of such suspension.

8. IMPACT OF INSOLVENCY AND WINDING-UP PROCEEDINGS ON ENFORCEMENT

8.1 Moratorium

Upon declaration of bankruptcy there is a moratorium (suspension) on the individual enforcement of claims by creditors. In particular, it is prohibited to initiate or continue any enforcement procedures as well as to file any new lawsuits or continue any (pending) litigation against the insolvent debtor in connection with the insolvency estate. With the exemption of the financial collateral law, the aforementioned applies to the creditors' union (in Greek *'enosi pistoton'*) stage of bankruptcy as well as to the special administration procedure.

8.2 Exemptions to security enforcement from insolvency

By way of exception to the aforementioned suspension of individual enforcement of claims, creditors whose claims are secured by a special privilege or security on the bankruptcy asset are not satisfied by the whole bankruptcy estate, but only by the liquidation of this specific asset in accordance with the applicable general provisions (see section 8.4.1 below), unless they have waived their privilege or security or the privilege or the security is not sufficient to fully satisfy them. In the latter case, secured creditors receive any proceeds from the remaining assets of the bankruptcy estate effectively only at the end of an insolvency.

³⁹⁶ *Supra* note 6, WB Principles C2, page 20.

³⁹⁷ *Supra* note 7, UNCITRAL Legislative Guide, para. 138, page 449.

³⁹⁸ *Supra* note 6, WB Principles, C2.1, page 20.

However, enforcement measures against the debtor's assets, which are operatively and directly related to the business of the debtor or to a production unit or operation of the debtor, are suspended until the approval of a reorganization plan, or until the decision of the Creditors' Meeting on how to proceed with the bankruptcy proceedings and in any case for up to ten (10) months from the date of the declaration of bankruptcy. Such suspension does not apply to assets belonging to guarantors, co-debtors or third debtors. It is noted that in practice, the creditors' union (in Greek '*enosi pistoton*') stage of bankruptcy when any individual enforcement is forbidden, takes place within the aforementioned ten (10) month period; which may result in practically no possibility of individual enforcement. Thus, in practice, the insolvency practitioner would be also responsible for the liquidation of the relevant asset.

If in the context of bankruptcy, it is decided that the bankrupt business will be sold as a whole, all individual enforcement actions of the creditors are suspended until the end of the relevant proceedings but only in respect of the debtor's assets which are operatively and directly related to the business of the debtor or to a production unit or operation of the debtor. In this case, the ten (10) month limitation shall not apply.

The above provisions are without prejudice to the specific arrangements for the enforcement of financial collateral arrangements.

Winding-up proceedings do not have any impact on enforcement.

8.3 Pre-insolvency proceedings – Rehabilitation agreement

8.3.1 Pre-Bankruptcy Scheme proceedings

Articles 99 106(f) of the Greek Bankruptcy Code (the "**GBC**") establish a collective pre bankruptcy rehabilitation procedure that allows debtors who are in a status of cessation of payments or facing an imminent threat of cessation of payments to avoid bankruptcy and to remain operational on the basis of a rehabilitation plan (the rehabilitation plan).

From the submission of the application for the ratification of the rehabilitation agreement and until the issuance of a relevant court decision, any individual and collective enforcement actions against the debtor are automatically suspended for a maximum period of four (4) months. Such suspension is available only one time per debtor. Following the above mentioned four (4)-month period, a moratorium may be imposed following an application to that effect by anyone having a legal interest.

8.3.2 Special administration proceedings (Articles 68-77 of the Special Administration Law)

Any natural or legal person that is eligible for bankruptcy, has its registered seat in Greece and is in a cessation of payments, may be put under special administration following a petition filed by its creditors representing at least 40% of the total amount of claims, among which at least one creditor is a financing institution. The acceptance of the petition results in the appointment of a "special administrator" for a period of twelve (12) months. All individual enforcement actions against the same debtor, including the administrative enforcement measures that are available for State authorities, are automatically suspended for as long as the special administration procedure is open.

The special administrator proceeds to a public tender and the creditors are expected to submit their claims and the sale consideration paid by the purchaser(s) is distributed to such announced creditors according to a ranking list created by the special administrator as described under articles 153-161 of the Greek Bankruptcy Code.

The special administrator will have to decide whether the liquidation amount is sufficient for the debtor's creditors. If the administrator considers that the amount does not suffice, then the

administrator is obliged to file a petition with the bankruptcy court for the debtor to be declared bankrupt.

After the filing of the application and before the issuance of the court's decision, anyone having legitimate interest (i.e. creditor and/ or a third party) may file an application for interim measures and the court may rule on the imposition of any interim measures deemed appropriate to prevent any harmful event for the creditors' deterioration of the insolvent debtor's property, including the suspension of individual enforcement actions.

8.4 Insolvency proceedings

8.4.1 Stricto sensu bankruptcy - liquidation

The bankruptcy trustee is responsible for the liquidation proceedings. Following the finalization of the creditors' claims verification, the liquidation stage starts, to the extent that no restructuring plan has been ratified. The liquidation of the debtor's business and assets, including any secured assets (only upon the inability of the secured creditors to liquidate them as per above (see section 8.2) is initiated by the bankruptcy trustee, while the distribution of the liquidation proceeds takes place in accordance with the applicable rules regarding the ranking of the creditors' claims as described in section 4.5 above.

8.5 Winding-up proceedings

It is to be noted that a voluntary winding-up proceeding has no impact on the enforcement procedure and/ or ranking system.

8.6 Appeal in insolvency

The Court decision declaring bankruptcy may be contested via an appeal and cassation which are exercised and heard under the same procedure as non-contentious proceedings. All rulings of the bankruptcy court are subject to a special type of appeal available to parties who did not participate in the hearing (in Greek "*anakopi erimodikias*"), appeal and cassation only on grounds specified by law. The appeal is brought against the bankruptcy trustee and is exercised before the court which rendered the judgment, by the debtor and any other person who has a legitimate interest, within thirty (30) days from the publication of the ruling at the Bulletin of Judicial Publications of the Jurists' Fund. Moreover, the ruling that declares bankruptcy can be revoked by the court that declared the bankruptcy, following a request by the debtor, under the condition that the creditors which participated at the procedure of the declaration of bankruptcy, as well as those who are indicated by the file, are satisfied or consent. The ruling that declares bankruptcy can also be revoked through a request by anybody having legitimate interest or through a proposition of the Judge Rapporteur.

Objections during the procedure of the verification of claims can be raised by the debtor, the bankruptcy trustee, as well as the creditors, whose claims were temporarily or permanently accepted. They may be submitted ten (10) days following the verification procedure completion, before the bankruptcy court; a relevant Judge Rapporteur Report is accordingly issued within twenty (20) days from the objections' filing. The debtor and the creditors whose claims were questioned, as well as those who submitted the objections, are served a writ of summons for the hearing care of the bankruptcy trustee. Anybody having legitimate interest and the creditors' committee can intervene in the procedure. Only an appeal is allowed against the ruling of the court.

It is to be noted that any particular procedure of the public auction conducted for the sale by auction of the debtor's assets either in total or of individual assets, can be contested by anybody having a legitimate interest through an action before the bankruptcy court within an exclusive time limit of fifteen (15) days from the implementation of each action. Creditors who have not lodged their claim within the legitimate time limit, in order to participate in the verification, may by an opposition and at their own expense request their verification by the bankruptcy court. The filing of the opposition does not stay the distributions that have already been ordered by the Judge Rapporteur. Anyone with legal

interest may file an action opposing the distribution table before the bankruptcy court. The judgment of the court is only subject to all legal remedies but for a by default stay of proceedings application.

Finally we note that a third party opposition may be filed against the rehabilitation agreement (which is a pre-bankruptcy procedure) before the bankruptcy court within thirty (30) days following the publication of the decision that ratified the rehabilitation agreement.

8.7 Appeal in judicial enforcement of secured claims

The debtor has several legal remedies against the enforcement procedure, which are common for both judicial and some of the extra judicial enforcement procedures (e.g. The LD 1923 which constitutes a semi-judicial enforcement procedure as aforementioned). Moreover, in case of a judicial enforcement, the debtor can file for an appeal against a decision made by first instance court or a payment order, and therefore intervene in the process of acquiring an enforcement deed, before enforcement commences. With respect to financial collateral, only interim measures may be sought by the debtor with limited chances of success.

As far as legal remedies against the enforcement procedure are concerned, under Article 933 of the GCPC, in case the debtor or any of its other creditors have any objections with respect to the enforcement title's validity, to the enforcement procedure or to the adjudicated claim of the creditor initiating the enforcement proceedings, they are entitled to file an appeal before the competent court. The hearing of that application should take place within sixty (60) days from the application's filing, while the court should deliver its ruling within another sixty (60) days from the hearing date. *A rough estimation until the issuance of an irrevocable decision on the appeals filed is approximately between 2-5 years (depending on the legal remedies the debtor or the creditor files against the decision issued in the first instance).* Even where an enforcement title is not required for the initiation of the enforcement procedure (LD 1923), the enforcement process is accelerated in cases where the debtor does not contest the enforcement. On the contrary, in cases where the debtor contests the enforcement, the time for the reaching of an irrevocable decision would be approximately the same. Moreover, any third party may object to the enforcement procedure, in case it is deemed that its right on the asset enforced is being infringed. Unnecessary appeals may be prevented by following the principle of due process. Procedures should be adopted to ensure the efficiency of the court which should be organized so that all interested parties are dealt with fairly, in a timely manner, objectively, and as part of an efficient, transparent system. Moreover, enforcement costs are generally deemed high, especially compared to other European jurisdictions.

Further, in order to suspend the auction, the debtor may file an application before the court, at least fifteen (15) business days before the auction's date, requesting the suspension of the auction for a maximum period of six (6) months. In order for such suspension to be granted in favour of the debtor, the following conditions should accumulatively be met: a) the interests of the creditor who initiated the enforcement proceedings should not be severely harmed, b) it should be assumed acting reasonably, that the debtor will most likely repay the creditor within this time frame or that higher auction proceeds will be achieved if the auction is suspended, c) the debtor is obliged to compensate the creditor for any expenses incurred with respect to the initiation of enforcement proceedings and d) the debtor must pay the creditor up to one fourth (¼) of its claims. The court should deliver its ruling on said application by latest on Monday, midday, preceding the auction day (which is always a Wednesday).

8.8 Financial collateral: close-out netting and treatment in insolvency procedure

The close-out netting provisions have two effects: (a) all transactions are terminated and (b) all claims deriving from such transactions are valued as of the early termination date and the parties' obligations are set-off (netted as an accounting act) against each other, so that only one net claim remains.

The early termination and valuation in case of bankruptcy is valid under Greek law. What would be questionable under the general provisions of Greek law would be the enforceability of the setting-off of the Parties' obligations in respect of the claims. However, such enforceability is safeguarded by special legal provisions.

More specifically, paragraph 1 of Article 36 of the GBC explicitly provides that the creditor may exercise its right to set off its claims against its counterparty's reciprocal claims irrespective of the declaration of Insolvency Proceedings against such counterparty, provided, however, that the conditions for set-off to be enforceable have been fulfilled prior to the declaration of the Insolvency. Article 440 of the GCC provides that the conditions for set-off to be enforceable are that the claims to be set off against each other must be (i) reciprocal, (ii) of the same kind and (iii) due and payable. Therefore, it would be questionable whether set-off in the context of close-out netting would be valid on the basis of the above provision, since the conditions for set-off are fulfilled upon and not prior to declaration of insolvency.

The issue is resolved by paragraphs 2 and 3 of Article 36 of the GBC, which provide that the set-off of claims under OTC derivatives transactions or in accordance with close-out netting provisions under financial collateral arrangements will be regulated by the relevant special legislation.

As far as the special legislation is concerned, the main provisions applicable are: a) Article 16 of the Bond Loan Law; b) Article 7 of the Collateral Law; and c) Article 9 of Insolvency Regulation 848/2015.

The provision of Article 16 of the Bond Loan Law makes it absolutely clear that set-off is valid and therefore, the close-out netting provisions are enforceable, even after insolvency, provided the following three conditions are met:

- (a) the claims being set-off derive from transactions between parties, one at least of which is a credit institution or an investment firm, or the state;
- (b) set-off is governed by an agreement; and
- (c) the agreement has a certain date (i.e. a date, which is established in accordance with one of the formal procedures recognised under Greek law to establish a "date certain"), which is prior to the declaration of insolvency or the commencement of the collective measure or procedure akin to insolvency.

In addition, the Collateral Law provides that within its scope close out netting provisions have to be recognized and given effect in the case of insolvency. The Collateral Law prevails over all previous laws in its field of application, including all general and specific insolvency law provisions, except from the limitations provided by the provisions of the Greek Law 4335/2015 transposing into the Greek Law the Directive 2014/59/EU (the "**BRR law**").

Finally, in accordance with Article 9 of the Insolvency Regulation 848/2015, the commencement of an insolvency proceeding does not affect the right of the creditor to set-off its claim against the respective claim of the debtor, provided that such set-off is permitted by the law governing the insolvent debtor's claim (usually either English or New York law, for which it is assumed that it recognizes the enforceability of the netting provisions).

It is worth noting that even though, contrary to a number of other provisions of the Insolvency Regulation, Article 9 does not differentiate between the law of Member States of the EU and the law of non-member states, the influential Virgos-Schmit report seems to conclude that Article 9 of the Insolvency Regulation will only apply if the law governing the insolvent debtor's claim is the law of a Member State of the EU, in this case English law.

We note that arguments regarding the enforceability of set-off provisions in the context of close-out netting can also be derived from special legal provisions applying on specific types of regulated entities, such as banks and insurance companies.

9. FINANCIAL (CONSENSUAL) RESTRUCTURING AND OTHER WORK-OUTS

Consensual restructuring in Greece usually involves the refinancing of existing loans, along with the provision of new and/or additional security. The interim negotiations period is usually covered by a standstill agreement.

10. TRANSFER OF LOANS (NPL SALE)

10.1 General regulatory requirements and obstacles for security transfer

Note: 'collateral transfer' has been included in this section.

Following the enactment of Greek Law 4354/2015, as amended and in force (the "**NPL Law**"), the transfer of performing and non-performing loan receivables (the "**Receivables**") that have been granted or originated by credit or financial institutions, falls under the scope of the NPL Law. Practically, this means that the Receivables can generally be acquired by any entity which has such statutory object of acquiring loan receivables, either Greek or non-Greek (the "**Receivables Acquisition Company**" or the "**RAC**"). As a legal prerequisite for a valid transfer, the RAC needs to have appointed a Greek licensed and regulated by the Bank of Greece servicer under the NPL Law to manage such Receivables (the "**Receivables Management Company**" or the "**RMC**"). According to the recent amendment of the NPL Law by virtue of Law 4549/2018, the RMCs are explicitly classified as "financial institutions".

The RAC shall in principle be entitled to hold any assets which may be used as collateral for the Receivables, such as real estate and equity instruments ("**Other Assets**") subject to any limitations or other restrictions applying under the rules of its country of establishment.

We note that a RMC is allowed to manage Other Assets only regarding real estate properties that had been initially granted as collateral to the Receivables and in the meantime have been transferred to a RAC. Such management includes letting the real estate on behalf of the RAC, maintaining and supervising the same etc. A RMC is not allowed to manage assets in any other form, such as shares, bonds and any other assets that may have been used as collateral to the Receivables. Therefore, such other non-eligible assets should be managed either directly by the RAC or by any other third party manager.

Moreover, according to Article 1(1) (d) of the NPL Law, its application shall be without prejudice to the provisions of the Bond Loan Law. This specific wording implies that the application of the NPL Law does not limit or otherwise prejudice a loan transfer under the GSL, but under circumstances both regimes can co-apply.

Lately, a number of transactions have been concluded in the Greek market, applying either an outright sale scheme under the NPL Law on the sale and servicing of receivables or the combination of the GSL for the acquisition of receivables with the NPL Law for the servicing of loan and credit receivables.

10.2 Issues relating to collateral transfer

Please see the section 10.1 above.

10.3 Form of transfer (notices, consents)

A Receivables sale and transfer agreement (the Receivables Sale and Transfer Agreement) must be executed in writing.

Following the amendment of the NPL Law by virtue of Greek law 4549/2018, which entered into force on 14 June 2018, Receivables may be offered for sale, provided that the debtor and the guarantor (the "**Debtors**"), only in the case where they fall within the meaning of "consumer" under article 1a of Greek law 2251/1994, as amended and in force, (i.e. natural persons who are acting for purposes which are outside their trade, business, craft or profession) have been notified - by means of an extrajudicial invitation within the last twenty (12) months before such offer- to settle their debts. This amendment aims to facilitate the transfer of business loan packages and at the same time limit the administrative transfer costs since the prior notification requirement does no longer apply with respect to all Debtors. Prior notification is also not required for claims that are judicially disputed, claims that have already been the subject of a court ruling and claims against non-cooperative debtors (as described in paragraph 2 of Article 1 of Greek Law 4224/2013, as in force). There is no time limit

for response to the invitation for settlement by the Debtors and such response does not constitute a legal requirement for the transfer of the receivables.

In cases of Receivables transfer, a RAC is obliged to continue the process provided under the Greek Code of Conduct from the point where it was left at the time of the transfer for all Debtors. The above obligation shall inevitably affect the management duties of the respective RMC that manages such transferred receivables.

In order for the Receivables Sale and Transfer Agreement to be effective against the transferor and third parties, a summary of the Receivables Sale and Transfer Agreement must be registered in the same public registry as for securitizations. The Debtors of the transferred Receivables must be notified, by any means, of the transfer. Prior to such notification, any payment to the transferor releases the Debtors. By the recent amendment of the NPL Law, it is clarified that the notification can be delivered to the Debtors by any appropriate means, including any electronic means of communication.

We note that in case both regimes (NPL Law and GSL) co-apply, the Receivables Sale and Transfer Agreement must reflect the GSL provisions and the RAC would act in parallel as a Securitization SPV under the GSL. Moreover, the servicing of the Receivables shall mandatorily be performed by a GSL-compliant servicer who will perform a series of standard collection and administration functions as provided under the GSL. Such function is typically assumed by the originating banks.

10.4 Compliance with banking secrecy, data protection, requirement for license and permits

10.4.1 Data Protection Law

The GDPR which is in force from 25 May 2018 automatically replaced Greek law 2472/1997 on personal data protection and a new Greek law is expected to enter into force shortly. The key principles however of data protection have not been altered under the GDPR.

The main obligation of the person who determines the purpose and the means of processing of personal data (the Data Controller), pursuant to the GDPR, is the notification to the Hellenic Data Protection Authority (the HDPA) regarding the maintenance of personal data records. Additionally, the subject of the personal data is entitled to have access to the data processed, to be informed about the identity of the Data Controller, the purpose of the processing, the potential receivers of the data and its right to have access and to object to the processing. Specifically, for the transfer of any personal data to a RMC and the transfer of receivables to RACs, the existing data controller is obliged to provide the data subject, i.e. the Debtors, with specific information set out above at the latest when the personal data are first disclosed and transmitted to the new data controller.

Pursuant to the GSL, no approval by the HDPA or consent by the debtor is required for the transfer of data related to the Receivables and the respective Debtors to the securitization SPV and any other participant to the securitization procedure. Pursuant to the NPL Law, the same applies to the transfer of the Debtors' data in the context of assignment of the management to the RMC by the RAC.

According to the recently issued decision of the HDPA no. 87/2017, in case the originating bank directly assigns the management of its due Receivables to a RMC, in order to fulfil its obligation as Data Controller to inform the debtors regarding the announcement or transmission of their data to another entity, i.e. the RMC, the originating bank should file an application to the HDPA in order for the latter to grant its approval for an announcement of the relevant transmission of data through the press and via email to each debtor (only to the ones who have provided the relevant contact information).

It remains unclear, however, what applies when a RAC acquires the Receivables from the originating bank. It could be argued that the RAC will be considered the Data Controller

thereon, according to the Data Protection Law, since the data of the debtors are transferred to it by the originating bank and thus, it will have to comply with all the conditions set out under the Data Protection Law as mentioned above. It is expected that a new decision of the HDMA will be issued that will clarify this matter.

In addition, the GDPR introduces a series of changes including in relation to regulatory policies, the penalties that may be imposed to both data controllers and processors if they are in breach of their obligations and the data subjects' rights (such as the right to access and the right to be forgotten) etc. Moreover, a material change is the mandatory appointment of the so-called Data Protection Officer (DPO) in case, inter alia, the core activities of the Data Controller or the processor consist of processing operations which, by virtue of their nature, their scope and/or their purposes, require regular and systematic monitoring of data subjects on a large scale. The DPO shall be designated by the data controller and processor on the basis of adequate professional qualities expert knowledge of data protection law and practices and the ability to fulfil the tasks set out in the GDPR.

10.4.2 Banking secrecy

It is provided by the NPL Law that the professional confidentiality duty of the RACs is lifted to the extent necessary for management purposes of the RMCs. According to the explanatory report of the law, the reference to professional confidentiality purports to also cover the strict banking secrecy obligation of the banks under Greek law. This was also clarified by providing in the NPL Law that paragraph 20 of Article 10 of the GSL will apply by way of analogy to the RMCs.

10.4.3 Requirement for licenses and permits

Please see the sections 10.4.1 and 10.4.2 above.

10.5 **Taking over by NPL purchaser of any existing enforcement procedure**

As a general rule, and as provided for in the GCPC, the transfer of the right under enforcement (i.e. the loan) does not influence a pending enforcement procedure (paragraph 2 of Article 225 of the GCPC). The purchaser/ transferee does not automatically take the place of the transferor, however has the right to intervene in the pending court proceedings and become a party, by the filing of an intervention action. Also as a general rule, and in case the purchaser does not intervene in the pending court proceedings, the res judicata from the court decision to be issued, applies for or against the purchaser as well.

10.5.1 NPL transfer

As already mentioned, in order for a RAC to acquire Receivables which were or are granted by credit or financial institutions, the prior appointment of an RMC is necessary. According to the NPL Law, the rights deriving from the transferred Receivables due to the transfer can be exercised exclusively through an RMC. It is noted that the transferred Receivables are considered banking Receivables even after their transfer.

10.5.2 Securitization (GSL)

In such type of transfer, the purchaser undertakes the legal position of the transferor (as per the general provisions above and the GSL provisions) and can intervene in the existing court proceedings. Usually the enforcement procedure can be pursued by an appointed servicer (if any) of the securitized loan(s). More specifically, in accordance with paragraph 10 (14) of Article 13 of the CSL, a credit institution that lawfully provides its services in the European Economic Area, or a financial institution and, in exceptional cases, other non-regulated companies, can be appointed as a servicer. If the purchaser/SPV does not have a seat in Greece

and the securitized loan(s) are claims against consumers payable in Greece, then there is a requirement to appoint a servicer operating in Greece.

11. DEVELOPMENTS IN LEGISLATION AND PRACTICE ON ENFORCEMENT OF CLAIMS

11.1 Legislative acts

There are no envisaged developments in Greek enforcement legislation. As far as insolvency proceedings are concerned, the European Commission has filed a proposal for a Directive on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures and amending the Directive 2012/30/EU,³⁹⁹ which has not been adopted yet.

Moreover, according to the Commission's Proposal for a Directive of the European Parliament and of the Council on credit servicers, credit purchasers and the recovery of collateral the Directive's aim is (1) to increase the efficiency of debt recovery procedures through the availability of a distinct common accelerated extrajudicial collateral enforcement, (2) to encourage the development of secondary markets for s and exposures. We note that the above mentioned are not yet adopted.

11.2 Court practice

There are no recent developments with regards to Court practice.

³⁹⁹ Note that the Directive 2012/30/EU has been repealed by the Directive 2017/1132.

PART (B) INSTITUTIONAL FRAMEWORK REVIEW

12. INSTITUTIONAL FRAMEWORK REVIEW

12.1 Courts

Judicial enforcement is considered by market participants as the primary method of enforcement in Greece as regards the majority of security instruments. This is because in most cases enforcement is initiated on the basis of a court decision or a payment order, which are issued by courts and judges, respectively. Moreover, even when enforcement is initiated on the basis of another enforcement title (e.g. notary deed), the courts are still involved in the enforcement procedure, because they are competent to judge any relevant legal remedies.

The most significant issues identified by the market participants relate to the time period required for the completion of the judicial enforcement process, which could be further hindered by the debtors' ability to file multiple legal remedies at all enforcement stages. Despite the legal provisions for the issuance of Court decisions within specific timeframes as from the hearing of the case, the caseload of judges does not allow them the compliance with those deadlines. Please see above under section 6.2.

12.2 Judges

Judges are appointed following successful participation in a special national examination and study in the National School of Judges. Judges do not get any specialization at the National School of Judges, except for the fact that there is separate programme of studies for those to be appointed to Administrative and those to be appointed to Civil and Penal Courts. The latter may be appointed to a specific department of the relevant court (e.g. the Court of First Instance of Athens, which according to its internal regulation has a separate department for commercial and insolvency cases), but they serve at this specific department for two (2) to four (4) years only, which does not allow for specialization.

Identified issue:

There are no specialist commercial or financial courts, but there are special commercial sections in the ordinary procedure of the First Instance and Appeal Courts. Enforcement cases are handled by first instance courts of general jurisdiction; there are no commercial courts or divisions, with a few exceptions such as Athens which has a commercial and insolvency division. Judges in commercial and insolvency cases therefore lack specialization and in certain cases knowledge and understanding of basic accounting and financial matters. Moreover, there is no practice of appointing one judge to deal with all enforcement questions relating to a particular debtor.

Recommendations for reform:

Judges should be appointed to a special department of a court for a longer period and be able to participate in relevant seminars before their appointment to the specific department as well as throughout their service there.

In addition, a good example for specialization is the maritime section of the Court of Piraeus, where the specialization of judges has led to an improvement in term of both timing and substance. Moreover, appointing one judge to deal with enforcement questions relating to a particular debtor would be useful, in order for the judge to be able to handle easier the relevant cases.

The plan of EU is to introduce an expedited procedure for cross-border commercial cases and to establish specialized courts or chambers for cross-border commercial matters in each Member State.

12.3 Enforcement agency

12.3.1 Notary Public

Notaries Public are involved in both the creation of certain types of security (see the section E3.2.1(a)(i) above) and the enforcement and in particular the auction proceedings (see the section 6.2 above). In general notaries are not perceived by market participants as impeding the granting of security or the enforcement procedure, compared with their fees with regards to the creation of mortgage which do impede the creation of mortgages. As for the creation of this type of security, market participants highlighted that, due to the high Notary Public fees, they tend to avoid registering a mortgage which requires the involvement of a Notary Public, and opt for pre-notation of mortgage instead, although the latter entails the risk of missing the three (3)-month deadline for the conversion thereof into a mortgage, in which case it becomes null and void. To the contrary, mortgages are most commonly used in cases of bond loans as in these cases the notarial fees are capped (see the section E3.2.1(a)(i) above).

The involvement of Notaries Public in the auction process is not considered by market participants to impede the procedure. On the contrary, in the Greek market Notaries are in general perceived as safeguarding that the proceedings they are involved in will take place in accordance with the applicable rules.

12.3.2 Court Bailiff

The Greek legislator, following the example of French legislation, entrusted mainly the Court Bailiffs with the undertaking of the enforcement procedure in their capacity as either enforcement or servicing officers. The Court Bailiffs enjoy a significant status in the enforcement proceedings, as they are responsible for the proper and timely service and notification obligation of the creditors during the enforcement proceedings.

Court Bailiffs are unpaid civil servants, but in practice they operate as independent professionals and are freely hired by their clients (e.g. the party who wishes to use their services). Under the current legal regime, they must have a law degree and, following successful participation in national exams, they are appointed at the periphery of a specific court, where they are able to provide their services. They are responsible for (a) serving judicial and extrajudicial documents; (b) enforcing or selling assets; and (c) any other duty established by law. Their fees are determined by virtue of a Ministerial Decision and depend on the type of service provided, as well as on the distance they have to go through (in case of service of documents) and, in certain cases, on the complexities they face in practice.

12.4 Competent bodies of registry system (ministry of justice, other authorities)

12.4.1 Land Registry

There is no centralized Land Registry system to facilitate enforcement. Over 300 Land Registries are established in Greece, being responsible for the registration of all rights and claims created over immovable property located within their territorial competence and such registries operate on a paper-based (non-digitalized) system. The publication system maintained by the Land Registries is decisive on the priority ranking of security instruments over immovable assets, because the priority ranking is determined based on the moment of registration request addressed to the competent Registry.

The personal system is based on keeping records of individuals who have proceeded to legal transactions on real property. More specifically, the following records are kept with the regionally competent Land Registries: (a) land registry records, wherein the changes in property relations (e.g. transfer of ownership, establishment of usufruct) are registered, (b) a

book of mortgages, wherein forms of security in rem (mortgages, pre-notation of mortgages) are registered, (c) seizure records, as well as (d) claims records.

The party interested in receiving information over a property's legal status shall begin with the search of the person alleged to be owner of the property. The interested party shall look for the alleged owner in an alphabetic list, so as to find the property transactions to which this person has proceeded with regard to the said property. These transactions will lead the interested party to the predecessor in title of the person that was originally under search. Thus, the interested party becomes aware of the line of changes regarding in rem rights on the property.

No list of properties exists within the personal system. Therefore, it is impossible to cross-check whether there have been other transfers of the same property by other persons (who may be the real owners) beyond the persons found in the public records by the interested party. These public records do not provide conclusive evidence on whether the alleged owner of a property is indeed the real owner or whether he/she had the power of disposal of the said property. Therefore, the property title search normally includes the examination of the line of past consecutive transfers, at least until the lapse of a time period required for the acquisition of ownership by adverse possession (in Greek '*christiktisia*'), i.e. until the lapse of 10 years in acquisition of ownership by ordinary adverse possession (in Greek '*taktiki chrisiktisia*') or 20 years in acquisition of ownership by extraordinary adverse possession (in Greek '*ektakti chrisiktisia*'), so that the acquisition of ownership is possible by adverse possession, even if the predecessors were not the real owners of the property. Even then it is not possible to reach absolute certainty, since possession with the belief of legal title (in Greek '*nomi*') could be contested and evidentiary difficulties could arise.

In practice, this process is cumbersome. The interested party usually reviews the sequence of past consecutive transfers spanning over a period of at least 30 years, because the acquisition of ownership by adverse possession cannot be invoked against the true heir, provided that the claim for inheritance is not time barred. Furthermore, it should be noted that not all properties are subject to acquisition by adverse possession, e.g. ownership on properties of common use or properties belonging to the State or the Church may not be acquired by adverse possession.

In the cadastral system, the search is conducted by using an index of properties (estates). However, in Greece, even in those areas where the cadastral system is implemented the registrations therein do not yet provide irrebuttable presumptions, due to the fact that the period for the correction of initial registrations has not yet passed, so as to ensure substantial publicity and certainty in transactions. For this reason, even in this system, property title search should cover at least a period of 30 years, for the completion of which the interested party should go back to the Land Registry operating in the region before the commencement of the Cadastral Office's operation.

All market participants emphasized the inefficiency of the non-digitalized and decentralized Land Registry and Cadastral Offices regime. They have stressed the necessity to establish an electronic record of all the information and accompanied documentation over the immovable property of the debtor, followed ideally by the ability of the creditors to obtain all the available information on the debtors' immovable assets throughout the country. Please see above in section 5.2 our recommendation on the ability of the already established electronic system G.E.MI. to act as a central electronic registration system.

The ability to easily identify the real property of the debtor throughout Greece would facilitate both commercial transactions and lending, since creditors could more easily form a view as to the assets of their commercial counterparty (debtor).

12.4.2 Pledge Registry

Pledge Registries are established in each of the over 300 Land Registries, and are kept in hardcopy form, thus creating obstacles in the efficiency of the registration system. The conduct of a check of these registrations by the potential creditors is cumbersome, because such due diligence has to be done in situ, in the pledge registry of the seat of the debtor and potentially in more land registries, in cases where the seat has been moved. The public faith and the protection of transactions are guaranteed by the determination of the priority ranking through the application of registration of the security instrument. Our recommendation on the ability of the already established electronic system G.E.MI. to act as a central electronic registration system is also relevant for this case as well.

12.4.3 Ship Registry

Ship mortgage records are kept by local port authorities around Greece in accordance with the decentralized ship registration system. Records are kept in non-electronic, hardcopy form. The creditor must be aware of the ship registration number in order to obtain information on its legal status, since the system does not allow for the identification of the assets per legal or natural person(s).

12.4.4 Aircraft Registry

Aircraft mortgage records are kept centrally by the Civil Aviation Authority situated in Athens. Records are kept in non-electronic, hardcopy form.

SOURCES

EU legislation

1. Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements;
2. Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC (General Data Protection Regulation);
3. Directive 2012/30/EU of the European Parliament and of the Council of 25 October 2012 on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 54 of the Treaty on the Functioning of the European Union, in respect of the formation of public limited liability companies and the maintenance and alteration of their capital, with a view to making such safeguards equivalent;
4. Directive (EU) 2017/1132 of the European Parliament and of the Council of 14 June 2017 relating to certain aspects of company law;

Greek legislation

1. Code of Aviation Law;
2. Code of Private Maritime Law;
3. Greek Civil Code;
4. Greek Code of Civil Procedure;
5. Greek Law 1665/1986;
6. Greek Law 1739/1987;
7. Greek Law 1818/1951;
8. Greek Law 2396/1996;
9. Greek Law 2472/1997;
10. Greek Law 2844/2000;
11. Greek Law 3156/2003;
12. Greek Law 3301/2004;
13. Greek Law 3588/2007;
14. Greek Law 4072/2012;
15. Greek Law 4112/1929;

16. Greek Law 4224/2013;
17. Greek Law 4270/2014;
18. Greek Law 4335/2015;
19. Greek Law 4354/2015;
20. Greek Law 4548/2018;
21. Greek Law 4549/2018;
22. Greek Law 612/1968;
23. Legislative Decree 3899/1958;
24. Legislative Decree 496/1974;
25. Legislative Decree of 17 July/13 August 1923;
26. Regulation (EU) 848/2015 ("Insolvency Regulation");

Available commentaries of applicable laws

1. Agallopoulou, Penelope, Basic concepts of Greek civil law (P., βασικές αρχές αστικού δικαίου) / manual of Greek Civil Law trnsl. from Greek into English;
2. Papantonopoulou, Geena, Greek Law Digest (GLD); Athens, 2006;

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1. Antonopoulou, Ioanna; Dimitropoulou, Evangelia; Nedelkopoulou, Antonia; Konstantinos Serdaris, The Securing of Bank Claims, 2016;
2. Karatzas M., Catherine; Salaka, Vassiliki; Tsatsi S., Angeliki, Insolvency Proceedings In Greece After Recent Reforms, Emerging markets restructuring journal issue no. 3 - spring 2017;
3. The World Bank Group Flagship Report. Doing Business 2018. Economy Profile Cyprus. URL: <http://www.doingbusiness.org/en/data/exploreeconomies/greece>.
4. Virgos, Miguel; Schmit, Etienne, Report on the Convention on Insolvency Proceedings, EU Council of the EU Document 1996.

ANNEX - LIST OF MARKET PARTICIPANTS

I.	Governmental authorities	Address details
1.	Ministry of Justice	Leof. Mesogeion 96, Athens 115 27, Greece
II.	Associations	Contact details
1.	Hellenic Federation of Enterprises	Xenofontos 5, 10557 Athens, Greece
III.	Banks	Contact details
1.	Alpha Bank S.A.	Stadiou 40, 105 64 Athens, Greece
2.	Eurobank Ergasias S.A.	8 Othonos Street, 105 57 Athens, Greece
IV.	Financial Advisors	Contact details
1.	Ernst and Young Chartered Accountants S.A.	Chimarras 8B, Marousi 151 25, Greece
2.	KPMG Chartered Accountants S.A.	400B Mesogeion Ave., Aghia Paraskevi, Greece
3.	Pricewaterhousecoopers Audit Company S.A	20 Kifissias Avenue & Kodrou Halandri, GR-152 32, Greece
V.	Others	Contact details
1.	Cepal Hellas Financial Solutions (Loans And Credits' Claim Management)S.A.	Leof. Andrea Siggrou 209, Nea Smirni 171 21, Greece

F UKRAINE

1. EXECUTIVE SUMMARY

This study aims to review the current state of affairs with regard to the enforcement of creditor claims in Ukraine. The study was conducted by DLA Piper under the auspices of the European Bank for Reconstruction and Development and is a part of a wider research project conducted in five selected jurisdictions: Albania, Croatia, Cyprus, Greece and Ukraine.

The Ukrainian statutory framework for security and enforcement appears comprehensive on paper, but in practice enforcement is not straightforward. Court-led enforcement is generally preferred to out-of-court enforcement due to certain regulatory benefits and greater protections afforded to enforcing creditors. Moreover, any out-of-court enforcement actions taken by the creditor are at risk of substantial obstruction by procedural appeals of debtors.

Potential issues in respect of enforcement relate to all Key Determinants of this study, namely the duration, simplicity, cost and overall predictability of the enforcement process. For example in respect of duration, enforcement of a claim in Ukraine may take from seven months up to a couple of years, which is an extremely long period compared with other European countries such as Germany or Austria where enforcement of security (with regards to ordinary proceedings of standard nature and extent) would usually be completed in a significantly shorter time period. In relation to cost, enforcement is expensive: enforcement fees for public and private bailiffs are equal to 10 percent of the amount of the proceeds of security. Furthermore, the auction trading venue and platform, to the extent used, may charge another 5 percent for public sale on the top of enforcement costs. Court fees account for 1.5 percent of the amount of claim subject to maximum cap of UAH 644,000 (approximately USD 24,800). The World Bank Doing Business 2018 annual report confirms that there is room for improvement in terms of enforcing contracts in Ukraine and estimates that it takes approximately 378 days to enforce a contract which represents a cost of 46.3% of the claim; the timeline for resolving insolvency is even longer at an estimated 2.9 years with a cost of 40.5% to the insolvency estate.

Assessment of the Key Determinants set out in this study is also supported by various responses from market participants, including foreign and state-owned banks, lenders' associations, the National Bank of Ukraine, the Ministry of Justice and other government authorities, which expressed similar concerns as to cost, speed and simplicity of the enforcement process (a list of the contributing participants and stakeholders is annexed to this report). Thus, there is room for further development of the enforcement infrastructure, including new e-trading venues, digitalization of the enforcement process and development of new security instruments such as financial collateral arrangements.

In the below table we highlight the main issues with respect to the security and enforcement framework identified in the report for discussion with the government authorities, based on our review of the legal framework and feedback from local stakeholders and market participants. A more detailed analysis of the issues and recommendations is found in the Report, which is divided into Part (A) a Legislative Review, which contains an analysis of existing legislative provisions regulating claims enforcement and recommendations for improvement; and Part (B) an Institutional Framework Review, which provides an analysis of the institutions involved in the enforcement process in Ukraine and, where applicable, suggestions for reform.

The cut-off date for the legislative review was 30 November 2018.

No.	Title	Issue	Recommendations for reforms	Report reference
1.	Out-of-court enforcement			
1.1	Discharge of principal obligation when opting for out-of-court enforcement	While Ukrainian law allows for out-of-court enforcement, as well as court-led enforcement, out-of-court enforcement is not popular among market participants in comparison with court-led enforcement because of the legal risks and disadvantages. In particular, when a creditor selects out-of-court enforcement involving taking on legal title to mortgaged property, the principal obligation will be discharged in full, even where the actual value of the secured property is less than amount of debt. Accordingly, with a full discharge of the principal obligation, any other security instruments (pledges, suretyships) representing a security package under the deal also falls away. While recent amendments on the Law of Ukraine "On Mortgage" remove this issue for enforcement of mortgages, the issue continues to apply to movable pledges. Moreover, the Law of Ukraine "On Securing Creditors' Claims and Registration of Encumbrances" admits a full discharge of the underlying debt regardless of the value of the movable collateral taken as a result of out-of-court enforcement action (even if the actual value of the collateral is less than the value of the outstanding debt).	It is advisable to amend the Law of Ukraine "On Securing Creditors' Claims and Registration of Encumbrances" to envisage discharge (reduction) of the outstanding debt by the actual value of the secured property, rather than the entire principal obligation. This would bring Ukrainian legislation into line with standard European practice e.g. in Austria and Germany. It should be noted that recent amendments to the Law of Ukraine "On Mortgage" aimed at remedying such unfavourable for creditors mortgage regulation have been signed by the President and will enter into force on 4 February 2019.	Section 6.3.4
1.2	Low use by creditors of extrajudicial collateral enforcement	Enforcing creditors often select court-led enforcement to avoid delays in the enforcement process resulting from appeals by the debtor which effectively lead to an automatic conversion of the out-of-court enforcement into court-led enforcement. Furthermore creditors often select court-led enforcement because it delivers formal ability to rely on the court decision when dealing with State authorities (registration and tax system). Court decisions are still more credible than a notarial writ, which may be issued in out-of-court enforcement.	It would be helpful to strengthen out-of-court enforcement by limiting the grounds for appeal and obstruction by debtors as recommended in Section 4.1 below (Abuse of Procedural Appeals).	Sections 6.3, 4.1
1.3	Inconsistencies regarding amount of	There is inconsistent court practice as to the amount of debt which can be recovered through enforcement under a notary writ, which	It would be reasonable to amend the Procedure for Making of Notarial Actions	Section 6.3.3

No.	Title	Issue	Recommendations for reforms	Report reference
	debt to be enforced out-of-court under a notary writ	can be used for out-of-court enforcement of notarised pledge and mortgage agreements. As a matter of procedure, before producing a notary writ, an enforcing creditor must serve a 30-day default notice on a borrower clearly stating the amount of indebtedness as of the date of the notice. Upon the expiry of the 30-day period, the actual amount of a claim may increase due to the effect of accrued interest, penalties, default interest, etc. In such circumstances, where the debtor has brought a legal challenge to the amount of the debt enforced some courts have refused to honour any amounts accruing after the 30-day period. Notaries and bailiffs are reluctant to recognise claims occurring after the 30-day period because of the position adopted by the court.	with a provision pursuant to which all scheduled payments on arm's length terms should be automatically added to the amount of indebtedness set out in a notary writ as of the actual enforcement date. Furthermore, in support of the above position detailed guidelines and instructions for courts and bailiffs should be developed to align understanding on automatic accrual of scheduled payments.	
1.4	Out-of-court enforcement of pledge over corporate rights	Despite a significant number of long-awaited changes, the new Law of Ukraine "On Limited Liability and Additional Liability Companies" (the " LLC Act ") introduced in June 2018 has some uncertainties. The Law envisages that an "enforcement document" is the sole ground for commencing enforcement against the pledged corporate rights. While a court enforcement decision or notary writ would appear to qualify, it is not clear whether the other modes of out-of-court enforcement set out in the general security law (such as taking on legal title and private sale) are available for the pledgee and what procedure generally should be followed in course of such out-of-court enforcement.	The LLC Act should be amended to include provisions explicitly stating to what extent and what modes of out-of-court enforcement may apply to the corporate rights pledge in order to remove existing uncertainties and enable lenders to use the extrajudicial mode of enforcement.	Section 3.5.3
2.	Security Instruments: Mortgages			
2.1	Prohibition on mortgaging agricultural land plots	The Transitional Provisions of the Land Code impose a statutory prohibition on security providers granting a mortgage over land plots dedicated for agricultural use for the benefit of non-banking lenders such as corporate, or institutional investors, investment funds and all foreign investors. According to publicly available statistics, as of today more than 96 percent of the total agricultural lands in Ukraine are not capable of being collateralised under a security agreement.	Repealing the prohibition will unlock new lending opportunities for the Ukrainian domestic market and provide lenders with a credible security instrument. According to estimates of reputable Ukrainian investment advisers presented at the Ukrainian Financial Forum 2018, it is	Section 3.4.1

No.	Title	Issue	Recommendations for reforms	Report reference
			expected that it will bring to the market more than 10 m ha of land plots which could attract at least USD 15-20 bln of investments to agricultural businesses. Furthermore, suggested amendments to the Land Code will align Ukrainian legal framework with the European legislation containing no such restrictions.	
2.2	Prohibition on mortgaging leased rights over state-owned and municipal land plots	Ukrainian law explicitly prevents a lessee from granting security rights over land plots owned by state and municipal authorities under a mortgage agreement. The only carve out from such prohibition relates to state-owned or municipal land plots used for the construction of residential buildings. This prohibition appears to be very restrictive and it should be considered whether other types of real estate used in project and infrastructure finance may be captured by additional carve-outs.	Amendments should be made to Land Code to lift the prohibition and/or at a minimum expand the carve-outs from such legislative prohibition in order to encourage greater secured lending.	Section 3.4.1
2.3	After-acquired property in mortgage over business unit	With respect to an integral property complex (a so-called "business unit"), it is unclear under the Law of Ukraine "On Mortgage" whether or not the mortgage covers any changes in the composition of the existing mortgage e.g. assets acquired after the date of the security agreement.	It would be reasonable to include statutory provisions whereby any assets/property acquired after the date of mortgage agreement (so-called "after-acquired property") is automatically captured by the existing mortgage unless parties have agreed otherwise. It will remove uncertainty at the stage of enforcement as to changes in composition of the collateral occurring after the date of mortgage agreement and enable lenders to control security under loan.	Section 3.4.4

No.	Title	Issue	Recommendations for reforms	Report reference
2.4	Irrevocable power of attorney for non-shareholders lenders (banks, financial institutions)	LLC Act introduces a new instrument for securing performance of obligations of the LLC's participants (shareholders). Thus, the LLC's participants who are parties to the shareholders' agreement can issue an irrevocable power of attorney for the benefit of other participants in order to enforce and/or secure the performance of their obligations under such agreement. It is not entirely clear from the current wording of the Law, whether or not an irrevocable power of attorney can be issued by a shareholder for the benefit of a non-shareholder (lender or bank) for securing the participants' obligations arising out from loans or facilities.	It is recommended to clarify that an irrevocable power of attorney may be given in favour of non-shareholders (lenders and banks) to secure performance of the participants' obligations under loans and facilities.	Section 3.5.3
3.	Registration system			
3.1	Reinstatement of a title entry	Ukrainian law lacks provisions for reinstating entries in the Immovable Property Register in certain circumstances. Specifically, if a court invalidates a title transfer over the mortgaged property made by a mortgagor for the benefit of any third party without a mortgagee's consent, then the ownership title of a new owner (i.e. third party) will be cancelled. However, an entry recording the ownership title of the original owner will not be automatically reinstated in the Immovable Property Register, which creates problems for both the original owner and the secured lender.	As a solution it is suggested to amend the regulation ⁴⁰⁰ for the Immovable Property Register to allow the respective officer to reinstate the entry on ownership title automatically on the basis of a binding court decision invalidating the previous entry.	Section 5.2.1
3.2	Re-registration of encumbrances over movables	The Law of Ukraine "On Securing Creditors' Claims and Registration of Encumbrances" sets a fixed five-year limit on the duration of movable encumbrances in the Movable Property Register, regardless of the fact whether or not a contractual security period on a given security is longer. This is an artificial and deliberate limitation, which attracts unnecessary paperwork for the secured parties since it requires re-registration of the security. A	It is proposed that the five-year limitation is removed to enable the secured parties to set the length of encumbrances in line with the contractual security period. We recommend that new provision is introduced, pursuant to which the duration of encumbrance must be equal to the	Section 5.2.2

⁴⁰⁰ On approval of Regulation on Maintaining the State Register of the Property Rights, approved by the Resolution No. 1141 of Ukrainian Government dated 26.11.2011.

No.	Title	Issue	Recommendations for reforms	Report reference
		creditor's failure to renew the record entry results in an expiry of the encumbrance and loss of the creditor's priority on secured assets. Moreover, the willingness of a debtor to renew collateral might decrease over time.	contractual secured period specified in a security agreement unless otherwise agreed by the parties.	
3.3	Internet-based access to Movable Property Register	In May 2017, the Ukrainian Government adopted an initiative to make the Movable Property Register publicly and electronically available for individuals and corporates via internet-based access by the end of 2017. However, as of the date of the report, the Movable Property Register is still publicly unavailable.	It is recommended to discuss with the Ministry of Justice of Ukraine the timeline and remaining issues which need to be resolved to launch public internet-based access to the Movables Property Register as soon as possible.	Section 5.2.2
4.	Enforcement			
4.1	Abuse of procedural appeals to delay enforcement	As a general rule, parties have an automatic right to appeal in all matters. Market participants complain that court appeals have become a routine remedy for debtors to delay the enforcement process. They indicate that the following types of procedural appeal have been used a lot by debtors in court-led enforcement with the sole purpose of delaying the whole process: (i) challenging the procedure of the debtor's notification; (ii) challenging the outcomes of the public auction process; (iii) challenging the procedural rulings of the State enforcement officer (for example, ruling on commencement of the State enforcement procedure, ruling on making inventory of the property attached, rulings on public auction).	It is our recommendation to place certain statutory limitations on automatic appeal to reduce the scope for unjustified delays and to ensure appeals are heard by courts promptly and in an organised fashion. For instance, the German approach may be followed, where matters with a value below a certain value threshold (e.g. in Germany less than 600 EUR) need court permission to be appealed. Furthermore, it may be helpful to envisage that if the requirement of fundamental significance of a matter is not met the court should declare the inadmissibility of the appeal. The appeal should be also declared inadmissible when it does not have a "reasonable chance" of being upheld.	Section 7.1
4.2	Deemed delivery of default judgements	While enforcing security via a civil law court, creditors may face difficulties if the security provider (being a natural person) is unwilling to participate in the court proceedings. In such case, the	As a solution, amendments should be implemented to the existing Civil Procedural Law to define cases of deemed	Section 6.2.1

No.	Title	Issue	Recommendations for reforms	Report reference
		court is authorized to render a default decision and the defendant (security provider) is entitled to receive a copy. In practice, defendants avoid receiving delivery of such a default decision which, in turn, obstructs the commencement of the enforcement procedures.	delivery of default decisions (for example, a default decision has been sent to the registered address of the party or to the residential address disclosed to the court, etc.) where the debtor acts in bad faith and to define what may constitute bad faith.	
4.3	Abuse of appeal rights	In practice, bad faith debtors use any procedural possibility afforded by Ukrainian law to obstruct the enforcement process. For example, debtors often ask the court for the appointment of an independent valuer in respect of the collateral with a view to delaying enforcement. Considering that Ukrainian law fails to set a timeframe for conducting an independent valuation, such debtor's request results in delay, which according to information provided by the market participants takes from 6 up to 18 months. Having received such valuation, the debtor may challenge it on formal grounds. This typically delivers another 6-18 months of delay in the debt enforcement process. Recently, in December 2017, in order to make the enforcement procedure more efficient, the Ukrainian procedural law was amended with a provision allowing the court to impose a fine on the party abusing its procedural rights. The amount of such fine may vary from UAH 19,210 (approximately USD 540) to UAH 96,050 (approximately USD 3,435) in case of repeated violation. It remains to be seen how courts will implement such measures and whether it would have an effect on bad faith debtors.	In addition to ensuring that courts apply fines to parties abusing procedural rights and have sufficient guidance to do so, it should be considered to amend the Commercial Procedural Code with a provision allowing lenders to make general (civil) claim on recovery of losses incurred as a result of a debtor's abuse of its procedural rights.	Section 7.1
4.4	Payment of enforcement professionals	Ukrainian regulation lacks transparent rules and procedures on the allocation of funds payable in advance by enforcing creditors to the bank accounts of the State enforcement agency. There are many instances where professionals are not paid by the State enforcement agency in time. For example, this often happens with fees which are due to the professional valuers for the preparation of the valuation report for collateral. This, in turn, delays the whole process of	As a solution, we advise introducing clear guidelines and procedures, including time limits, for the State enforcement agency on payments and strengthening the liability of the agency for delayed payments.	Section 6.6

No.	Title	Issue	Recommendations for reforms	Report reference
		rendering services and realizing the collateral.		
5.	Impact of bankruptcy and pre-bankruptcy proceedings on the enforcement			
5.1	Moratorium in pre-trial rehabilitation and ordinary insolvency	<p>The Insolvency Act gives parties full discretion to frame the terms and conditions of the rehabilitation plan. In practice, however, such flexibility and the applicable moratorium protection may give a debtor ability to frustrate and delay the enforcement procedure. A moratorium imposed in general insolvency proceedings does not have a statutory timeframe and may cover the duration of the whole insolvency proceedings. Hence, such moratorium in insolvency may delay the enforcement process against secured assets for several years. An unlimited duration of such moratorium is likely to result in secured creditors being incapable of protecting their rights and enforcing their secured claims effectively. It is important to emphasise that the duration of the insolvency moratorium has been significantly limited under the new Bankruptcy Code described in Section 8.7 below, which is pending and awaiting the presidential signature. Once the Bankruptcy Code becomes effective the above legal shortcomings will be removed. The new rules will apply to all existing and new insolvency proceedings, except for ongoing pre-rehabilitation cases.</p>	<p>The Insolvency Act should be amended with a provision allowing the majority of creditors to terminate the pre-trial rehabilitation and, consequently, moratorium protection, in the event of failure of the distressed debtor to resolve its financial difficulties within six months or any other term agreed by the creditors in the rehabilitation plan. It would be also reasonable to include a provision enabling the secured creditor to file a motion to court seeking lifting the moratorium on enforcement of the secured property provided that such secured property is not material for the debtor's rehabilitation.</p> <p>In respect of moratorium in general insolvency proceedings, it would be helpful for the Insolvency Act to set out more definitive moratorium timeframes for the secured creditors. For instance, amendments should be implemented to envisage automatic termination of moratorium protection upon expiration of 170 calendar days from the date of commencement of insolvency, unless a debtor was declared bankrupt or a rehabilitation plan was adopted.</p> <p>It should be noted that the Bankruptcy Code adopted by the Ukrainian</p>	Sections 8.2, 8.3, 8.7

No.	Title	Issue	Recommendations for reforms	Report reference
			Parliament embodies the above principles which are critical for protection of secured creditors' interests in the course of debtor's insolvency.	
5.2	Haircuts in liquidation (insolvency public auction)	<p>The Law of Ukraine "On Restoring Debtor's Solvency or Declaring It Insolvent" sets out an inefficient regulation of public (auction) sale of secured assets in course of liquidation of an insolvent entity. In particular, under the above law the property may be offered to auction (sale) in three sessions. Within the first trading session, the sale must be made at 100 per cent value as determined by the insolvency practitioner or, at the creditors' request, by an independent valuer, during the second trading session (<i>povtornoї auktsion</i>) the insolvency practitioner applies a haircut from 80 percent up to 50 percent of the price of the first trading session; and at the third session (<i>drugyi povtornoї auktsion</i>), the insolvency practitioner may apply the biggest haircut starting from 64 percent of the price of the first trading session and literally lowering the price down to 1 Ukrainian hryvnia. Furthermore, it is unclear whether or not a mortgagee is entitled to purchase collateral with the discounts available for the third-party purchasers in public (auction) sale.</p> <p>It is important to emphasize that the above concerns have been substantially addressed in the Bankruptcy Code described in Section 8.7 below, which is pending and awaiting the presidential signature.</p>	<p>The Law of Ukraine "On Restoring Debtor's Solvency or Declaring It Insolvent" should be amended as follows to maximise return to secured creditors of sale of secured assets in insolvency:</p> <ul style="list-style-type: none"> the sale of assets of an insolvent entity must be conducted only through an electronic trading venue, which obtained the trading venue licence to improve the transparency and liquidity around auctions, as well as encourage the participation of the new bidders; secured creditors must be entitled to approve haircuts applicable to the initial price for the second and third trading sessions. For unsecured property, such haircuts should require the approval of a committee of creditors; if the secured property is not sold in the second or third session, a secured creditor should be entitled to acquire it at the initial price for the relevant round; the secured obligation should be able 	Sections 8.4.3, 8.7

No.	Title	Issue	Recommendations for reforms	Report reference
			<p>to be netted against the price of the secured asset without the relevant secured creditor having to advance fresh money. The same netting arrangements are to be applied to settlement in the event that secured creditor has won the public auction sale, provided that the expenses of preservation and the sale process of the assets have already been reimbursed.</p> <p>The above amendments will allow harmonisation of Ukrainian law with best practice aimed at maximisation of the recovered funds.</p> <p>We note that the above recommendation for reforms have been addressed in the Bankruptcy Code which should improve the efficiency of the public (auction) sale procedure. Furthermore, we recommend monitoring the effect of the new legislation to make sure that the practical issues are indeed addressed by legislation.</p>	
5.3	Lack of equitable subordination	Under the Insolvency Act, a shareholder lender, whose transaction was invalidated by a court under the statutory clawback provisions, may receive repayment of its debt at the first rank inside the liquidation procedure, notwithstanding the significantly negative impact that this may have on bona fide creditors. For example, if a shareholder has advanced a loan to an insolvent company, which would normally qualify for the fourth rank of priority due to legal subordination of such loan, and such shareholder's loan is then	It is recommended to ensure fair treatment of first, second and third ranking creditors by subordinating payment of debts arising under any invalidated transactions including shareholder loans. Shareholder loans should retain their subordinated fourth priority ranking, regardless of whether invalidated or not.	Sections 8.4.1, 8.7

No.	Title	Issue	Recommendations for reforms	Report reference
		<p>invalidated by a court, then such shareholder's claim would be ranked in the first ranking instead of the fourth-ranking.</p> <p>Although for the existing insolvency cases equitable subordination may be of concern, the Bankruptcy Code which is pending and awaiting the presidential approval, removes this problem entirely.</p>	We note that the Bankruptcy Code removes the above unfavourable statutory provision on subordination of debts payments arising under invalidated transactions.	
5.4	Integral property complex disposal: whole vs. piecemeal sale	<p>There is an inconsistent approach to the sale of an integral property complex through public auction in the course of insolvency. Specifically, the Law of Ukraine "On Restoring Debtor's Solvency or Declaring it Insolvent" requires an insolvency practitioner to dispose of the assets of an insolvent entity as a business unit to maximise the sale proceeds. After a failure to dispose, the whole business unit may be divided by an insolvency practitioner and sold piecemeal. It is not clear how many times the assets must be marketed as a business unit before the insolvency practitioner may undertake the sale of the assets by way of separate bids which typically realises less value than sale of the business unit as a whole.</p> <p>This issue is <i>not</i> addressed by the Bankruptcy Code, since the draft does not envisage the procedure for splitting of the business unit into separate assets for sale.</p>	<p>As a solution, we would suggest amending Article 44 to envisage a separate legal treatment for handling the sale of a business unit as follows:</p> <ul style="list-style-type: none"> • three auction sale sessions to be conducted until the split of the business unit into separate assets; • discounted initial price shall be applied for the first and second repeated auction sale sessions, provided this shall not result in any discount of the underlying secured obligation; • upon an unsuccessful third session, the business unit is to be split into assets to which the abovementioned general procedure is applied. 	Section 8.4.3
6.	Financial collateral			
6.1	Netting, insolvency and perfection and insolvency carve-out for financial collateral	<p>Ukrainian law still lacks a financial collateral law, which is vital and fundamental for banks, corporates and alternative debt providers to raise money efficiently and to utilize derivatives, repo and securities lending and capital market instruments. Adoption of such regulation will boost economic growth and development of the country.</p>	<p>It is recommended to adopt a standalone law governing execution, performance and enforcement of financial collateral transactions. In particular, the law should define the settlement principle for financial collateral trades and create</p>	Section 3.9

No.	Title	Issue	Recommendations for reforms	Report reference
			<p>(i) carve-outs for "close-out netting" from moratorium and claw-back provisions of the insolvency law (Bankruptcy Code); and (ii) carve-outs for out-of-court enforcement (shortening mandatory 30-day remedy period for enforcement set out in Article 26 of the Law of Ukraine "On Securing Creditors' Claims and Registration of Encumbrances"). Consideration should also be given to extending the application of the law to benefit transactions where one party is a corporate to enable ordinary security over cash arrangements concluded in the context of a commercial loan. This law should be developed in line with the EU Financial Collateral Directive and the EU Directive on Settlement Finality in Payment and Securities Settlement Systems.</p>	

2. GLOSSARY

Appraisal Act	shall mean the Law of Ukraine "On Appraisal of Property, Property Rights and Professional Appraisal Activity" No. 2658-III dated 2 July 2001 as amended from time to time
Bankruptcy Code	shall mean the draft Code of Ukraine on Bankruptcy Procedure No. 8060, adopted by the Parliament on 18 October 2018
Corporate Governance Act	shall mean the Law of Ukraine "On Amendment to Certain legislation of Ukraine Regarding Improvement of Corporate Governance of Joint Stock Companies" No. 1983-VIII dated 23 March 2017
Civil Code	shall mean the "Civil Code of Ukraine" No.435-IV dated 16 January 2003
Civil Procedural Law	shall mean Code Of Civil Procedure Of Ukraine No. 1618-IV dated March 18, 2004
Credit Register	shall mean the registry established pursuant to the Regulation "On the Credit Register of the National Bank of Ukraine" approved by Resolution of the Board of the National Bank of Ukraine No. 50 dated 04 May 2018
Draft Law on Amendments to the Tax Code	shall mean the Draft Law No. 2460a "On Amendments to the Tax Code of Ukraine on Access to Information on Taxpayers", registered in Parliament on 29 July 2015
Draft Law on Capital Markets	shall mean the Draft Law No. 3498 "On Amendments to Certain Legislative Acts of Ukraine as to Regulated Markets and Derivatives", registered in Parliament on 20 November 2015
Draft Law on Turnover of Agricultural Lands	shall mean the Draft Law of Ukraine "On Turnover of Agricultural Lands" No. 5535, registered in the Parliament on 13 December 2016
EU Financial Collateral Directive	shall mean Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements
EU Directive on Settlement Finality in Payment and Securities Settlement Systems	shall mean the Directive 98/26/EC of the European Parliament and of the Council of 19 May 1998 on settlement finality in payment and securities settlement systems
Enforcement Act	shall mean the Law of Ukraine "On Enforcement Proceedings" No. 1404-VIII dated 2 June 2016 as amended from time to time
Immovable Property Register	shall mean the State Register of Proprietary Rights and Encumbrances Over Real Property
Insolvency Act	shall mean the Law of Ukraine "On Restoring Debtor's Solvency or Declaring It Insolvent" No. 2343-XII dated 14 May 1992 as amended from time to time
IP	shall mean an intellectual property
JSC	shall mean a joint stock company
Land Cadastre	shall mean the State Land Cadastre

Land Code	shall mean the "Land Code of Ukraine" No. 2768-III dated 15 October 2001
Law On Lease of Land	shall mean the Law of Ukraine On Lease of Land" No. 161-XIV dated 06 October 1998.
Law No. 1983-VIII	shall mean the Law No. 1983-VIII "On Amendments to Certain Legislation of Ukraine Regarding Improvement of Corporate Governance of Joint Stock Companies"
Law On Resuming of Lending	shall mean the Law of Ukraine "On Amendments to Certain Legislative Acts of Ukraine on Resuming of Lending" No. 2478-VIII dated 3 July 2018
Law On Securing Creditors' Claims	shall mean the Law of Ukraine "On Securing Creditors' Claims and Registration of Encumbrances" No. 1255-IV dated 18 November 2003
LLC	shall mean a limited liability company
LLC Act	shall mean the Law of Ukraine "On Limited Liability and Additional Liability Companies" No. 2275-VIII dated 06 February 2018
Mortgage Act	shall mean the Law of Ukraine "On Mortgage" No. 898-IV dated 05 June 2003 as amended from time to time
Movable Property Register	shall mean the State Register of Encumbrances over Movable Property
NBU	shall mean the National Bank of Ukraine
Notary Act	shall mean the Law of Ukraine "On Notary" No. 3425-XII dated 02 September 1993
NPL	Non-Performing loan
Pledge Act	shall mean the Law of Ukraine "On Pledge" No. 2654-XII dated 02 October 1992 as amended from time to time
Procedure for Making of Notarial Actions	shall mean the procedure for making of notarial actions by the notaries of Ukraine dated 02 September 1993

PART (A) LEGISLATIVE REVIEW

3. TYPE OF CLAIMS

3.1 Unsecured claims

Ukrainian law does not provide for a definition of unsecured claims. In practice, unsecured claims include any claims which are not secured by collateral given by a borrower or a third-party provider. In contrast to secured claims, an unsecured creditor takes on a higher credit risk having no collateral in place in the event of default by the borrower. As such, extrajudicial modes of enforcement are unavailable for unsecured creditors. The primary remedy for unsecured creditors to collect debt appears to be a court-led enforcement against a borrower, albeit, such proceedings are often time-consuming and cost-intensive.

3.2 Secured claims

Under Ukrainian law, a claim is deemed to be secured when a creditor has a security interest over a certain property or a suretyship. The collateral secures the discharge of payment obligations to be due to a creditor. Certain selected types of security instruments employed in Ukraine are reviewed below in more detail along with their problem areas. In addition to security, the Report briefly describes claims on "quasi security" (escrow arrangements) and claims on financial collateral, both of which differ from secured claims as they do not entail a remedy of redemption.

A closer look at the Ukrainian security law shows that it lacks rules and procedures accommodating the role of a security agent in syndicated loans. Ukraine as a civil law jurisdiction requires the incorporation of a "parallel debt" concept to enable local banks to service syndicated creditors in matters of security administration. In this context, the EBRD has been working closely with Ukrainian government authorities on a separate project to help adopt the required regulation implementing the concept of security agent.

3.3 The types of security

Generally, Ukrainian law recognizes the following types of security:

- (a) mortgage over immovable property;
- (b) pledge over movable property;
- (c) guarantee; and
- (d) suretyship.

Each type of security varies as to the scope and effect and has its specific enforceability features contemplated by Ukrainian law and market practice.

3.4 Immovable

A mortgage is a specific type of pledge that may be created over immovable property. Local market participants consider a mortgage to be the most safe and liquid type of security which is widely used in practice. Immovable property is a generic term under Ukrainian law⁴⁰¹ which includes land plots, all buildings, structures and other property that are firmly attached or otherwise affixed to the land. Generally, a mortgage may be created pursuant to the parties' agreement, a court decision or by virtue of the law. To be valid and binding, any mortgage agreement must be in writing, notarized and duly

⁴⁰¹ Article 1 of the Law of Ukraine "On Mortgage" No. 898-IV dated 05.06.2003.

registered with the Immovable Property Register.

Although a mortgage is deemed to be a credible security instrument in the local market with a balanced and developed legal framework governing its creation, performance and enforcement, it has been possible to identify certain concerns set out Section A1 below.

3.4.1 Mortgage on land plots

Subject to exceptions below, land plots owned by a borrower or a security provider are generally capable of being the subject of a mortgage.

Agricultural land plots

Identified issues:

There is prohibition (in Ukrainian: "Moratori") on granting agricultural land plots into mortgage due to the statutory prohibition or moratorium, except for cases where a Ukrainian bank is a mortgagee under such mortgage instrument. In spite of Ukrainian banks being permitted to be a party to a mortgage over such lands, there are legal limitations imposed on such banking mortgages.

It is not permissible to change the intended use of the mortgaged lands and the modes of enforcement are restricted. Ukrainian law allows enforcing a mortgage over agricultural lands through public auction sale to qualifying buyers only, namely: (i) Ukrainian citizens (individuals) having agricultural education/experience or producing agricultural commodities; (ii) Ukrainian corporates, being authorized to carry on agricultural production.

Ukrainian banks are nevertheless placed at risk of being unable to enforce the mortgaged land due to an illiquid market (i.e. the limited number of qualifying buyers) and other complications contemplated by auction-based processes. According to market participants, the aforesaid mortgage over agricultural land is not much used in practice because of the above legal restrictions. According to publicly available statistics, more than 96 percent of the total agricultural land in Ukraine is not capable of being collateral under security agreement. As such, prohibition on sale of agricultural lands obstructs the investment to agricultural businesses and represents an impediment for the Ukrainian domestic market.

Recommendations for reform:

It is advisable to consider the lifting of legislative prohibition which will unlock new lending opportunities for agricultural industry and potentially include the provision governing perfection and priority of agricultural liens.⁴⁰²

State-owned and Municipal Land Plots

Identified issues:

Ukrainian law explicitly prohibits using a lease title to the state-owned and municipal land plots as collateral under a mortgage agreement.⁴⁰³ The only carve-out from such prohibition seems to be state-owned or municipal land plots used for the construction of residential buildings. This prohibition appears to be very restrictive and should be relaxed to capture other types of real estate which are used in project and infrastructure finance.

⁴⁰² *Supra* note 12, UCC Section 9-302.

⁴⁰³ Article 8-1 of Law On Lease of Land.

Recommendations for reform:

Ukrainian land law requires amendments to lift the prohibition or at least expand the carve-outs from such legislative prohibition.

3.4.2 Mortgage on premises and buildings, including buildings under construction

The mortgage over premises and buildings is quite a common type of security instrument in Ukraine. In a legal sense, buildings (premises) are normally inseparable under Ukrainian law from the land on which they are situated. Consequently, if a building is mortgaged under a security agreement, this implies that the underlying and necessary land plot owned by a mortgagor (on which such building or structure is situated, and/or which is required for its use) is also automatically included into the mortgaged property under the same mortgage agreement for the benefit of the same mortgagee.⁴⁰⁴ This position has regularly been emphasized by Ukrainian courts.⁴⁰⁵

In practice, however, there may be a separation of legal regimes applicable to a building owned by the mortgagor but located on a land plot leased by the mortgagor from the landlord (when the mortgagor is merely the lessee of the land plot). In that case, subject to limitation on a mortgage over lease rights to state-owned and municipal land plots, the mortgagee is entitled to have the same lease title to the land plot as the mortgagor does. Thus, the mortgagee may be granted with a lease of the land as owner/occupier of the building.

On a practical note, the building may only be subject to a mortgage if the land plot on which it is situated has been assigned a cadastral number.

3.4.3 Mortgage over buildings under construction

With respect to a building under construction, there is a common separate category of security which is regularly seen in project finance and infrastructural projects in Ukraine. Mortgage Act⁴⁰⁶ defines a building under construction as construction assets which have not been commissioned yet but in respect of which a construction license has been granted and such construction has been funded. While taking a mortgage over buildings under construction, a regard must be given to the detailed description of the collateral under the mortgage agreement which must cover the following assets:⁴⁰⁷ (i) mortgage over property rights to the building under construction; (ii) mortgage over the building under construction; (iii) mortgage over the lease and ownership title to land plot.

Identified Issues:

Another inconsistent area of mortgage regulation relates to circumstances where the building under construction owned by one person is situated on the land plot owned by a landlord who has mortgaged such land to a landlord's creditor. As such, that landlord's mortgage will automatically extend under Ukrainian law to the building under construction located on the land so mortgaged by the landlord, regardless of whether the ownership title to that building under construction belongs to a person other than the landlord. As a result, a real owner of the building under construction would automatically become a surety provider for the debts of the landlord.

⁴⁰⁴ Article 6 of the Law of Ukraine "On Mortgage" No. 898-IV dated 05.06.2003.

⁴⁰⁵ Ruling of the Supreme Court of Ukraine dated 8 December 2010 case No. 6-50440cb10.

⁴⁰⁶ The Law of Ukraine "On Mortgage" No. 898-IV dated 05.06.2003.

⁴⁰⁷ Article 16 of the Law of Ukraine "On Mortgage" No. 898-IV dated 05.06.2003.

Recommendations for reform:

It is recommended to amend Article 6 of the Mortgage Act to prevent the automatic extension of mortgage of buildings under construction on a plot of land pursuant to a mortgage of the land plot.

3.4.4 Mortgage over business unit (integral property complex)

A mortgage over a business unit (an integral property complex) in practice means a pledge of an enterprise as on-going concern. A definition of "an integral property complex" set out in Ukrainian law⁴⁰⁸ includes a wide range of assets, for instance, all types of property intended for its operation, land plots, buildings, structures, equipment, inventory, raw materials, production, rights of claim, debts, the right to a trademark or IP rights and other rights.

Proceeding from the above definition set out in the Civil Code, a mortgage over an integral property complex should cover all movable, immovable assets and even receivables and liabilities of an enterprise, which, in practice, are listed and recorded on the company's balance sheet as of the date of the security agreement.

Identified issues:

Ukrainian law lacks detailed rules and procedures governing how enterprise mortgages should accommodate changes in the composition of the mortgaged property occurring after the date of security. This may create unnecessary uncertainty at the stage of enforcement. In particular, given that the assets and liabilities of any enterprise are a dynamic category, changing from time to time as a result of the ordinary course of the company's business, it is unclear whether or not the mortgage would cover the assets acquired by the enterprise after the date of the mortgage agreement. The absence of rules on changes in the composition of collateral creates a risk that creditors would not be able to enforce the "after acquired" assets under the existing mortgage.

Recommendations for reform:

It would be helpful for the Mortgage Act to envisage a separate procedure for carrying out enforcement of the mortgage on a business unit. We believe that it would be reasonable to include statutory provisions whereby any assets/property recorded on the balance sheet of the enterprise at the date of enforcement must be captured by the existing mortgage unless the parties have agreed otherwise. In that case, all "after acquired" assets would be automatically included in the composition of the mortgaged property.⁴⁰⁹ Furthermore, in order to prevent situations when at the date of enforcement no valuable assets are left on balance sheet of the enterprise, we suggest introducing the requirement to obtain the mortgagee's prior consent for alienation of the assets/property of the enterprise essential for the mortgagee. The parties may agree the list of such assets/property or, as an alternative, establish the value of the property that cannot be alienated without the mortgagee's consent.

Aside from such "after acquired" assets problems, there are other notable concerns relating to the enforcement as described in Section 8.4.3.

⁴⁰⁸ Article 191 of the Civil Code of Ukraine No. 435-IV dated 16 January 2003.

⁴⁰⁹ *Supra note 7*, UNCITRAL Legislative Guide para. 64, pages 23-24.

3.5 Movables

3.5.1 Movable pledge

Security over movable property is usually documented by a pledge agreement in writing. Ukrainian law sets out the essential terms for such agreement such as: the secured obligation, description of the collateral and the term for discharge, etc. The registration of a movable pledge is optional for the parties. However, pledges are often registered with the Movable Property Register with a view to securing the ranking and preserving the priority as explained in Section 4.2 below. Although an unregistered pledge will be still valid and binding vis-a-vis the parties to it (so-called inter-parties effect), it may, however, not preserve ranking and priority of a pledgee whose claims may be overridden by duly registered claims of the third parties. Thus, a registered pledge always has a priority before an unregistered pledge.

3.5.2 Pledge over shares

Ukrainian law stipulates two types of corporate entities: a joint stock company ("**JSC**") having two forms, namely the private JSC and the public JSC, and a limited liability company ("**LLC**"). Importantly, that nature of equity in JSCs and LLCs differs, which influences the taking and enforcement of security as described below.

Security over securities is taken by way of a pledge. Under Ukrainian law, shares are considered to be securities. This requires the engagement of a custodian at the stage of taking and enforcing the security as noted below. Unless otherwise agreed by the parties, dividends payable on pledged shares are not included into pledged obligations under the security agreement. If dividends are covered, it is unclear under Ukrainian law whether the dividends are classified as receivables. Therefore, they are required to be pledged under the rules governing receivables pledges.

While carrying out an enforcement of share pledges, two approaches are commonly used in practice, in particular, a transfer of shares is triggered by (i) the pledgee or (ii) the pledgor. To implement the pledgee's scenario, the pledge parties execute a tripartite agreement on the enforcement of a share pledge with a custodian (a legal entity holding a custody license), whereby such custodian is authorized to credit the pledged shares to the securities account of the pledgee upon: (i) the occurrence of a default, (ii) a written instruction on crediting the securities being delivered by the pledgee to the custodian, and (iii) the pledgee having successfully passed the custodian's know-your-customer ("**KYC**") check.

Furthermore, in December 2017, the National Securities and Stock Market Commission introduced amendments to the legislation⁴¹⁰ aimed at simplifying and enhancing the efficiency of the out-of-court enforcement of share pledges. Thus, for enforcing the shares in the out-of-court manner upon occurrence of a default the pledgee should provide the custodian with the following documents:

- (a) a pledge agreement with express contractual stipulation that the out-of-court enforcement is available for the pledgee;
- (b) a default notice delivered to the pledgor in due manner;
- (c) a document confirming delivery of the default notice to the pledgor (i.e. postal receipt);

⁴¹⁰ The Regulation on the Depository Activity approved by the Decision of the National Securities and Stock Market Commission No. 735 dated 24 April 2013.

- (d) an extract from the Unified State Register of Legal Entities, Individual-Entrepreneurs and Public Organizations with information on the pledgor as of the date of delivery of the default notice (if a pledgor is a legal entity or individual-entrepreneur);
- (e) a document confirming registration of the commencement of enforcement of the pledged shares in the Movable Pledge Register;
- (f) a sale and purchase agreement concluded by the pledgee on behalf of the pledgor with the third party (when enforcement is carried out by way of private sale of the collateral); and
- (g) a certificate issued by the pledgee confirming the outstanding debt of the pledgor and validity of the pledge agreement.

It is important that prior to initiation of the enforcement procedure the pledgee is obliged to pass the custodian's KYC check.

Alternatively, for the pledgor-led scenario, an express contractual stipulation should be included into a pledge agreement allowing the transfer of the title to the pledged shares to the pledgee upon the occurrence of a default and satisfaction of other formalities. In practice, share pledge agreements containing such provisions may be successfully enforced if a custodian is provided with the written order of a pledgor for transfer of the pledged shares to the benefit of the pledgee.

Public JSCs do not have a pre-emption right at all. Therefore, no engagement of an external party (other than a pledgee and an independent custodian) at the stage of enforcement is required. In private JSCs⁴¹¹ in contrast, a disposal of shares by a shareholder may be subject to pre-emption rights of the remaining shareholders to the extent to which the by-laws of private JSCs impose such limitations. In such circumstances, an enforcing shareholder must obtain waivers from each remaining shareholder. It is equally important that a shareholder is given a two-month prior notice on the disposal of shares under a pledge agreement, unless another period was set out in a constituent document of the JSC. Any share transfer to a pledgee contrary to the above limitations will be unlawful and may be challenged in court.

A pledge over shares may also require contractual blocking arrangements between a pledgor, a pledgee and the relevant custodian which maintains the relevant pledgor's securities accounts. This gives additional comfort to the pledgee in matters of priority of its claims and makes impossible any unauthorized transfer of shares, once the pledged shares are blocked by a custodian in the clearing settlement system. However, on top of that, pledges over securities may be optionally registered in the Movable Property Register.

In addition, Ukrainian law allows the shareholder to issue an irrevocable power of attorney for securing the performance of its obligations. Such power of attorney shall be notarized and terminated in the event of termination of the obligation for the fulfilment or enforcement of which the same was issued.

Market participants and the National Depository of Ukraine note that there is a lack of out-of-court enforcement of pledges over securities. It should be mentioned that until recent legal amendments, the out-of-court enforcement actions (transfer of shares to the securities account of the pledgee) could be taken either by a direction of the court or by a holder of the shares. In

⁴¹¹ Article 7 of the Law "On Joint Stock Companies" No. 514-VI dated 17 September 2008.

fact, the pledgee had no technical ability to initiate the out-of-court enforcement within the depositary system. Hence, it remains to be seen whether the recent amendments will improve the pledgee's position in the out-of-court enforcement of the shares pledge.

3.5.3 Pledge over corporate rights

A pledge over corporate rights in a LLC is quite often employed by non-banking lenders as a security in project finance. Ukrainian banks, however, are unwilling to take corporate rights as collateral as they are classified as a weak security. Consequently, a loan being so secured will be assigned a higher credit risk under the prudential requirements of the central bank. Another reason why market participants do not employ that type of pledge in practice originates from: (a) banking prudential regulation which may treat a pledgor as a related party to a bank if the latter takes corporate rights on its balance as a result of security enforcement (taking title); (b) anti-monopoly regulation requiring banks to get competition clearance in certain cases.

The new LLC Act⁴¹² effective from 17 May 2018 introduces certain amendments into regulation of the procedure of enforcement of the corporate rights. In particular, it provides that enforcement of the corporate rights shall be carried out by a bailiff under an enforcement document. Such enforcement document may be issued either for recovery of debt of the LLC's participant or for enforcement of the corporate rights pledged for securing the third party's obligations. In the course of enforcement, other participants of LLC shall have the pre-emptive right to purchase the pledged corporate rights. In case of their failure to exercise such right, the state or private bailiff shall arrange the sale of collateral through public (auction) sale. It should be mentioned that the LLC Act allows obtaining the waiver of pre-emptive rights from other LLC's participants in advance (prior to execution of the pledge agreement).

Out-of-court enforcement of pledge over corporate rights

Identified Issues:

Despite a significant number of long-awaited changes, the LLC Act has some loopholes. The law envisages that the enforcement document is the sole grounds for commencing the enforcement against the pledged corporate rights. Such enforcement document may be issued either by a court or a notary by means of producing a notary writ. It is not entirely clear whether the other modes of out-of-court enforcement (such as taking on legal title and private sale) are available for the pledgee and what procedure should be followed in the course of such out-of-court enforcement.

Recommendations for reform:

We believe that it is worth including into the effective law a provision explicitly stating to what extent and what modes of out-of-court enforcement may apply to the corporate rights pledge.⁴¹³ It is advisable to amend the LLC Act and general security law (the Pledge Act, and the Civil Code) to make taking on legal title and private sale available for the pledgee. It might be worth considering also a combination of share pledges with pledges of corporate rights and providing for unified enforcement possibilities, similar to other European jurisdictions. However, such combination would require redesign of custodian system to enable to record corporate rights in the same way as securities and shares.

⁴¹² The Law of Ukraine "On Limited Liability and Additional Liability Companies" No. 2275-VIII dated 06.02.2018.

⁴¹³ *Supra* note 6, WB Principles para. 64, page 7, B3-B4 pages 18-19.

Irrevocable power of attorney for non-shareholders lenders (bank, financial institutions)

Identified issues:

The LLC Act introduces a new instrument in the form of an irrevocable power of attorney for securing performance of obligations of the LLC's participants (shareholders). Thus, the LLC's participants parties to the shareholders' agreement can issue an irrevocable power of attorney in order to enforce and/or secure the performance of their obligations under such shareholder agreement. As follows from the current wording of the law, an irrevocable power of attorney can be used for securing the participants' obligations arising out from the shareholders' agreement and does not cover other types of obligations (such as facilities and loans of banks or other non-shareholder entities). Consequently, it cannot be issued in favour of non-shareholder lenders (such as banks, financial institutions, corporates).

Recommendations for reform:

It is recommended to exclude the reference to the shareholders' agreement from Article 8 of LLC Act and make the new instrument (the irrevocable power of attorney) available for securing performance of the participants' obligations available also to non-shareholder lenders. This would make this new instrument an effective form of security for financing arrangements.

3.6 Title retention

Title retention⁴¹⁴ secures the performance of the payment obligations of a debtor under sale and purchase agreements, service, agency and other agreements, providing a creditor with the right to retain its asset or performance until a full discharge of the debtor's obligations. According to market participants, this type of security is rarely used in Ukraine. Title retention must arise on the basis of the law. In practice, however, title retention needs to be created in writing with the parties' contract.⁴¹⁵

Under the Civil Code, title retention may be made in respect of physical assets. The Ukrainian courts practice⁴¹⁶ specifies that title retention may not be made in respect of proprietary rights, works, services, results of intellectual property and intangible assets without physical substance, as well as funds.

3.7 Rights

3.7.1 Receivables pledge

A security over receivables can be created by way of a pledge. A receivables pledge may cover existing and future rights or claims with respect to payments made to a pledgor. The pledgor's debtor must be notified about such pledge. The receivables pledge is commonly used in project finance. But it is completely unhelpful in the banking lending space where prudential requirements of central banks classify receivables as illiquid collateral.

Generally speaking, a receivables pledge may be enforced in an out-of-court manner, such as through assignment of receivables for the benefit of a pledgee, sale of the receivables to a third party and other methods permissible under law.

The Pledge Act⁴¹⁷ requires that a pledgor must specify a debtor in the pledge agreement, which is supposed to be an essential term of the security agreement. In absence of information on the

⁴¹⁴ Article 594 of the Civil Code of Ukraine dated 16.01.2003.

⁴¹⁵ Decision of the High Commercial Court of Ukraine dated 19 January 2011 case No. 3/115-09.

⁴¹⁶ Decision of the High Commercial Court of Ukraine dated 2 August 2010 case No. 11/194/09.

⁴¹⁷ Article 49 of the Law of Ukraine "On Pledge" No. 2654-XII dated 02.10.1992.

identity of the pledgor's debtor, this requirement may jeopardise the effect of the pledge over the future receivables which may lack all the required essential terms.

According to market participants, Ukrainian law lacks consistent court practice and guidance in respect of resolution of disputes involving receivables pledges, which complicates the creditor's enforcement over rights pledged under such security instruments.

3.7.2 Pledge over bank account

A pledge agreement securing funds standing/credited to a bank account is classified under Ukrainian law as a pledge over property rights rather than funds as such. Aside from a pledgee and a pledgor, the bank in which the bank account is open and funds are held must also be a party to such pledge agreement. In March 2017, the Ukrainian Parliament adopted a new law⁴¹⁸ which improves the mechanism for enforcing pledges over bank accounts ("**Law No. 1983-VIII**").

The Law No. 1983-VIII allows the bank to debit the pledge funds standing/credited to bank accounts (in the amount envisaged in the pledge agreement) upon the pledgee's instruction, provided that the bank has been notified of the pledge and the pledge agreement expressly permits such debiting. Alternatively, the pledge can be enforced by way of assignment or sale of receivables to a third party. Any termination or amendment to the terms of a bank account agreement entered by the bank with a debtor for the bank account that is subject to a pledge requires a prior written consent from the pledgee. The new mechanism for enforcement of the pledge over bank account has not been much tested in practice so far. Thus, it remains to be seen how the above amendments and improvements will enhance the creditor's protection.

3.7.3 Pledge over IP rights

A security over intellectual property ("**IP**") rights can be created under a pledge agreement, but, in practice, it is an uncommon type of security due to complications with registration and with enforcement procedures. Certain IP rights⁴¹⁹ (other than copyrights) are subject to registration with IP registers. It is critical that the registered duration of the IP rights representing collateral matches the maturity of the secured obligations.

The enforcement of IP rights may be carried out by (i) an auction-based sale of such rights to the third parties or (ii) taking the title to the pledged IP rights. In practice, however, it is not entirely clear under Ukrainian law whether a pledgee may enforce certain IP right by way of taking ownership of such rights without the intermediation of the pledgor. In order to enforce such a pledge in that manner, a pledgee would be additionally required to: (i) enter with a pledgor into a separate agreement on the transfer of exclusive proprietary rights to the IP as required by the Civil Code⁴²⁰ and (ii) register such agreement and corresponding IP rights with the IP registers. Upon the occurrence of a default, it is likely that a pledgee may not be able to get the consent of the pledgor for entry into such an agreement, which would render the pledge unenforceable in extrajudicial manner.

Recommendations for reform:

It is recommended to amend the current Instructions on Submission, Consideration, Publication and Registration of Transfer of Title to IP Rights with a provision envisaging that

⁴¹⁸ Law No. 1983-VIII "On Amendments to Certain Legislation of Ukraine Regarding Improvement of Corporate Governance of Joint Stock Companies".

⁴¹⁹ For instance, industrial properties, trademarks, inventions, utility models, patents, industrial designs, etc.

⁴²⁰ Article 1113 of the Civil Code of Ukraine.

a pledge agreement with a standalone clause on availability of the out-of-court enforcement for the pledgee or the agreement on satisfaction of pledgee's claims shall be a ground for making an entry on change of title in the respective IP register. This should simplify the registration procedure and enable a pledgee to take ownership title to the pledged rights without intermediation of a pledgor. Such approach has been already envisaged by the recent amendments to the Mortgage Act.

3.8 Suretyship

Suretyship is one of the most widely used types of security in Ukraine. Both individuals and corporates can grant suretyships. Under the surety agreement, a surety provider guarantees to the creditor the due performance of obligations undertaken by the debtor. The surety provider is liable to the creditor to the same extent as the debtor, including for the repayment of the outstanding principal amount, interest, penalty, and reimbursement of damages unless otherwise agreed in the suretyship agreement.

Unlike a financial guarantee, a suretyship cannot be structured as an absolute obligation and is a secondary obligation. The suretyship ceases to be effective once the underlying obligation is terminated or invalidated.

In July 2018, the Parliament of Ukraine introduced certain amendments to surety regulation aimed at resolving the main obstacles in the enforcement of surety. For a more detailed analysis of the recent legal amendments please refer to Section 6.3.8 below.

3.8.1 Assets not capable of being pledged

The Civil Code⁴²¹ and the Pledge Act⁴²² and other laws list property and assets which are not allowed to be subject of a security instrument. In particular:

- (a) state-owned or municipal property representing cultural values being recorded in the State Register of National Cultural Property;
- (b) monuments of cultural heritage recorded in the List of Monuments of Cultural Heritage;
- (c) museum values and museum collections being the state-owned part of the Museum Fund of Ukraine;
- (d) non-alienable (personal) claims, claims which are prohibited to be pledged;
- (e) state-owned property which is not subject to privatization, and any integral property complex held by state-owned companies and their structural divisions which is in the process of corporatization;
- (f) property of state-owned and municipal higher education institutes;
- (g) land servitude;
- (h) leasehold of state-owned and municipal land plots; and
- (i) agricultural land in circumstances described in Section 3.4.1 above.

3.8.2 Bank guarantee

Bank guarantees are classified as a security instrument in Ukraine. Despite their reliability and high level of protection of the creditor's rights, they are not often seen in the Ukraine lending space according to market participants. From an origination perspective a bank guarantee is an

⁴²¹ Article 576 of the Civil Code of Ukraine.

⁴²² Article 4 of the Law of Ukraine "On Pledge" No. 2654-XII dated 02.10.1992.

instrument being as expensive as a loan commitment itself and requires credit committee approval.

A bank guarantee can only be issued by banks and financial institutions. Under a bank guarantee, should the debtor under the principal agreement fail to perform its contractual obligations, the bank undertakes to make a partial or full payment of the amount due to the creditor under the principal agreement.

The bank guarantee is an obligation of a non-accessory character. In particular, it does not depend on the principal obligation even if such principal obligation is directly referred to in the guarantee. The non-accessory nature of bank guarantees has practical advantages for creditors, since in case the principal agreement should be declared invalid by court, this would not lead to automatic invalidation of the bank guarantee (non-accessory nature).

Recommendations for reform:

We recommend extending the possibility to issue a guarantee with a non-accessory nature to other (corporate) entities. Private individuals could be excluded from this extension.

3.9 Claims under financial collateral regulations

Ukrainian law still lacks a financial collateral law, which is vital and fundamental for banks, corporates and alternative debt providers to raise money efficiently and to utilize derivatives, repo and securities lending and capital market instruments. However, reform of the financial collateral regulation should be a component of the overall redesign of the local capital market infrastructure and pre- and post-trade processes. A number of fundamental concerns seem to have been addressed in various draft laws described in Section 11.1 below.

Identified issues:

Ukrainian legislation lacks a comprehensive legal regime governing execution, performance and enforcement of financial collateral transactions. There are a number of notable gaps in the regulation which hinder financial collateral operations. Firstly, the concept of financial collateral and its categorization do not seem to be developed in statutory law. Secondly, Ukrainian law fails to include a clear-cut definition of financial collateral parties and their rights and benefits. Thirdly, the absence of finality of the settlement principle which is fundamental for the operation of financial collateral, on the one hand, and unavailability of carve-outs for "close out netting" in insolvency law, including from avoidance provisions and any moratorium arising on insolvency, on the other hand, create a legal framework that prevents the smooth operation of financial collateral. A specific law is needed to regulate financial collateral including appropriate carve-outs. Ukrainian law also lacks essential components of a modern financial infrastructure (a concept of regulated markets, multilateral trading systems, trade repository and developed clearing models and central counterparty).

Recommendations for reform:

Considering best international practice, it is advisable to include the regulation on financial collateral in a separate law as a standalone document rather than introducing amendments to various existing legal acts. In particular, the law should define the settlement principle for financial collateral trades and create (i) carve-outs for "close-out netting" from moratorium and claw-back provisions of the insolvency law; and (ii) carve-outs for out-of-court enforcement (shortening mandatory 30-day remedy period for enforcement set out in Article 26 of the Law of Ukraine "On Securing Creditors' Claims and Registration of Encumbrances"). Consideration should also be given to extending the application of the law to benefit transactions where one party is a corporate to enable ordinary security over cash arrangements concluded in the context of a commercial loan. This law should be developed in line with the EU Financial Collateral Directive and the EU Directive on Settlement Finality in Payment and Securities Settlement Systems.

4. RANKING AND PRIORITY OF CLAIMS

4.1 Unsecured claims

Unsecured claims will be junior to secured claims. Secured claims may be set aside in certain circumstances,⁴²³ such as: (i) the security interest is created after the adoption of the court decision on debt recovery; (ii) the amount of collateral exceeds the sum of debt which is due to a registered creditor.

4.2 Secured claims

Security over movable and immovable property must be registered with the Movable Property Register or the Immovable Property Register, respectively, to make the security interest enforceable against the claims of third parties. The movable and immovable security instruments rank in priority according to the time of their registration.⁴²⁴ Priority is defined under Ukrainian law as a preferential right of a creditor over claims of another creditor in respect of the same property.

Ukrainian law specifies that competing security interests over the same property registered by creditors at the same time with the Movable Property Register will give both equal rights for satisfaction of their claims.

There is a conflicting issue related to the loss of priority and ranking over movable encumbrances if a secured creditor fails to renew and maintain records with the Movable Property Register in the timeframes set out by Ukrainian law. Further details on the problem and suggested solutions are described in Section 5.2.2 below.

4.3 The highest ranking security interest

A holder of higher priority ("**first-ranking creditor**") always takes priority and has a preferential enforcement right on encumbered assets or property. Furthermore, the law gives first-ranking creditors the right to terminate any enforcement of security initiated by a holder of lower priority ("**second-ranking creditor**"). Such first-ranking creditor may also start its own enforcement over the secured property.

4.4 The security interest with subsequent ranking

Unless otherwise set out in a security agreement, encumbered assets can be re-mortgaged under Ukrainian law to other creditors upon the consent of existing holders of the security. A second-ranking creditor is subordinated to claims held by the first-ranking creditor. Accordingly, the claims of a second-ranking creditor must be satisfied only after full discharge of claims of a first-ranking creditor.

4.5 Possibility of contractual assignment of a priority ranking

Ukrainian law allows creditors to transfer rankings to a third party and modify the order of priority in payment.

A registered creditor may transfer its rights under collateral instruments to a third party, provided that such contractual arrangements contemplate a transfer of the underlying (principal) obligation, which is secured by such collateral. Consequently, a transferee becomes a party to an underlying obligation (e.g. loan agreement) and assumes all ancillary rights relating to the secured assets, including the priority ranking set out in respect of such assets. The transferor (pledgor/mortgagor) must register the

⁴²³ Article 54 of the Law of Ukraine "On Enforcement Proceedings" No. 1404-VIII dated 2 June 2016.

⁴²⁴ Law of Ukraine "On Securing Creditors' Claims and Registration of Encumbrances" No. 1255-IV dated 18 November 2003 and Law of Ukraine "On Mortgage" No. 898-IV dated 5 June 2003.

change of security (pledge/mortgage) with the corresponding registers in five days upon the date of assignment.

Aside from transferring their rankings to a third party, registered creditors may contractually modify their order of priority, provided that such modification will not cause damage to other registered creditors. The change of priority as a result of assignment must be registered with the public registers within five days of the date of assignment.

4.6 Priority between public and private encumbrances (court rulings, tax pledge effect on a security instrument)

All encumbrances are divided into private and public ones. Private encumbrances are deemed to be those which are created on the basis of a contract. Public encumbrances, by contrast, are created pursuant to the law or a court decision. The priority of public encumbrances is determined in relation to the date of its registration with the register. In legal theory, a public encumbrance has no priority over a private encumbrance in respect of the same property, to the extent the public encumbrance has been registered after the date of registration of the private encumbrance.

Nevertheless, a holder of private encumbrance would not be able to enforce against the secured assets if a court injunction or other public encumbrance (tax lien, seizure) were created in respect of the same secured assets. A holder of private encumbrance would then be required to bring a claim in court. It is highly likely that the court would respect its claim and lift the public encumbrance. However, it would usually take time, expense and efforts on part of such a holder of a private encumbrance.

At the same time, while enforcing against the collateral, a holder of a public encumbrance (being a second ranking creditor) must notify the first ranking holder of private encumbrance on the commencement of any enforcement proceeding. In such a case, the holder of the private encumbrance will be able to control and even stop the enforcement taken by the holder of the public encumbrance.

4.7 General priority of satisfaction of claims in insolvency and winding-up

Generally, secured creditors have priority over unsecured creditors in insolvency proceedings. Moreover, the secured creditors' claims are ranked ahead of the first ranking of priority established by the Insolvency Act. Unsecured creditors' claims fall within the fourth to the sixth ranking of priority.

In particular, assets and funds of an insolvent entity that have been collected or realised must be distributed by an insolvency practitioner in the below order of priority:

- (a) Ahead of ranking: secured claims
- (b) First priority: salary, employment allowances, loan repayments (taken for salary payoff), insurance payment, insolvency related costs and fees
- (c) Second priority: claims for death, personal injury and health claims, social payments liabilities
- (d) Third priority: tax claims, other duties
- (e) Fourth priority: unsecured claims
- (f) Fifth priority: equity repayment to employees, additional liquidator's fees
- (g) Sixth priority: other residual claims.

The Bankruptcy Code which is pending does not modify or change the above order of priority.

As noted above, the Insolvency Act and the Bankruptcy Code also emphasise that the proceeds obtained from the sale of the secured property must be used to satisfy the claims of a security holder first (in order of their priority ranking) before satisfying all other claims under their relevant priority ranking.

At the same time, the regulation on winding-up proceedings described in Section 8.5 below sets out the priority ranking which differs from insolvency-related priorities. Accordingly, the distribution of

assets to the creditors in winding-up proceedings must be made in accordance with the following priorities:

- (a) First priority: claims for death, personal injury claims and social payment liability, secured claims
- (b) Second priority: salary, wages and author fees
- (c) Third priority: tax claims and other duties
- (d) Fourth priority: other claims

When a company is unable to satisfy all claims and the winding-up proceedings are converted into insolvency proceedings, the insolvency-related priority will be applied. For a more detailed analysis of the impact of insolvency and winding-up proceedings on enforcement please refer to Section 8 below.

4.8 Subordinated claims

The contractual subordination of unsecured indebtedness is one of the techniques used in practice by Ukrainian banks and investors.

Identified issues:

Ukrainian creditors often enter into subordination arrangements in order to modify the priority of indebtedness. However, such arrangements in relation to third parties and their enforceability against such parties in post insolvency scenario may be rendered unenforceable because the order of priority of indebtedness and insolvency claims is mandatory and governed by insolvency and enforcement laws which override and prevail over the parties' choice.

Recommendations for reform:

It is recommended that the rules be implemented by security regulation (the Mortgage Act, the Pledge Act and the Civil Code) to give effect and protection to the parties' agreement modifying the priority of claims in the pre-insolvency period. It would be further helpful to set out the insolvency rules (the Bankruptcy Code) as to how the insolvency waterfall interact with contractual subordination arrangements with a special focus being given to instances where the modification is made to the order of satisfaction of claims held by the creditors belonging to different insolvency priorities.⁴²⁵

Aside from that, equitable subordination which protects unaffiliated creditors by giving them rights to corporate assets which rank ahead of creditors who are the shareholders of the borrower is not recognized in Ukraine. However, the effect of equitable subordination may be achieved synthetically through using the powers of the insolvency practitioner, who may disclaim the security or the shareholder loan via court as described in Section 8.4.1 below. This would effectively mean the reclassification of a secured liability into an unsecured one and trigger the downgrade (change) of insolvency priorities from a super priority down to a first priority ranking.

⁴²⁵ *Supra* note 11, UNCITRAL Insolvency Guide paras. 57-59 page 268.

5. REGISTRATION AND PERFECTION WITH REGISTRY SYSTEM

5.1 Form: Notarial deed

Ukrainian law requires the pledge and mortgage agreements to be concluded in writing. However, mortgages created over immovables and pledges over transport vehicles and others, must be notarized. These security instruments become legally binding upon the moment of notarization. The notarizing of mortgage agreements and pledges over vehicles is carried out at the location (registration place) of the property or one of the parties.

In addition, a movable pledge (other than a transport vehicles pledge) can also be voluntarily notarized if the parties so agree.

A notarized pledge or mortgage confers on a pledgee or a mortgagee the benefit of out-of-court enforcement on the basis of a notarial writ as described in Section 6.3.3 below.

Notarisation of the security agreement is subject to the payment of a notary fee. Ukrainian law sets out a fixed fee for services of a state notary, which consists of the state duty and payment for additional notary services (e.g. consultation, drafting agreement etc.). The state duty for notarisation of a mortgage agreement shall be equal to 0.01 percent of the value of secured property. The state duty for notarisation of a pledge agreement also depends on the value of secured property, but is capped at UAH 850.00 (USD 33.70). This makes notarisation of the pledge very cost-effective, compared with other European jurisdictions.

Private notaries are flexible in setting out the fee for their services. Generally, the fee for notarisation of a pledge or a mortgage agreement equals 0.1 percent of the amount of the agreement. However, the fee of a private notary may be subject to negotiations with a notary.

5.2 Registration

5.2.1 Immovable Property Register

The Immovable Property Register was created in 2013⁴²⁶ and contains information about all existing in-rem rights and encumbrances over immovable properties (ownership title, lease right, mortgage, seizure, etc.) and the land plot on which those immovable properties are located. Ukrainian law⁴²⁷ envisages a relatively simple, transparent and straight-forward procedure for the registration of encumbrances. A mortgagee may deliver particulars of its security either to the state registrars or the notaries for registration of encumbrances, regardless of the location of the mortgaged property. As long as land is the subject of encumbrances, those can be successfully registered with the Immovable Property Register provided that such land plots have been already registered with the Land Cadastre. If a land plot does not have an assigned cadastral number, it is not capable of being mortgaged or encumbered in practice.

It is worth noting that the state administrator (a state entity responsible for maintenance and technical support of all state registers) is in the process of developing special e-based tools (software) which will allow an applicant to submit an electronic pre-application for registration of an encumbrance. Upon review of such pre-application, a state registrar may request additional documents or make an appointment for carrying out the registration. The registration itself, however, cannot be performed online due to the requirement for the authorised person to sign the application in front of a state registrar.

⁴²⁶ Law of Ukraine "On State Registration of Proprietary Rights to Real Property and Their Encumbrances", No. 1952-IV, dated 1 July 2004.

⁴²⁷ Procedure of State Registration of Proprietary Rights to Real Property and Their Encumbrances approved by the Resolution of the Cabinet of Ministers of Ukraine No. 703 dated 22 June 2011.

The Immovable Property Register is accessible online. Information from the Immovable Property Register is available for any individual or legal entity. In order to receive an extract from the Immovable Property Register, one should enter either name of a legal entity or individual who owns the land plot or address/ cadastral number of such land plot.

Identified issues:

Ukrainian law lacks provisions for reinstating entries in the Immovable Property Register in certain circumstances. Specifically, if a court invalidates a title transfer over the mortgaged property made by a mortgagor for the benefit of any third party without a mortgagee's consent, then the ownership title of a new owner will be cancelled. However, an entry recording the ownership title of the original owner will not be automatically reinstated in the Immovable Property Register. The original owner is the only person entitled under Ukrainian law to request the reinstatement of a title entry in the Immovable Property Register. Until submission of the respective request by the original owner, there is no entry on the property owner in the Immovable Property Register. Moreover, market participants emphasize that the Immovable Property Register will not give effect to the mortgagee's request for reinstating such entry by reason that it is not a legal owner of the property.

Recommendations for reform:

As a solution it is suggested to amend the regulation⁴²⁸ for the Immovable Property Register to allow the respective officer to reinstate the entry on ownership title automatically on the basis of the binding court decision invalidating previous entry, which can be done once there are clear provisions with regards to the registration of amendment and cancellation notices.⁴²⁹

5.2.2 Movable Property Register

The Movable Property Register contains information on the creation, change and termination of encumbrances over movable property along with records on any commencement of enforcement. It is common practice for creditors to register the pledges over movable property in order to make their security interest enforceable against the claims of third parties.

The extracts from the Movable Property Register are available for inspection by individuals and corporates on the basis of an agreement with the Ministry of Justice or via special users (being either the Ministry or notary who has entered into separate agreement with such Ministry). In May 2017, the Ukrainian Government⁴³⁰ adopted an initiative to make the Movable Property Register publicly and electronically available for individuals and corporates via internet-based access by the end of 2017. However, as of the date of the report, the Movable Property Register is still publicly unavailable. It remains to be seen how much time will be needed for the anticipated internet-based access to be finally phased-in.

We believe that the above initiative should significantly improve the position of creditors holding a security interest over movable assets. Firstly, the internet-based access gives everyone the ability to retrieve data from the Movable Property Register without needing to engage a special administrator (i.e. notaries or the Ministry of Justice). Secondly, such access reduces time and costs needed for the information retrieval by a creditor, in particular, there is no need to visit an administrator and/or make payment of an administrator's fees.

⁴²⁸ On Approval of Regulation on Maintaining the State Register of the Property Rights, approved by the Resolution No. 1141 of Ukrainian Government dated 26 November 2011.

⁴²⁹ *Supra* note 8, UNCITRAL Guide paras 221-263 pages 93-112.

Identified issues:

Under Ukrainian law, an encumbrance over movables in the Movable Property Register is valid only for five years, regardless of the duration of the secured obligation. If the security period exceeds a five-year period under a particular pledge, the secured creditor must renew the encumbrance entry with the Movable Property Register before the expiration of the above period in order to preserve the original priority going forwards. In case such creditor fails to renew in time the original encumbrance for the next five years, it will lose its priority ranking and will be placed at the bottom of priority ranking. Market participants emphasize that the statutory duration of movable encumbrances is an artificial construct and a five-year limitation is not justified in practice.

Recommendations for reform:

The encumbrance should exist for the duration of the security obligation as set out in the security agreement. In such circumstances, a secured creditor would not be required to comply with renewal formalities to preserve the ranking of the original encumbrance. We recommend removing the statutory limitation provisions enabling the secured parties to determine the extent of the relevant encumbrance at their discretion.⁴³¹ It also may be helpful to introduce a provision stipulating that the duration of encumbrance must be equal to the secured period specified in a security agreement unless otherwise agreed by the parties. The suggested proposal would then be consistent with the approach utilized in the Immovable Property Register where the duration of encumbrances is unlimited.

5.2.3 Consequences of absence of registration with the public authority

The encumbrance of immovable property with a mortgage is subject to a mandatory state registration. Consequently, an absence of state registration affects the validity of a mortgage.

A pledge agreement relating to a movable property is binding upon the parties from the moment of its execution. The creation of movable encumbrances does not affect the validity of a pledge agreement. However, in the absence of a registered movable encumbrance, a pledgee will not obtain priority in relation to the registered rights or claims of other creditors.

5.2.4 Registration fee

A registration fee may consist of the administration fee for recording security in the register and the notary fee (if registration actions are performed via a notary). The amount of the administration fee is set out by the regulation⁴³² and, in general, is not high. In particular, the administration fee for movable security registration equals 0.025 of subsistence minimum for able-bodied persons,⁴³³ which as of the date of the report constitutes UAH 46.02 (approximately USD 1.80). Whereas the administration fee for mortgage registration equals 0.05 of subsistence minimum for able-bodied persons - UAH 92.05 (approximately USD 3.60).

The notary fee for security registration is subject to negotiation with a notary.

5.3 Exemptions from perfection requirements for financial collateral

As noted in Section 11.1 below, the Ukrainian regulation on financial collateral is in a state of development. There is no carve-out envisaged by the effective Ukrainian law in respect of the

⁴³¹ *Supra* note 7, UNCITRAL Legislative Guide, para. 55 pages 78-79.

⁴³² *Ibid*, Art. 33 page 40.

⁴³³ The subsistence minimum is a minimum level of income, which is considered to be necessary to ensure sustenance and other basic personal needs at a level allowing the individual to survive. The amount of the subsistence minimum is set out by the Law "On State Budget" on an annual basis and could be further changed within a period.

perfection and registration of financial collateral. A financial collateral taker has no perfection benefits. Accordingly, a financial collateral taker would be required to register the financial collateral instrument with the Movable Property Register in the usual way.

For more on existing regulatory problems relating to financial collateral please refer to Section 3.9 above.

6. ENFORCEMENT PROCEEDINGS

6.1 Obtaining of information on a debtor's assets

Obtaining information on the debtor's assets, whether the debtor is either a natural person or a legal person, is a key element for successful, speedy and low cost enforcement proceedings. An enforcing party is unable to achieve these parameters without having in place a reliable and well-functioning central system recording collateral and assets held by a debtor or a security provider. Market participants generally emphasize that the state authorities and enforcement officers are quite inactive and ineffective in asset tracking as further specified below. In practice, conducting a search against the debtor's assets is burdensome for a creditor in both cases where the debtor is a natural person or a legal person.

Currently, there is no unified base or central system publicly available for creditors and containing summarized information on a debtor's assets. Instead, the above information is now segregated across a multiple of public registers, such as: the Movable Property Register, the Immovable Property Register and the Land Cadastre (for more details, please refer to Sections 5.2.1 and 5.2.2 above). Except for the Movable Property Register, all public registers are web-based and may be easily accessible by users via internet.

In practice, the Immovable Property Register experiences certain disruptions in operations which can be explained by technical problems of the state administrator responsible for maintenance of the state registers. Market participants highlight that public registers may reflect incomplete search results. For example, it is not an uncommon situation, in which a search in the Immovable Property Register made against the name of the relevant debtor may not be fully reliable. To be on the safe side, it is also required for the creditor to check the information on each immovable property owned by such debtor.

It is also important to note that searches made in the Movable Property Register with respect to collateral created in favour of a foreign pledgee may also be incomplete because the name of a foreign entity must be specified in the register in the Ukrainian language. As there are several ways of translating the name into the Ukrainian language available, this may distort the search results. The above problems are of technical nature and their negative impact could be mitigated by an additional search.

The Land Cadastre may be helpful for mortgaged creditors to retrieve information on land plots of a debtor and/or a collateral provider. The register also allows tracking down existing rights of third parties in respect of such land plots (lease of land, superficies, etc.). A creditor may conduct a more in-depth search over the counterparty's assets, for example, by checking the Company Register,⁴³⁴ the Court Decisions Register,⁴³⁵ as well as Bankruptcy Register⁴³⁶ and an automated system of enforcement proceedings.

In addition, the market participants use a number of privately-owned bureaus of credit histories,⁴³⁷ which collect data on banking loans from the participating Ukrainian banks.

⁴³⁴ The Unified State Register of Legal Entities, Individual Entrepreneurs and Public Organizations of Ukraine.

⁴³⁵ The Unified State Register of Court Decisions.

⁴³⁶ The Unified State Register of Enterprises against which bankruptcy proceedings have been initiated.

⁴³⁷ According to available statistic as of 27 July 2017, there are ten bureaus of credit histories.

It is worth noting that recently the NBU has set up the Credit Register, which is the centralised information exchange system accumulating information on loans advanced by banks to both legal entities and individuals. Starting from May 2018, all Ukrainian banks as well as the Deposit Guarantee Fund are under an obligation to supply to the Credit Register information on the loans the amount of debt under which is equal to or exceeds 100 minimum wages (approximately USD 14,300).

Identified issues:

Despite the great importance and positive impact of the Credit Register on enhancing the adequate and uniform approach of all banks to risk assessment of borrower in course of lending, there is still room for improvement of its regulation. The threshold amount of a defaulting loan to be recorded in the Credit Register is calculated on the basis of the minimum wage and constitutes 100 minimum wages. The amount of minimum wage is revised by the Ukrainian Parliament on an annual basis. It could be expected that in future, due to an increase of the minimum wage, the threshold amount of defaulting loan will scale up massively. As a result, information on a great number of defaulting loans do not exceeding the increased threshold amount will be not reflected in the Credit Register. In that case banks will be again required to use privately-owned credit history bureaus.

Recommendations for reform:

It is advisable to amend the effective regulation with a provision stipulating a fixed threshold amount of the defaulting loan to be recorded in the Credit Register rather than relying on a multiple of the minimum wage which may fluctuate from year to year. This may be reviewed at periodic intervals.⁴³⁸

6.2 Judicial enforcement

Judicial enforcement is treated by market participants as the primary method of enforcement in Ukraine. A court-led approach is commonly used by an enforcing party for the majority types of security instruments.

6.2.1 Court proceeding

The court plays a critical role in the enforcement process under mortgages and pledges. Secured creditors may seek court enforcement of pledged and mortgaged property by way of private sale or public auction sale. In addition, the taking of a title to movable collateral is an optional mode of enforcement available for a pledgee.

Market participants have raised certain concerns as to the court-led determination of the sale price for an auction sale under a mortgage instrument. Until recent legal amendments, while enforcing a mortgage or pledge claim by way of auction sale, courts were under obligation to determine an initial sale price to be used for the sale of the property. The new Law On Resuming of Lending obliges the court to determine an initial sale price only upon request of one of the parties.

Identified issues:

While enforcing the security via a civil law court, creditors may face difficulties if a security provider (being an individual) is unwilling to participate in the court proceedings. In such case, the court is authorized to render a default decision and defendant (security provider) is entitled to receive a copy. Market participants underline that in practice defendants avoid receiving delivery of such a default decision which, in turn, obstructs the commencement of the enforcement procedures.

⁴³⁸ *Supra* note 8, UNCITRAL Guide, paras. 90-91 page 35.

Recommendations for reform:

To remedy the problem of defendants who are natural persons not participating in court proceedings and avoiding delivery of default judgments, consideration should be given to introducing amendments to the existing Civil Procedural Law to define cases of deemed delivery of default decisions if a borrower acts in "bad faith" to avoid such delivery by all means.⁴³⁹

6.2.2 Arbitral hearing

An arbitral procedure is an alternative component of the judicial enforcement of security instruments. Generally, arbitration ("**Treteyskiy Sud**") has jurisdiction to resolve disputes between a creditor and a collateral provider pursuant to a consensual arbitration agreement (clause). Disputes with respect to certain types of security instruments such as mortgages⁴⁴⁰ and/or security under consumer loans are not capable of being resolved by arbitration due to arbitrability limitations set out in procedural law. Accordingly, arbitration may resolve disputes with respect to security instruments over movable assets which are not subject to the security supporting consumer lending. Given the above limitations, secured creditors may seek arbitral enforcement against the pledged property by way of private sale, public auction sale or taking of title to movable collateral. An arbitral court must approve the sale price of the pledged property for private sale and public auction.

In fact, arbitration is well-known for speedy, simple and cost-efficient proceedings that may effectively accommodate needs of the parties. As opposed to lengthy state court proceedings, potentially involving a number of appeal claims on the merits of dispute, arbitration hearings are viewed as a handy dispute resolution mechanism. Generally, it is uncommon for Ukrainian commercial transaction to use arbitral process for enforcement of security instruments. To our knowledge, there are a couple of arbitration courts established within the banking association which usually handle disputes over loan and security documents. From the practical perspective parties tend to resolve their security disputes in Ukrainian state courts.

Since Ukraine is a member to the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, a foreign arbitral award should be recognized as binding and enforced upon the filing by a party of an appropriate motion with a competent Ukrainian court. However, an arbitral award may be appealed by the opposing party provided that it proves the existence of any of the grounds established by the New York Convention or the applicable Ukrainian legislation for the denial of the recognition and enforcement of the foreign arbitral award.

The following are the grounds for denial of the recognition and enforcement of the foreign arbitral award by Ukrainian courts:

- (i) invalidity of the agreement to arbitrate under the chosen law;
- (ii) incapability of one of the parties when entering into the arbitration agreement;
- (iii) undue notification of the losing party of the appointment of the arbitrator or the conduct of the arbitration proceedings;
- (iv) existence of valid reasons for the losing party failure to submit its explanation;

⁴³⁹ *Supra* note 7, UNCITRAL Legislative Guide, para 56 page 21

⁴⁴⁰ Law dated 5 March 2009 № 1076-1, Court practice: Rulings of Highest Commercial Court of Ukraine dated 23 February 2011 in dispute No. 3/126/10, dated 23 April 2012 in dispute No. 3/196, dated 6 June 2012 in dispute No. 5023/2442/11.

- (v) the arbitration award was rendered on an issue outside the scope of the arbitration agreement;
- (vi) non-compliance of the arbitral tribunal or procedure with the arbitration agreement;
- (vii) the arbitral award did not enter into force, or was annulled or its execution was suspended by the court of the country, according to the laws of which such arbitral award was rendered.

Moreover, a foreign or local arbitral award may be unenforceable in Ukraine if a Ukrainian court determines that the subject-matter of the dispute cannot be subject to arbitration under Ukrainian legislation, or the recognition and enforcement of such arbitral award contradicts the public order of Ukraine.

6.3 Extrajudicial (out-of-court) enforcement

When an event of default has occurred, a creditor must typically comply with certain formalities (e.g. serving a default notice, registering with public registers, observing remedy periods and others). Each particular mode of enforcement may impose additional formalities on a secured creditor.

The majority of market participants identify the determination of the date of delivery of a default notice on the debtor and the further calculation of a 30-day remedy period as a problem for commencement of security enforcement in an out-of-court manner. In fact, Ukrainian law requires the secured creditor to furnish evidence of due receipt by the debtor of the relevant notice. If the debtor avoids receiving such notice (for example, does not appear at a post office etc.), this jeopardizes the validity of any further enforcement actions taken under the security instrument and, de facto, converts out-of-court enforcement into court enforcement.

6.3.1 Enforcement of unsecured claims by way of notary writ

A notary writ may be produced by a notary in respect of both unsecured and secured claims. For example, a loan agreement may be enforced by way of a notary writ if such loan was notarised. It is not permissible under Ukrainian law to issue a notary writ in respect of a non-notarised agreement. For more details on applicable procedures and prerequisites required for a notary writ to be issued, please refer to Section 6.3.3 below.

6.3.2 Extrajudicial enforcement of secured claims

A secured creditor may upon its sole discretion enforce security in judicial (for example, through public auction as set out in Section 6.2.1 above) or extrajudicial modes. With respect to the extrajudicial mode, a secured party is free to choose the preferable extrajudicial remedy taking into account the nature of a given security and statutory limitations on enforcement modes. For example: the following out-of-court enforcement modes are available for a movable pledge: (i) private sale; (ii) taking title to pledged property; (iii) public (auction) sale; (iv) notary writ (v) assignment and (vi) debiting (for the cash funds and securities). For a mortgage – (i) private sale; and (ii) taking title to mortgaged property. Some of those methods which are widely used within the Ukrainian market are reviewed below.

6.3.3 Enforcement by way of notary writ

A notary may enforce a security agreement by means of producing a notary writ. Under Ukrainian law it is permissible to issue a notary writ only in respect of a notarised security instrument. A notary writ may be produced under pledge and mortgage agreements.

A notary writ will be valid provided that it was produced within the prescribed limitation period (a year for a transaction involving corporates and three years for one involving an individual,

calculated from the date when the contractual claim originated). A notary would require an enforcing party to deliver a set of documents according to the list set out in regulation. Such list is transaction-specific and depends on the type of a contract being subject to enforcement (e.g. loan, mortgage, pledge etc.).

Ukrainian law sets out that a notary writ shall be regarded as an enforcement document in the same way as state enforcement proceedings. On that basis, the state enforcement agency (bailiff) may commence (open) the enforcement proceedings against the secured assets. In the context of the enforcement proceedings, the state enforcement agency will proceed with performing an enforcement document (a notary writ) in accordance with the requirements of the Enforcement Act.⁴⁴¹

(a) Pledge

As noted above, pledged property may be enforced by way of a notary writ. Such writ is furnished to the bailiff, who then determines the manner of realization of property: public (auction) sale or private sale. In fact, public (auction) sale applies to transport vehicles and all material collateral exceeding UAH 160,000 (approximately EUR 5,300), whereas a private sale is used for immaterial collateral. With respect to a public (auction) sale or private sale of collateral arranged by the bailiff, the starting price shall be determined by the agreement of the parties. In case of their disagreement, the value of such collateral may be defined by a licensed valuer (for transport vehicles, ships, aircrafts) and the bailiff (for all other movable collateral).

(b) Mortgage

Pursuant to a notary writ, mortgaged property may be sold by the bailiff through public (auction) sale only. The starting price shall be determined by the agreement of the parties; however, in case of their disagreement, such value to be determined by a licensed valuer. The starting price will also be used by the bailiff for the public (auction) sale and may be discounted according to haircuts set out in the Mortgage Act.

Identified issues:

Even though enforcement through a notary writ appears to be a quite simple and straightforward process, Ukrainian courts have not developed a common approach to disputes involving a notary writ.

There is inconsistent court practice as to the calculation of amounts of debts to be enforced under a notary writ. As a matter of procedure, before producing a notary writ, an enforcing creditor must serve a 30-day default notice on a borrower clearly stating the amount of indebtedness as of the date of the notice. Upon the expiry of the 30-day period, the actual amount of claim may be increased due to the effect of accrued interest, penalties, default interests, etc. In such circumstance, there are court precedents,⁴⁴² whereby courts refuse to honour the excess amount, arguing that it evidences a dispute between the parties. Ukrainian law does not allow the use of out-of-court enforcement if there is a disagreement between the parties over the debt amount.

Recommendations for reform for reform:

As a solution, it would be helpful to develop detailed guidelines and instructions

⁴⁴¹ Law of Ukraine "On Enforcement Proceedings" No. 1404-VIII dated 2 June 2016.

⁴⁴² Rulings of the High Specialized Court of Ukraine for Civil and Criminal Cases dated 24.02.2016 in dispute No. 6-36739cr15.

pursuant to which all scheduled payment (commissions, fees, default interest) stipulated by a commercial contract at arm's length will be automatically added the amount of indebtedness set out in notary writ. Such amendments, however, shall not affect retail and consumer contracts, which shall be subject to additional protection.⁴⁴³

6.3.4 Enforcement by way of taking on legal title

Enforcement by way of taking a title is an out-of-court mechanism to realize a security over shares, corporate rights, movable and immovable property, whereby a legal title to the collateral is transferred for the benefit of a security holder in exchange for the discharge of the security provider's debt. It is often used by the parties in mortgages and pledges because, in practice, it is more beneficial for the creditor to receive the collateral rather than to sell it at an auction at a price which is well below the market price. This mode of enforcement is implemented by an enforcing party through a notary or state registrar only, which is authorized under Ukrainian law to record and register title transfers with the appropriate public registers.

However, such mode of enforcement is allowed only if the parties have contractually agreed so in writing. The parties' consent can be drafted either in the form of a standalone clause in a security agreement or as a separate agreement (i.e. agreement on satisfaction of the creditors' claims). In the absence of such stipulation or a separate agreement, this mode of enforcement is unavailable for an enforcing party.

In general, the whole enforcement procedure is considered complicated. The market participants in their feedback also raised a number of concerns to the effective regulation. We have identified the following problem areas of the procedure:

(a) Corporate right pledge

The new LLC Act lacks provision regulating the out-of-court enforcement of the corporate rights. Thus, there is an uncertainty whether this mode of enforcement will be applicable to pledge over corporate rights. For a more detailed analysis of this issue please refer to Section 3.5.3 above.

(b) Movable pledge

Identified issues:

Another conflicting issue relates to the extent to which the secured debt is discharged upon the out-of-court enforcement carried out by way of taking title over the movable collateral. Under the Law of Ukraine "On Securing Creditors' Claims and Registration of Encumbrances",⁴⁴⁴ if in enforcing a pledge, a pledgee uses the enforcement remedy of taking title over the collateral, the principal obligation shall be discharged in full and cease to exist. Consequently, with a full discharge of the principal obligation, the relevant secured obligation will be also deemed fully discharged and will fall away. The statutory wording seems to be vague and especially detrimental to secured creditors, according to market participants, as it may be construed in a way that the debt will be discharged in full, regardless of the value of the collateral, rather than to be reduced by the actual amount of the collateral.

⁴⁴³ *Supra* note 11, Insolvency Guide, Recommendations 69-86, pages 132-135.

⁴⁴⁴ Article 29 of the Law of Ukraine "On Securing Creditors' Claims and Registration of Encumbrances" No. 2654-XII dated 2 October 1992.

Recommendations for reform:

It is advisable to amend the above statutory provision stipulating that the amount of the outstanding debt shall be discharged (reduced) by the actual value of the secured property determined by an independent valuer.⁴⁴⁵ This would bring movable pledge regulation into line with the amendments to the Mortgage Act which removes such unfavourable conditions for enforcement by creditors.

Furthermore, any enforcement actions taken by a creditor in an out-of-court enforcement may be obstructed by the court's injunctions which suspend the entire enforcement process unless the court's ban is lifted as described in Section 7.1.

(c) Mortgage

Until recent legal amendments enforcement by way of taking title over the mortgaged property faced registration obstacles. A notary or state registrar required the mortgagee to deliver an original title document to the mortgaged property, which was held by the mortgagor. Although the Mortgage Act provides that the mortgage agreement is a sufficient document for the change of title, notaries and state registrars rely on specific regulations on title registration and request additional documentation. Such legal inconsistencies prevent the efficient enforcement of mortgages.

The Law On Resuming of Lending has remedied the mortgage regulation envisaging that the mortgage agreement with a standalone clause on availability of the out-of-court enforcement for the pledgee or the agreement on satisfaction of mortgagee's claims shall be a ground for making an entry on change of title in the Immovable Property Register.

6.3.5 Enforcement by way of public (auction) sale of collateral

Enforcement by way of public sale is commonly used in mortgages and pledges. Ukrainian law makes a distinction between the procedural rules governing a public auction in respect of mortgages and movable pledges. Market participants did not specify any problems with respect to sale of movable assets, whereas a number of concerns were expressed as to sale of mortgaged property. It is important that the main problems addressed by the market participants have been already resolved by the new Law On Resuming of Lending.

Under the Mortgage Act, the initial sale price of collateral may be subject to discounting if a trading session arranged by a bailiff has not resulted in a sale of the mortgaged property. For instance, if there is no purchaser at a trading session, the initial sale price can be reduced for further trading session as follows: first reduction - no less than 80 percent of the initial sale price, second reduction - no less than 70 percent of the initial sale price (in accordance with the last amendments; previously the initial sale price could be reduced to 50 percent). At any session, collateral may be bought by a mortgagee. Until recent legal amendments,⁴⁴⁶ it was questionable whether the statutory discount may be applicable to a mortgagee in the same way as it applies to other bidders. The new Law On Resuming of Lending expressly entitles the mortgagee to purchase the mortgaged property relying on the above discount.

In addition, the Law On Resuming of Lending excludes the statutory provision⁴⁴⁷ allowing the court to terminate the mortgage agreement provided that a mortgagee fails to exercise its right to purchase the mortgage property following three auction trading sessions. We note that the

⁴⁴⁵ Ibid, para.39 (c) page 100.

⁴⁴⁶ Adoption of the Law of Ukraine "On Resuming of Lending".

⁴⁴⁷ Article 49 (3) of the Mortgage Act.

above provision was rather detrimental to the creditors' stance.

6.3.6 Enforcement by way of private sale of collateral

Enforcement by way of a private sale is regularly seen for mortgages and pledges. However, such mode of enforcement is only allowed if the parties have contractually agreed so in writing. The parties' consent must either be drafted in the form of a standalone clause of a security agreement or as a separate agreement. In absence of such stipulation or separate agreement, this mode of enforcement is unavailable for the enforcing party.

It is common practice that while the mortgagee initiates an enforcement of the mortgage by way of private sale, for the purpose of registration of the change of title, a notary or state registrars require a mortgagee to deliver an original title document to the mortgage property, which is held by the mortgagor. Although the Mortgage Act sets out that the mortgage agreement is a sufficient document for the change of title, notaries and state registrars rely on specific regulations on title registration and request additional documentation. Such legal inconsistencies prevent the efficient enforcement of mortgages. To cure that problem, the Law "On Resuming Lending" introduced certain amendments into the Notary Act according to which no original title document to the mortgaged property is required for registration of the change of title. It remains to be seen how the above amendments will enhance the creditor's protection and simplify the enforcement procedure.

Problems and obstructions related to the injunction over collateral which are described in Section 7.1 below, prevent the mortgagee from enforcing a security by way of private sale in the same way.

6.3.7 Enforcement by way of security assignment

Enforcement by way of security assignment is available only under a receivables pledge. Ukrainian law sets out that receivables and other rights being subject to a security may be enforced by way of assignment. In order for receivables to be validly transferred by way of assignment, a pledgee must serve a default notice on a pledgor, the Movable Proper Register and comply with a 30-day notice period before enforcing.

6.3.8 Enforcement of the suretyship

Enforcement of suretyship may be carried out through the court or arbitration proceedings. Below are some inconsistencies which relate to the enforcement of suretyship in Ukraine.

Under Ukrainian Law, a suretyship is supposed to be a type of security securing the underlying obligation, meaning that any suretyship has an ancillary nature. Until recent legal amendments, termination of the underlying obligation by reason of liquidation of a borrower automatically resulted in termination of the corresponding suretyship given by a surety provider (other than borrower). Thus, a liquidation of the borrower could be used as a loophole allowing the surety provider not to honour its payment obligations under the suretyship agreement. After adoption of the Law On Resuming of Lending the liquidation of a borrower will not lead to termination of the suretyship, provided that a creditor brings legal action against a surety provider prior to registration of the borrower's liquidation in the Company Register.⁴⁴⁸

Furthermore, previously the Ukrainian law provided for that any change of the underlying obligation which increases the scope of the surety's liability results in the termination of the

⁴⁴⁸ Unified State Register of Legal Entities, Individual Entrepreneurs and Public Organizations of Ukraine.

suretyship unless the surety provider has approved such changes. Such construction of the rule was detrimental to the creditor as an increase of the underlying obligation terminated the suretyship completely, thus, a security provider was no longer liable even in the initial amount of the suretyship. The Law On Resuming of Lending amended the above provision stipulating that the initial scope of suretyship shall survive even though an increase of the underlying obligation occurs without the consent of such surety provider.

6.4 Exemption for enforcement requirements for financial collateral

As noted in Section 11.1 below, the Ukrainian regulation on financial collateral is in a state of development. There is no carve-out envisaged by the effective Ukrainian law in respect of the enforcement of financial collateral. A collateral taker has no enforcement benefits. Accordingly, a collateral taker would be required to give a 30-day prior default notice to a collateral poster before commencement of enforcement. Additionally, such notice must be registered in the Movable Property Register.

For more information on existing regulatory problems relating to financial collateral please refer to Section 3.9 above.

6.5 Enforcement of bank guarantee

The NBU emphasised that the bank guarantee is quite an uncommon instrument in the Ukrainian banking space. In the non-banking space, this instrument is not used due to legal requirements set out for a guarantor, which is required to be a regulated entity (a bank or a financial institution). Market participants did not specify any complications with respect to the enforcement of bank guarantees.

6.6 Enforcement costs

Generally, the costs of enforcement proceedings (court duties, notary fees and advance for enforcement process) are payable by an enforcing creditor prior to taking an enforcement action. In law, however, all such enforcement costs incurred by an enforcing creditor may be reimbursed under Ukrainian law at the expense of the collateral.

Where a loan is secured by a security package involving multiple security instruments, a creditor would be required to bring a separate claim against each borrower, pledgor, mortgagor, surety provider, etc. The market participant emphasizes that the above requirement is rather unfavourable for the creditor and increases the court expenses to be incurred by the creditor. We understand that the above shortcoming impacts the simplicity and cost of the enforcement proceeding. However, it is quite hard to find a solution here that will keep the balance between the interests of both creditors and debtors.

If enforcement actions are taken through the state enforcement agency (bailiff department), there is another bailiff fee to be payable to that department (including fees to valuers of assets, auctioneers) for carrying out such proceedings. The bailiff fees are 10 percent, calculated by reference to the amount of proceeds of the enforcement and debited by the bailiff upon its completion. In addition, enforcement may attract the fees of a trader which takes 5 percent of the proceeds of the enforcement.

Identified issues:

Ukrainian regulation lacks transparent rules and procedures on the allocation of funds payable in advance by the enforcing creditors to the bank accounts of the state enforcement agency. As such, there are a lot of instances where enforcement professionals are not paid by the state enforcement agency in time. For example, this often happens with fees which are due to the professional valuers for the preparation of the valuation report in respect of collateral. This, in turn, delays the whole process of rendering services and realizing the collateral.

Recommendations for reform:

As a solution, we advise introducing clear guidelines and procedures, including time limits, for the state enforcement agency on payments and increasing the liability of the agency for delayed

payments.⁴⁴⁹

7. PROCEDURAL APPEAL

7.1 Appeal in judicial enforcement of secured claims

A security provider has the right to appeal or challenge the enforcement process under Ukrainian law. This right cannot be waived in a contract. According to market participants, it is quite common that a debtor may appeal the underlying obligation at any time even after an enforcing party has called an event of default and commenced the enforcement. This usually suspends the enforcement proceeding, initiated by a creditor until the resolution of a debtor's claim by court, which in turn may delay the enforcement at least for six months.

Alternatively, a debtor often asks a court for the power to obtain an independent valuation in respect of the collateral with a view to obstructing an enforcement process. Under Ukrainian procedural law a valuer shall be appointed by mutual consent of the parties. If there is a disagreement between the parties, it is the court which will be able to appoint a valuer which is typically a public valuer. It is worth mentioning that before October 2017, an independent valuation could be conducted exclusively by the public valuers entered into the State Register of Certified Judicial Experts. However, the law was amended and with effect from October 2017, a court is allowed to appoint also a private valuer. Such amendments are helpful for the parties because as a matter of practice public valuers are overburdened with numerous valuation requests.

Moreover, Ukrainian law does not set a timeframe for conducting a valuation process. As market participants highlight, an average valuation procedure takes from 6 up to 18 months. Further, a borrower may then appeal the valuation report itself on formal grounds, which, in turn, delivers another 6-18 months of delay in the enforcement of a debt.

To sum up, market participants stress that debtors routinely use the following types of appeal for delaying the enforcement proceedings: (i) challenging the procedure of the debtor's notification; (ii) challenging the outcomes of the public auction process; (iii) challenging the procedural rulings of the state enforcement officer (for example, ruling on commencement of the state enforcement procedure, ruling on making inventory of the property attached, rulings on public auction).

It is highly likely that a non-performing borrower or a security provider will bring the above claim against a creditor. The NBU estimates the chances of such claims being brought to be in the range of 70 to 80 percent of NPLs. It would also be fair to say that in the majority of cases such claims are rejected by courts, but the proceedings take time and increase the efforts and expense spent by the creditors to resolve them.

In order to make the enforcement procedure more efficient, the Ukrainian procedural law was amended in December 2017 with a provision allowing the court to impose a fine on the party abusing its procedural rights in order to delay the dispute resolution. The amount of such fine may vary from UAH 19,210 (approximately USD 540) to UAH 96,050 (approximately USD 3,435) in case of repeated violation.⁴⁵⁰ It remains to be seen how courts will implement such measures and whether it will have an effect on bad faith debtors.

⁴⁴⁹ *Supra* note 11, Insolvency Guide, paras.76-78 page 63.

⁴⁵⁰ Article 135 of the Commercial Procedural Code No. 1798-XII dated 6 November 1991 as amended from time to time.

7.2 Appeal in out-of-court enforcement of secured claims

An out-of-court enforcement procedure which is carried out, for example, through a notary (enforcement by way of a notary writ, registration of title or private sale made by a notary) may be appealed by a security provider in courts. The legal grounds for an appeal claim may range from substantive matters (for example, a dispute on whether or not there are existing liabilities) to procedural pitfalls (disputes on creditor's failure to give required notices, comply with statutory periods, etc.).

Identified issues:

In Ukrainian market practice, it is quite common that out-of-court enforcement proceedings appear to be ineffective because a debtor or a security provider appeals almost every enforcement step taken by a creditor. Debtors abuse their appeal rights with a view to delaying and frustrating the whole process. In tandem with the main appeal claim on merits (existence of debt, etc.), a debtor usually seeks to obtain an injunction to stop the enforcement taking place at all. Such strategy may be rather effective given the fact that a debtor may additionally bring appeal and cassation claims, which significantly increase the creditor's time spent on enforcement.

Recommendations for reform:

We note that the right to take legal action for protection of violated rights is a fundamental right of every person that cannot be restricted.⁴⁵¹ However, it is our recommendation to place certain statutory limitations on automatic appeal to reduce the scope for unjustified delays and to ensure appeals are heard by courts promptly and in an organised fashion. For instance, the German approach may be followed where matters with a value below a certain value threshold (e.g. in Germany less than 600 EUR) need court permission to be appealed. Furthermore, it may be helpful to envisage that if the requirement of fundamental significance of a matter is not met the court should declare the inadmissibility of the appeal. The appeal should be also declared inadmissible when it does not have a "reasonable chance" of being upheld.

In addition to the abovementioned procedural rule which allows the court to impose a fine on the party abusing its procedural rights, the existing problem with protracted court disputes may be partially resolved if courts would meet the statutory timeframes for consideration of the debtors' appeals.⁴⁵² However, in practice, it is not always feasible due to the caseload of judges.

7.3 Appeal in insolvency and winding-up proceedings

After the commencement of insolvency proceedings, any claim against a debtor must be reviewed by the commercial court which handles the particular insolvency claim. Tax claims may be reviewed by an administrative court. Ukrainian law appears to be developed in this context. To avoid the insolvency process being obstructed by external claims, the regulation limits the types of appeal decisions to be petitioned, on the one hand, and the list of claimants entitled to bring a claim on the other hand.

Specifically, the Insolvency Act⁴⁵³ specifies the exhaustive list of court decisions adopted in insolvency proceedings which can be appealed or petitioned to higher courts. In particular, the cassation court may only challenge/appeal decisions made in respect of the following: (i) the commencement of insolvency proceedings, (ii) setting aside debtor's agreements, (iii) consideration of creditors' monetary claims, (iv) dismissal (removal, termination of powers) of the insolvency practitioner, (v) application of further steps of insolvency proceedings, (vi) approval of the solvency renewal plan, (vii) termination of insolvency proceedings, (viii) declaring the debtor insolvent and (ix)

⁴⁵¹ Ibid, Section D pages 205-206.

⁴⁵² Ibid, Section D Recommendation 138 page 207. "Time limits for appeal should be in accordance with generally applicable law, but in insolvency need to be shorter than otherwise to avoid interrupting insolvency proceedings."

⁴⁵³ Law of Ukraine "On Restoring Debtor's Solvency or Declaring It Insolvent" No. 2343-XII dated 14 May 1992.

commencement of liquidation proceedings. No other decision may be challenged by the cassation court.

Additionally, the Supreme Court of Ukraine narrowed down the list of persons which can initiate an appeal in respect of decisions relating to insolvency. The Supreme Court of Ukraine has stated that only parties involved in the insolvency proceedings may challenge the decisions of the commercial court in respect of the insolvency proceedings to avoid the insolvency proceedings being interrupted by other parties.⁴⁵⁴

The judicial reform contemplates on creating a specialist court for insolvency within the Commercial Court of Cassation, being part of the new Supreme Court of Ukraine. Such specialist court would handle all cassation claims in insolvency disputes.

8. IMPACT OF INSOLVENCY AND WINDING-UP PROCEEDING ON ENFORCEMENT

In essence, the Insolvency Act offers an exit mechanism (liquidation), a rehabilitation mechanism and a final debt recovery mechanism for creditors. In each of these scenarios, a separate legal regime will govern the secured claims of creditors and the security documentation.

8.1 Exemptions to security enforcement from insolvency

A secured creditor may not initiate insolvency proceedings, except if: (i) a secured creditor considers that its claims are not secured in full by collateral, or (ii) the collateral has been lost or appears to be insufficient for debt recovery. In those cases, a secured creditor may file a petition for insolvency proceedings and participate in the capacity of a general creditor with respect to the unsecured part of its claims.

The Insolvency Act is intended to afford maximum protection to a secured creditor. In theory, there are a number of rules enhancing the position of a secured creditor. Firstly, the collateral shall not be included into the liquidation estate of a debtor and covers security claims only. Secondly, the sale of collateral shall be made by an insolvency practitioner with the consent of the secured creditors. If, however, the secured creditor does not give its consent to the sale by the insolvency practitioner, such approval may be granted by court. Market participants specifically note that courts often grant approvals invoked by the insolvency practitioner without taking into account creditors' arguments that the proposed sale price is well below the fair market price. Thirdly, the secured creditors are granted a right to veto the reorganization plan or a settlement agreement.

Loss of control over collateral:

In practice, a secured creditor often loses its control over the secured property during insolvency proceedings. It could be the case that collateral is sold at a price which is well below the market price⁴⁵⁵ or the selling procedure takes longer time than initially expected.

Recommendations for reform:

It seems that the problem described above may be resolved by strengthening the secured creditors' control over their collateral and giving additional protection to the secured creditors in the process of the sale of secured assets under the Insolvency Act. It may be helpful to amend the Insolvency Act with a provision allowing the secured creditor which does not agree with the sale price of the collateral suggested by the insolvency practitioner to arrange an independent valuation of the property. In that case the insolvency practitioner will be obliged to use the value of the property determined in the valuation report as the sale price provided the valuation meets criteria established

⁴⁵⁴ Ruling of the High Commercial Court of Ukraine dated 11 May 2016 case No. 927/84/16.

⁴⁵⁵ Article 66 of the Law of Ukraine "On Restoring Debtor's Solvency or Declaring It Insolvent" No. 2343-XII dated 14 May 1992.

by the law. Should the secured creditor fail to provide its consent for the sale and arrange an independent valuation within two months, the court should be entitled to approve the sale price. In this regard, the Bankruptcy Code which is pending, allows the secured creditor to request a change of the sales conditions proposed by an insolvency practitioner. However, if there is a disagreement between the insolvency practitioner and the secured creditor, it is the court which will decide and approve final sales conditions

In addition, it is suggested to increase the liability of the independent valuer in order to improve the quality of the valuation report prepared by him/her since in practice, valuers may be subject only to disciplinary measures (i.e. a warning) or to cancellation of the certificate.⁴⁵⁶

Indeed, the Appraisal Act contains no specific provision on the financial liability of valuers. It lacks legal guidance on whether or not valuers might be held liable by non-contractual third party which relies on the valuation report in case of poor quality of valuation services. Though, the Civil Code gives right to bring claim for damages under the general "expert" liability regulation, the Appraisal Act does not set out the scope of compensation and type of damages to be claimed, for example, whether or not the loss of profit and consequential damages in addition to direct losses can be claimed. It would be helpful to address the above issues in the Appraisal Act and strengthen its liability component to include financial liability. Despite the statutory division of public and private valuers, we are of opinion that responsibility and code of conduct must be the same in order not to create legal disadvantages or incentivise counterparties to select those who have less burdensome liability regime and code of conduct.

8.2 Moratorium / Automatic stay

The Insolvency Act affords a debtor moratorium protection that prevents creditors from taking enforcement actions against the debtor and the secured assets. A moratorium can be imposed either as a part of a pre-trial rehabilitation of the debtor (Section 8.3) or of a general insolvency proceedings (Section 8.4). In case of pre-trial rehabilitation, a moratorium will be imposed automatically for 12 months upon approval of the rehabilitation plan by all secured creditors and the general meeting of the borrower's creditors.

Identified issues:

In the event of insolvency proceedings, a moratorium is imposed once the insolvency proceedings are commenced (the date of the court decision on the commencement of insolvency)⁴⁵⁷ and continues to be in full force until the termination date (liquidation or other insolvency-related proceedings)⁴⁵⁸. It is worth noting that such type of moratorium does not have a statutory timeframe and may cover the duration of the whole insolvency proceedings. Hence, it may delay the enforcement process for several years. An unlimited duration of such moratorium is likely to result in creditors being incapable of protecting their rights and enforcing their claims effectively. This increases the unpredictability and uncertainty of the enforcement proceedings.

It is important to emphasize that the duration of moratorium has been significantly limited under the new draft Bankruptcy Code which is pending and awaiting the presidential signature.

Recommendations for reform:

It would be helpful for the relevant legislation to set out more definitive moratorium timeframes, which may improve not only the protection of the creditors' rights, but also assist with speeding-up the general insolvency proceedings.⁴⁵⁹

Once it becomes effective the Bankruptcy Code will allow automatic termination of the moratorium

⁴⁵⁶ *Supra* note 11, Insolvency Guide para. 46 page 177.

⁴⁵⁷ Paragraph 2 of Article 19 of the Insolvency Act.

⁴⁵⁸ Paragraph 7 of Article 19 of the Insolvency Act.

⁴⁵⁹ *Supra* note 11, Insolvency Guide, para. 26 page 83.

upon the expiration of 170 calendar days from the date of commencement of asset administration, unless there was a decision of the commercial court on recognition of the debtor as bankrupt or a decision on introduction of the financial rehabilitation. This should significantly address the issue of the duration of moratorium referred to above.

8.3 Pre-insolvency proceedings - pre-trial rehabilitation (sanation)

Where a debtor is at a risk of financial distress, but is worth more as a going concern than a liquidated enterprise, a majority of creditors can approve financial rehabilitation (pre-trial sanation) proceedings prior to the commencement of insolvency by the court. The Insolvency Act sets out voting requirements for the approval of the pre-trial rehabilitation. The first requirement is the written consent of the debtor and the creditors having in aggregate more than 50 percent of the claims on the debtor's debts. Second, all secured creditors and the general meeting of creditors must approve a rehabilitation plan. Further, a debtor or a creditors' representative shall file a motion to the court, seeking final approval of the rehabilitation plan. In terms of timing, the whole rehabilitation procedure must not exceed 12 months and creditors may not file an insolvency petition before the court or seek to enforce their security until the termination of the rehabilitation.

Identified issues:

The Insolvency Act gives parties full discretion to frame the terms and conditions of the rehabilitation plan. In practice, however, such flexibility and the applicable moratorium protection may give a debtor the ability to frustrate and delay the enforcement procedure. It is important to emphasize that protection of the secured creditor's rights inside rehabilitation has been significantly increased under the new Bankruptcy Code which is pending and awaiting the presidential signature.

Recommendations for reform:

It would make sense to amend the Insolvency Act with a provision allowing the majority of creditors to terminate the pre-trial rehabilitation and, consequently, moratorium protection, in case of failure of the distressed debtor to solve its financial difficulties within three months or any other term agreed by the creditors in the rehabilitation plan. The suggested amendments have been addressed in the Bankruptcy Code which is pending. New rules set out that pre-trial rehabilitation may be terminated by a court decision upon a creditor's request, provided that there are grounds to believe that the rehabilitation plan will be not achieved or fulfilled.

It would be also reasonable to include provisions enabling the secured creditor to file a motion to court seeking lifting the moratorium on enforcement of the secured property provided that such secured property is not used in course of the debtor's rehabilitation.⁴⁶⁰ This recommendation is covered in the Bankruptcy Code and would enable the secured creditor to enforce its security outside of the bankruptcy framework.

8.4 Insolvency proceedings

Insolvency is a generic term under Ukrainian law denoting a three-phased process where the asset administration and liquidation are mandatory phases and solvency renewal is an optional one depending on the specific debtor's performance.

Insolvency proceedings appear to be long and cost-intensive processes for creditors in Ukraine. Although there are few sources of reliable statistic data, *Doing Business*⁴⁶¹ shows that the average duration of the whole insolvency proceedings equals 2.9 years, whereas the cost of average proceedings takes 42 percent of the debtor's property and the average recovery rate for a creditor is 7.5 cents on a dollar.

⁴⁶⁰ EBRD, Core Principles for an Insolvency Law Regime (2004), Art. 4 page 1.

⁴⁶¹ <http://www.doingbusiness.org/~media/wbg/doingbusiness/documents/profiles/country/ukr.pdf>.

From a procedural standpoint, insolvency proceedings are initiated by the Ukrainian commercial courts at the location of the debtor. The petition on insolvency proceedings may be filed either by a debtor itself, or by creditors holding incontestable⁴⁶² claims against such debtor provided that (i) the amount of such claims exceeds 300 minimal monthly salaries (UAH 900,000 (approximately EUR 29,000)) and (ii) the debt remained unpaid for three months after the due date.

The court must decide on the date of the commencement of insolvency proceedings, giving a 30-day period where any creditor (other than a secured creditor) must file its claims to a debtor joining the insolvency proceedings. If a creditor fails to do so, its claims are supposed to be ranked at the bottom of insolvency priority. Secured creditors' claims, by contrast, are to be joined to the insolvency automatically and ranked ahead of insolvency priority. Secured creditors do not participate in a creditors' committee and are blocked from voting. Upon commencement of the insolvency proceedings, a debtor is under moratorium protection.

8.4.1 Asset administration

Asset administration is an early phase of the insolvency procedure intended to preserve the debtor's assets. It is implemented automatically with the commencement of insolvency and goes in tandem with a moratorium protection. Under the Insolvency Act, the asset administration takes 115 days and may be subject to further extension by a court for additional two months.

An assets administrator is a licensed insolvency practitioner appointed by the court to investigate the assets of a debtor, supervise the management of the company and prevent it from disposing the company's assets. Generally, an insolvency practitioner may also challenge antecedent transactions (e.g. disclaim contract, onerous property, set aside transactions at an undervalue). However, to give effect to the above powers, an insolvency practitioner must seek a court ruling.

Aside from their preservation functions, courts may confer on insolvency practitioners rescue powers. In that case an insolvency practitioner assumes the control over the whole business of a company and replaces the company's management.

In the context of antecedent transactions, a security instrument may be set aside by the court pursuant to the application of an insolvency practitioner, if the security is granted by a debtor within a one-year period prior to the onset of insolvency. For example, this would be the case if a company giving the security received considerably less consideration, and as such, the transaction was at an undervalue. Security may also be challenged on other grounds relating to the insolvency (such as preferential treatment).

Identified issues:

Under the Insolvency Act, an unsecured creditor, whose transaction was invalidated by the court, may receive repayment of its debt at first rank inside the liquidation procedure. However, lack of clarity and unclear drafting of the statutory provisions may lead to distorted results for the ranking of creditors. For example, if a shareholder has advanced an unsecured loan to a company, which would normally qualify for the fourth rank of priority, and such shareholder's loan is invalidated by a court, then such shareholder's claim would be ranked in the first ranking⁴⁶³ instead of the fourth ranking.

Another example, if the secured loan turns to an unsecured debt as a result of the invalidation

⁴⁶² Claims or debt are supposed to be incontestable under Ukrainian law if they are evidenced by the binding court decision and state enforcement proceeding are commenced in respect of such debt.

⁴⁶³ Article 20 (3) of the Insolvency Act.

of the corresponding security instrument by the court, then, the unsecured debt will be ranked in the first priority.⁴⁶⁴ It is unclear from the Insolvency Act whether such creditor will be treated as an unsecured creditor which is entitled to vote and participate in the meeting of creditors.

Recommendations for reform:

It would be important for the Insolvency Act to set out that the rank of unsecured shareholder loan and/or related party loan shall not be moved ahead from 4th to 1st priority ranking in case of invalidation of transaction. We note that the Bankruptcy Code removes the above unfavourable statutory provision on subordination of debt arising under so invalidated transactions.

8.4.2 Solvency renewal administration (restructuring /investor step-in)

As an optional phase of the insolvency procedure, the solvency renewal administration applies in circumstances where there is a viable business which expects to deliver more of a return to creditors in comparison to a liquidation scenario. It is implemented by the court in accordance with a request of the creditors' committee. Under the Insolvency Act, the renewal administration takes at least six months and may be subject to a further extension up to 12 months.

A renewal administrator is a licensed insolvency practitioner appointed by court to act as a manager of a debtor and prepare a renewal plan. The renewal plan requires approvals from all secured creditors, the creditors' committee and the court.

According to market participants, renewal administration is an uncommon method of insolvency procedure and is rarely used because at the point of insolvency there are not many assets in the insolvent entity and the business is no longer viable.

8.4.3 Liquidation

Liquidation is a remedy of last resort which signals the end of a debtor company. It is implemented by a court order upon the completion of either the assets administration, or the optional phase – a renewal administration.

Under the Insolvency Act, liquidation proceedings shall take 12 months from the day of its commencement. However, in practice, the liquidation proceeding may take much more time.

An insolvency practitioner (known as a *liquidator*) appointed by court assumes the management powers to run a debtor company and replaces all governing bodies of a company. Furthermore, an insolvency practitioner has a wide range of authorities conferred under the law with a view to maximising the assets available for distribution to the creditors, such as powers to investigate and collect assets of a debtor (known as a *liquidation estate*), challenge antecedent transactions (e.g. disclaim contract, onerous property, set aside transactions at an undervalue), dispose assets to distribute the proceeds to the creditors in accordance with the statutory order of priority below.

To maximise sale proceeds, the debtor's assets must normally be realised via a public auction. Private sale may be also applied in a limited number of insolvency cases, where the assets are not material or the public auction does not result in an actual sale. Furthermore, the proceeds from the sale of such collateral must be distributed by an insolvency practitioner to the secured creditors.

⁴⁶⁴ Article 20 (3) of the Insolvency Act.

Identified issues:

As highlighted above, the sale of collateral, subject to the liquidation estate, requires consent from the secured creditors. However, Ukrainian law lacks requirements as to the form and content of the request prepared by an insolvency practitioner with a view to seeking consent from a creditor. As a part of a solution, market participants proposed that clear-cut requirements should be set out as to the format of the request of the insolvency practitioner. Specifically, such request must, among other matters, contain: the value of the secured property, its description, and the expenses on its realisation.

Aside from that, market participants specify that the procedure for sale of the secured property set out as part of the insolvency is not adequate. The haircuts which are to be applicable during the trading sessions of the public auction allow a decrease of the initial price down to zero, which is detrimental to the secured creditor. In particular, the Insolvency Act provides that property may be offered to auction (sale) in three sessions. Within the first trading session the sale must be made at 100 percent value, during the second trading session (in English – "first repeated trading session", in Ukrainian – "**Povtorny Auktsion**") insolvency practitioner applies a haircut set in form of a collar (from 80 percent up to 50 percent of the price of the first trading session). At the third trading session (in English – "second repeated trading session", in Ukrainian – "**Drugyi Povtorny Auktsion**"), an insolvency practitioner may apply the biggest haircut starting from 64 percent of the price of the first trading session and literally lowering the price down to 1 Ukrainian hryvnia. This unfavourable regulation on haircuts is supported by the High Commercial Court of Ukraine which justifies the discount to one (1) Ukrainian hryvnia. In tandem with another provision of the Insolvency Act, which sets forth that the remaining amount of claim (being discounted by insolvency practitioner) is considered satisfied upon sale by virtue of law, a secured creditor is at a risk of being unable to get even a modest recovery upon security enforcement.

Recommendations for reform:

To improve the auction procedure and maximise the recovered funds, it is worth envisaging the following principles in the Insolvency Act:

- the sale of assets of an insolvent entity must be conducted only through an electronic trading venue;
- a secured creditor must be entitled to approve the haircuts applicable to the initial price for the first repeated and second repeated trading sessions. For unsecured property, such haircut requires the approval of a committee of creditors;⁴⁶⁵
- if the secured property is not sold upon the first repeated session, a secured creditor may acquire it on its balance at the initial price for the first repeated trading session (80 percent).

the consideration must be capable of being netted against the debt owed to the secured creditor. The same netting arrangements are to be applied to settlement in the event that a secured creditor has won the public auction sale, provided that the expenses of preservation and the sale process of the assets have been already reimbursed.

We note that the above recommendations have been substantially addressed in the Bankruptcy Code which is pending.

⁴⁶⁵ *Supra* note 11, Insolvency Guide, paras.79-82 pages 106-107.

Integral property complex disposal: whole vs. piecemeal sale

In addition, the existing regulation allowing discounting of the sale price up to one (1) Ukrainian hryvnia also affects the disposal of an integral property complex of an insolvent company. Specifically, the Insolvency Act requires an insolvency practitioner to dispose of the assets of an insolvent entity as a business unit to maximise the sale proceeds. Only when an insolvency practitioner fails to make such a sale, may the whole business unit be divided in specific assets to be disposed of separately. On the one hand, it is not entirely clear under Ukrainian law how many times the assets must be marketed as a business unit before the insolvency practitioner may undertake the sale of assets by way of separate bids. One group of court precedents asserts that assets must be offered three times as a business unit before a split sale (namely, the first repeated and the second repeated auction sessions), whereas another ruling supports a more creditor friendly approach, requiring one auction session. On the other hand, where the approach requiring three sessions is used, the business unit will be never split into separate assets since haircuts allow buying the whole complex at an undervalue.

Recommendations for reform:

The Bankruptcy Code does not envisage the procedure for splitting of the business unit into separate assets for sale. We would suggest amending Article 44 of the Insolvency Act to envisage a separate legal treatment for handling the sale of a business unit as follows:

- three sessions to be conducted until the split of business unit in separate assets;
- discounted initial price shall be applied for the first and second repeated sessions; however, the application of haircuts is not permissible;

upon an unsuccessful second repeated session, the business unit is to be split into assets to which the abovementioned general procedure is applied.⁴⁶⁶

8.5 Winding-up proceedings

A debtor company may undergo voluntary liquidation (winding-up) or reorganisation if its shareholders pass a winding-up resolution. Such resolution appoints a liquidation commission, which may be composed of the company's employees, rather than of insolvency practitioners. The liquidation commission will take control over the collection of assets for the distribution to creditors and generally run the company's business. Upon commencement of such proceedings, creditors (including secured ones) are required to submit the details and amounts of their claims to the company within the deadlines set out in the winding-up resolution, subject to a maximum length of six months. The company must also notify the Company Register about the passing of the winding-up resolution. The liquidation commission will be in charge of selling all the debtor's assets, including any secured assets and distributing the proceeds to creditors.

From the perspective of the treatment of the secured creditors' claims, the secured creditors must normally be paid out of the collateral or the proceeds of the realisation of the secured assets. The competing secured claims are to be satisfied in accordance with ranking priorities on a pro rata basis. If secured claims compete with other claims being ranked in first priority (e.g. personal injury claims) they would be satisfied on a pro rata basis. Please see the winding-up waterfall in Section 4.7 above.

If, as a result of the winding-up procedure, it appears that the company is unable to satisfy all claims, the winding-up proceedings will be converted into insolvency proceedings with the consequent application of the insolvency-related priority. For more details on insolvency please refer to Section 8.4 above.

⁴⁶⁶ *Supra* note 11, Insolvency Guide, Recommendation 57 page 112.

8.6 Financial collateral: close-out netting and treatment in insolvency procedure

As noted in Section 3.9 above, the Ukrainian regulation on financial collateral is in a state of development. There are no laws or regulations in Ukraine explicitly stating that close-out netting would be unenforceable. However, Ukrainian law does not set out a clear position on this issue and a new law is needed to govern financial collateral arrangements and exemptions.

Without specific amendments to Ukrainian law, a Ukrainian court will not enforce close-out netting arrangements in the course of insolvency proceedings. Consequently, banks and other professional market participants will not be able to use derivatives, repo transaction or other capital market instruments to rise capital efficiency. Draft Law on Capital Markets and Draft Law on Capital Markets and Regulated Markets envisaging carve-outs for close-out netting from moratorium, temporary administration and other insolvency proceedings may be seen as a solution of the above problem.

For more information on existing legislative initiatives relating to financial collateral please refer to Section 11.1 below.

8.7 Brief analysis of novelties contemplated by the Bankruptcy Code

On 18 October 2018 the Ukrainian Parliament adopted the Bankruptcy Code⁴⁶⁷ aimed at improving the efficiency of the existing bankruptcy procedure and the level of protection of creditors' rights. It should be noted that the Bankruptcy Code was developed by the Working Group of the Ministry of Justice of Ukraine jointly with experts from the World Bank and was further approved by the International Monetary Fund. However, the draft has not yet come into effect and is still subject to Presidential decision. While the law awaits the relevant approval, its final text is not available at the date of the report on the Parliament website.

The available Bankruptcy Code is a consolidated act which includes four books: (i) general part; (ii) insolvency practitioner; (iii) bankruptcy of legal entities; (iv) restoration of solvency of an individual. Upon its entry into force the Bankruptcy Code will override other existing laws on matters pertaining to insolvency, namely the Insolvency Act.

The Bankruptcy Code introduces the following critical improvements to the current bankruptcy regulation:

- introduction of new legal concept of personal bankruptcy in respect of individuals;
- limitation of the duration of asset administration proceedings up to 170 calendar days;
- disposal of debtor's property on a competitive basis through an online e-auction only;
- granting insolvency practitioners access to the public databases and registers with information on the debtors;
- granting insolvency practitioner with association right to create the self-regulatory organization of such practitioners;
- cancellation of the moratorium:
 - (1) in the course of pre-trial rehabilitation the secured creditor may request the court to terminate a moratorium on satisfaction of its claims, provided that collateral: (i) is not used for the procedure of the debtor's pre-trial rehabilitation; (ii) is a short-life product or a perishable good;

⁴⁶⁷ Draft Code of Ukraine on Bankruptcy Procedure No. 8060, registered in the Parliament on 26 February 2018.

- (2) moratorium protection shall automatically expire upon 170 calendar days from the date of commencement of asset administration, unless court adopts decision on debtor's bankruptcy or on introduction of the rehabilitation proceedings;
- invalidation of transactions upon the debtor's insolvency:
 - (1) term for disclaiming transaction as invalid was increased from one year up to three years prior to onset of the insolvency;
 - (2) secured creditors are allowed to file a motion to court seeking invalidation of the debtor's transaction; and
 - (3) introduction of additional grounds for invalidation of transaction: (i) the debtor has entered into the agreement with the interested persons (related persons, parent companies, guarantors, relatives); and (ii) the debtor has gifted an asset/ assets;
- removal of a statutory provision envisaging unfair subordination of debt arising under invalidated transactions as described in more details in Section 8.4.1 above (Article 20 of the Law of Ukraine "On Restoring Debtor's Solvency or Declaring It Insolvent").
- the insolvency proceedings may be initiated by the secured creditors;
- the creditor's committee shall be entitled to coordinate the terms of sale of assets (composition of property assets, initial price, bidding steps, text of the publication, etc.);
- the creditor shall participate in selection of the insolvency practitioner who shall be obliged to disclose the information on the debtor's financial standing and the progress of the enforcement proceeding;
- the amicable agreement and the solvency renewal administration shall be merged into a single procedure.

9. FINANCIAL (CONSENSUAL) RESTRUCTURING AND OTHER WORK-OUTS

The Restructuring Act⁴⁶⁸ appears to be a temporary measure⁴⁶⁹ to overcome a huge volume of NPLs in Ukraine. The management of a debtor company (other than a bank or a credit institution) may voluntarily propose and promulgate an out-of-court restructuring procedure. The debtor company may restructure outstanding exposures if it involves debt owed by the debtor to at least one bank or other financial institution such as a leasing or factoring company. The Restructuring Act allows not only financial institutions, but also trade and commercial creditors to join the restructuring with their commercial debts. The contemplated work-outs are intended to be a fast-track restructuring tool for viable business models. The Restructuring Act sets out certain tax breaks meaning that the tax liability of distressed companies may be restricted or even written off which is a considerable benefit. At the same time, it is anticipated that consensual work-outs will successfully operate in Ukraine. So far, more than twenty debtors' petitions for consensual restructuring have been considered under this Act.

9.1 Standstill

The Restructuring Act provides for a standstill agreement. The standstill agreement arranges the implementation of a new restructuring strategy being commonly focused on the business plan for a specific asset, individual tasks for the debtor/creditor along with a timetable, detailed cash flow and budget, cash sweep arrangements, bank account limitations, reporting requirements and restrictions on disposal imposed on a debtor. The Restructuring Act specifies that the standstill agreement may

⁴⁶⁸ The Law of Ukraine "On Financial Restructuring" No. 1414-VII dated 14 June 2016.

⁴⁶⁹ The Restructuring Act has come into force on 19 October 2016 and is effective until 16 October 2019.

impose a liability on non-compliant parties for breach. It remains to be seen how this instrument will work in practice.

9.2 Other arrangements

9.2.1 Moratorium protection

A debtor company can have an advantage of a moratorium protection that prevents creditors from taking any enforcement actions against the debtor company or its assets. These also include a prohibition on the satisfaction of creditors' claims, the entry into pledge or mortgage agreements (other than for refinancing purposes), making any set-off and offsetting arrangement towards any claim, and the selling or disposal of any non-charged debtor's fixed assets available at the date of commencement of the restructuring procedure. Ultimately a moratorium is tied to the statutory timeframe of the financial restructuring which is 90 calendar days from the posting date, but can be extended up to 180 days. It is worth highlighting that any claims of the debtor's related parties are automatically captured in the operation of a moratorium and are not capable of being discharged under the Restructuring Act.

9.2.2 Restructuring Plan

The outcomes of financial restructuring proceedings are typically documented in the Restructuring Plan that requires the approval of all participating creditors. However, if there is any dissenting creditor, then such plan is allowed to be pre-approved by more than two-thirds (by value of claims) of the majority of participating creditors with a subsequent final approval by the arbitration to which such plan is to be referred for final ratification. If approved, the Restructuring Plan is generally binding on all participating creditors. However, certain reserved matters (explicitly envisaged by the Restructuring Act) are not allowed to be imposed on a creditor without its express consent. Such matters, *inter alia*, include: a provision of additional financings to the borrower, forgiveness of the secured debt, etc.

Finally, another component of consensual restructuring is the settlement of any contentious matter of the restructuring by means of arbitration. However, disputes over immovable property are not capable of being resolved by arbitration under Ukrainian law due to arbitrability limitations under the Arbitration Act. With that in mind, the dispute settlement of consensual restructurings and work-outs, involving NPLs backed by mortgages, may be obstructed. It remains to be seen to what extent such limitations on arbitral competence will be detrimental to the restructuring of NPLs backed by mortgages.

10. TRANSFER OF LOANS (NPL SALE)

10.1 General regulatory requirements and obstacles for security transfer

Ukrainian law lacks special regulations helping Ukrainian banks reduce NPLs. Securitization is in a state of development. Except for certain tax benefits, the Ukrainian government authorities do not set a guarantee scheme for banks to clean their balance sheet from illiquid assets.

In practice, the transfer of loans and loan portfolios is made by way of assignment, factoring agreement or sale purchase contract.

10.2 Issues relating to collateral transfer

10.2.1 Form of transfer (notices, consents)

Ukrainian law distinguishes between transfers of rights under movable pledges and mortgages. If a loan secured by a movable pledge has been assigned to an NPL purchaser, Ukrainian law

sets out that rights and benefits under the security will be automatically assigned to such NPL purchaser. It is, therefore, not required for a NPL purchaser to obtain any consent from the pledger. However, assistance of the original NPL seller is required for amending encumbrances. In contrast, if a loan secured by a mortgage has been assigned to an NPL purchaser, Ukrainian law requires amendments to mortgage instrument, which need to be notarized and registered with the Immovable Property Register. Additionally, an initial mortgagee must serve notice on the borrower about the mortgage transfer within five calendar days upon the date of those amendments. No borrower's consent is required for such transfer. If the security package documentation envisages insurance arrangements (for example, the mortgaged property has been insured), then the consent of the insurer (borrower) would be required for the change of the beneficiary. Such changes would be normally documented by amendments to the initial insurance agreement.

Compliance with banking secrecy, data protection, requirement for licence and permits

NPL purchasers must comply with local requirements as to (i) who may be a holder of the collateral (e.g. Ukrainian banks for agricultural land) and (ii) assets being incapable of being pledged (please refer to Section 3.8.1 above).

Consents relating to banking secrecy, data protection and other requirements are usually covered in transfer instruments (assignment or factoring agreements) relating to the transfer of the underlying obligation. If these matters are dealt with properly elsewhere, there are no further requirements to insert them into the transfer documentation relating to the security.

10.2.2 Taking over by NPL purchaser of any existing enforcement procedure

NPL purchasers can step-in into any existing court proceedings; however, the relevant Ukrainian court must approve the replacement of an initial plaintiff by adopting its rulings. If the security claim acquired by an NPL purchaser is enforced in the course of enforcement proceedings, Ukrainian law allows changing an initial creditor to an NPL purchaser. Such changes would be documented by rulings of the court. In practice, however, it is likely that the court will not give such approval to a NPL purchaser if the state enforcement officer has commenced a public auction in respect of the borrower's collaterals and realised the security.

The NPL resolution needs a holistic approach and involvement of many institutions. The timely NPL recognition is one of the important stages of successful NPL resolution. The implementation of an early warning system in banks will allow identifying potential credit risk at an early stage and applying pre-emptive remedial solutions as soon as possible. The appropriate loan provisioning has a significant influence on the development of the NPL market. The provisioning should be timely, according to regulation, realistic repayment and recovery expectations.

11. DEVELOPMENTS IN LEGISLATION AND PRACTICE ON ENFORCEMENT OF CLAIMS

11.1 Legislative acts

At present, a number of draft laws required for advancing the financial sector reforms are pending approval by the Ukrainian Parliament. Those draft laws, which are critical for moving reforms forward and the development of the financial sector, are discussed below.

Draft Law on Amendments to the Tax Code⁴⁷⁰ is primarily designed to minimise the risks of banks in lending operations and reduce the volume of NPLs in the banking sector. The Draft allows banks to access information on the income of a customer-taxpayer and any other information necessary for determining its financial status and solvency, directly from the State Register of Natural Persons – Taxpayers and Single Data Bank on Taxpayers – Legal Entities.

The implementation of the Draft will create legal conditions for obtaining reliable information needed for the assessment of the borrowers' creditworthiness by banks.

Draft Law on Turnover of Agricultural Lands⁴⁷¹ is designed to launch the agricultural land market and introduce a legal framework for the turnover and efficient use of agricultural land.

New features of the agricultural land market, contemplated by the Draft Law on Turnover of Agricultural Lands, are as follows:

- (a) phase-in the agricultural land market;
- (b) sale of lands via electronic auctions on a competitive basis;
- (c) improvement of the mechanism for the alienation by banks of agricultural land plots and extension of the list of qualifying buyers (please refer to Section 3.4.1 above); and
- (d) foreign investors' access to the local agricultural land market, mortgage to such investors.

Draft Law on Capital Markets⁴⁷² proposes a new model of the financial market infrastructure and creates a comprehensive legal regime governing the execution, performance and enforcement of the financial collateral. The Draft Law on Capital Markets has already been approved by the Ukrainian Parliament in the first reading.

The Draft Law on Capital Markets, *inter alia*, introduces changes to the financial collateral:

- (a) discharge of a secured obligation resultant from taking a title to an undervalued collateral;
- (b) creation of carve-outs conferring perfection and ranking benefits on the collateral-takers of the financial collateral (e.g. first ranking security interest to be created over (i) certified securities from a moment of their delivery to a collateral-taker (ii) uncertified securities and/or ancillary rights from the moment of the book-entry record in the central depository settlement). Such financial collateral will rank in priority to all other encumbrances, including registered encumbrances; and
- (c) creation of carve-outs conferring enforcement benefits on the collateral-takers of the financial collateral (e.g. parties are free to contractually agree on the remedy period required for the commencement of enforcement, which shall not be less than the period set for the holder of the first ranking interest registered with the Movable Property Register. The carve-out shall not apply if the borrower is an individual or other person which carries on entrepreneurial (business) activity).

It should be mentioned that since 20 June 2017 no further progress in adoption of the above draft law has been achieved.

Furthermore, on 1 September 2017, another Draft Law on Capital Markets and Regulated Markets was registered with the Ukrainian Parliament. This draft law generally repeats the provisions on financial collateral set out in Draft Law on Capital Markets. In addition, it introduces new financial instruments for capital markets, including bondholders committee and bondholders' representative. Despite that, Ukrainian Parliament by its decision dated 3 July 2018 rejected the Draft Law on Capital

⁴⁷⁰ Draft Law No. 2460a "On Amendments to the Tax Code of Ukraine on Access to Information on Taxpayers", registered in Parliament on 29 July 2015.

⁴⁷¹ Draft Law No. 5535 "On Turnover of Agricultural Lands", registered in Parliament on 13 December 2016.

⁴⁷² Draft Law No. 3498 "On Amendments to Certain Legislative Acts of Ukraine as to Regulated Markets and Derivatives", registered in Parliament on 20 November 2015.

Markets and Regulated Markets.

Therefore, as of today, the Ukrainian Parliament has failed to perform its obligations under European Union Association Agreement and there is still a lack of legislation on financial collateral in Ukraine.

11.2 Court practice

The Supreme Court of Ukraine is the highest judicial body which may review the court practice and preserve a uniform application of the statutory law. In 2014 and 2015, the Supreme Court of Ukraine summarized the court practice on disputes relating to suretyships and mortgages⁴⁷³ and prepared relevant guidance which is mandatory for the Ukrainian courts. There have been no further developments on the guidance as to security matters since then.

⁴⁷³ Analysis of the court practice of application of legislation regulating a suretyship and Analysis of the court practice of application of legislation regulating a mortgage.

PART (B) INSTITUTIONAL FRAMEWORK REVIEW

12. INSTITUTIONAL FRAMEWORK REVIEW

12.1 Courts

Judicial enforcement is treated by market participants as a primary method of enforcement in Ukraine. The enforcing party commonly uses the court for the majority types of security instruments. Ukrainian procedural law allows enforcement of multiple security instruments granted by the same security provider in a single proceeding.

In Ukraine, commercial courts exercise jurisdiction over disputes between business entities, disputes regarding economic agreements and cases related to enforcement and bankruptcy. There are no special divisions dealing exclusively with enforcement proceedings.

Generally, the structural feature of Ukrainian court system allows a borrower or a security provider to abuse the enforcement process by using its right to bring an appeal petition before the court of appeals and a cassation petition before the Supreme Court, which may delay the enforcement on average up to 1.5 years.

The market participants highlight frequent failures of the courts to meet the statutory timeframes for consideration of disputes due to the caseload of judges.

Ukrainian courts frequently apply an inconsistent approach to security enforcement matters. In the absence of the court guidance, such inconsistency influences predictability of the enforcement procedure and limits creditor's ability to control security under loan. As an example, there is a different approach by the courts in respect of distinction as to amount of the claim specified in notice to a borrower and in a notary writ.

12.2 Enforcement agency

12.2.1 Public enforcement agency (state bailiffs)

Under Ukrainian law the enforcement actions shall be carried out by the state bailiffs at the place of residence, stay, work of the debtor or at the location of its property. In cases when the enforcement procedure may be opened in several state enforcement offices, the creditor has the right to choose the particular one on his own discretion.

The fees of the state bailiff consist of an official salary, bonus, and payment for the rank and allowances for seniority. In addition, Ukrainian law envisages the remuneration scheme for the state bailiffs aimed at encouraging the better realisation of assets. In particular, as a result of successful enforcement process, the state bailiff is entitled to 2 percent of the recovered funds or value of the debtor's property, but not exceeding 200x the subsistence minimum for able-bodied persons (approximately USD 13,800). In cases of enforcement of court decision of a non-property nature, the state bailiff is entitled to remuneration equal to 1x the subsistence minimum for able-bodied persons (approximately USD 69) - if the debtor is an individual and 2x the subsistence minimum for able-bodied persons (approximately USD 138) - if the debtor is a legal entity.

The market participants emphasised the failure of state bailiffs to actively participate in enforcement procedures. The lack of access to a number of the state registers (for instance, the Land Cadastre, respective IP registers) was highlighted by market participants as one of the most critical problems and gaps in the regulation governing state bailiffs' activity. To obtain information from those registers, a state bailiff has to comply with the general procedure (i.e. submit request and get an extract). This prevents the speedy and effective process of obtaining information on borrowers' assets.

Another drawback of Ukrainian legislation in the enforcement is the lack of a unified approach for state bailiffs in questions related to the process of obtaining information on borrowers' assets. There is no statutory methodology providing detailed instructions to state bailiffs and timeframes for the whole process.

12.3 Private enforcement agency (private bailiffs)

In 2016 the Ukrainian government established the institute of private bailiffs. The reform was aimed at enhancing the effectiveness and speed of the enforcement procedure, as well as streamlining the entire enforcement system. As a result, the number of the enforced court decisions in civil and commercial cases rose to 18 percent during the last year as compared to 6 percent before 2017.

As of today, more than 100 private bailiffs have obtained certificates and are recorded in the Unified Private Bailiffs Register.

It is worth noting that Ukrainian law sets out numerous requirements for a candidate to be allowed to carry out activity as a private bailiff. In particular, the candidate should be a Ukrainian citizen who has reached 25 years of age, has higher legal education and at least two years' experience in the field of law after completing higher education. Furthermore, in order to be admitted to the qualification exam to be conducted by the Committee of the Ministry of Justice of Ukraine, the candidate should attend three months of special courses and an internship. Upon passing the exam and obtaining the certificate of a private bailiff, the enforcement officer is also required to obtain professional liability insurance.

Ukrainian law restricts the types of enforcement that can be carried out by private bailiffs. In particular, among others the private bailiffs are not entitled to enforce:

- (a) Decisions against the state of Ukraine, the NBU, state and local authorities, state and municipal enterprises and companies where the state owns more than 25 percent of the charter capital;
- (b) decisions in respect of state-owned or municipal property;
- (c) decisions on seizure of property
- (d) decisions of administrative courts of Ukraine and awards of the European Court of Human Rights.

In addition, Ukrainian law introduces the regulatory restrictions for private bailiffs' activity, among which: (i) threshold of UAH 20 million for enforcement per a separate court decision during the first year of practicing; and (ii) insurance requirements during the first three years of practicing. The private bailiff accepts enforcement documents at the place of the debtor's residence or stay – if the debtor is an individual, and at the location of the debtor – if the debtor is a legal entity or the location of the debtor's property.

The fees of the private bailiff consist of a mandatory basic fee set forth by the Cabinet of Ministers of Ukraine and an additional fee, which may be agreed between the private bailiff and a creditor. The mandatory basic fee constitutes: (i) 10 percent of the recovered amount (debt, property value); or (ii) in cases of decisions of a non-property nature (i.e. obligation to perform actions, removing obstacles in use, etc.) may vary from two minimum wages (approximately USD 280) if the debtor is an individual up to 4 minimum wages (approximately USD 560) if the debtor is a legal entity.

12.4 Other professionals

12.4.1 Insolvency practitioner

An insolvency practitioner is a critical player in the insolvency process and a person which manages the collateral and security transactions of the debtor.

In order to be allowed to carry out activity of an insolvency practitioner, a candidate shall pass

the qualification exam by means of automated anonymous testing, receive a certificate and be entered into the Unified Register of Insolvency Practitioners of Ukraine.

Among the requirements for candidates for admission to the exam are the following:

- (a) higher legal or economic education at the second level of a master's degree;
- (b) absence of prohibition to hold management positions;
- (c) relevant professional experience of not less than three years or one year's experience in management position after completing higher education;
- (d) completed special education required by Ukrainian law; and
- (e) completed internship required by Ukrainian law.

An insolvency practitioner is appointed by the court by means of an automated system among the persons recorded in the Unified Register of Insolvency Practitioners of Ukraine. The insolvency practitioner elected in such way should provide the court with an application for participation in this case.

When the insolvency practitioner fails to submit such application, the court shall at its discretion appoint another insolvency practitioner among the persons recorded in the Unified Register of Insolvency Practitioners of Ukraine. In the case of appointment of an insolvency practitioner for solvency renewal administration and liquidation, the court may take into consideration candidates proposed by the creditor committee.

The activity of an insolvency practitioner is subject to scheduled and unscheduled inspections. The scheduled inspection is carried out once in two years by the state bodies responsible for bankruptcy issues. The unscheduled inspection may be initiated upon request of individuals or legal entities.

As mentioned above, the insolvency practitioner has the authority to disclaim the antecedent transactions and, therefore, change the priority and ranking of security given to a creditor.

Market participants emphasize that the liability of the insolvency practitioner needs to be strengthened. Presently, an insolvency practitioner, in practice, may be subject only to disciplinary measures (i.e. a warning) or to cancellation of certificate and exclusion from the register.

Given the wide range powers that the insolvency practitioners are granted, we believe that the above types of liabilities are not enough.

12.4.2 Trading venues

Enforcement authorities utilize special electronic trading venues for sale of property owned by the debtor who is unable to discharge its liabilities as per a court decision or notary writ.

Among others, one of the most widely used trading venues in Ukraine is SETAM. It is operated by the Ministry of Justice of Ukraine. This trading venue is built as web-based venue but it is still in the process of development. For instance, the Ministry of Justice of Ukraine is attempting to implement block chain, an innovation technology for storage and protection of databases, within SETAM. However, the market participants raised a number of concerns about the system.

According to them, the system may not always be responsive. In particular, there were cases when market participants were unable to receive a confirmation of payment of guarantee bond, which is requisite for further participation in trading session.

Aside from that, according to the decision of the Antimonopoly Committee of Ukraine, SETAM enjoys a monopoly in enforcement of courts' decisions and notary writs in Ukraine. It may be helpful to phase in alternative trading venues in order to create a competitive market and enable creditors and lenders to choose the one on their discretion.

It should be mentioned that in October 2017, the Deposit Guarantee Fund introduced the pilot project for sale of the assets of insolvent banks through electronic platforms linked to ProZorro.Sale. The new auction model implements the so-called Dutch auction envisaging two stages: (i) step-by-step automatic reduction of the initial price of a lot until any of the bidders stops the process and fixes the current price; and (ii) offering by the rest of bidders of a price higher than the fixed one.

The Dutch auction allows the shortening of the time for asset sales (the auctions are completed in one day) and engaging new buyers due to the easier access to the bidding (everyone can register for participation in the auction on the day of auction). The introduced digital model enables fast and effective selling of those so-called illiquid lots whose price is hard to determine or which are not in popular demand on the market.

Considering the advantages of the new approach, it may be helpful to apply the Dutch auction model administrated on digital platform for enforcement sales as well. However, this would require introducing amendments to the Mortgage Act and Pledge Act establishing statutory discounts to be applied at different trading sessions.

12.4.3 Valuation experts

Under Ukrainian law an independent valuation of the property shall be conducted by a professional valuer. There is a distinction between private and public (state) valuers.

A private valuer shall be a duly registered private-entrepreneur or a legal entity that carries out business activity and has received a certificate of valuer. A public valuer shall be a state and/or local governmental authority, which received the right to carry out valuation activities in course of management and administration of state-owned or municipal property and which has at least one valuer.

In order to be allowed to carry out activity of a valuer, a candidate shall pass the qualification exam, receive a certificate and be entered into the Unified Register of Valuers maintained by the State Property Fund of Ukraine.

At least once in two years valuers are obliged to improve their qualification by attending a professional advanced training. Failure to comply with the above requirement constitutes a ground for suspension of the certificate of valuer.

The property valuation is conducted pursuant to a contract to be entered into by a valuer and a customer or based on a court ruling appointing valuation expertise.

Generally, parties are free to select and appoint private valuers, except for state-owned companies. For example, engagement of a public valuer is mandatory in the enforcement and insolvency processes in respect of assets of state-owned companies or companies where 50 percent of shares held by the state. Although Ukrainian law does not have any other limitations on selection of private valuers, in practice, courts and public bailiffs may give preference to public valuers where counterparties are in disagreement as to their appointment.

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ANNEX - LIST OF MARKET PARTICIPANTS

I. Governmental authorities		Address details
1.	Ministry of Justice	13 Horodetskogo Str., Kyiv
2.	National Bank of Ukraine	9 Instytutska Str., Kyiv
3.	Deposits Guarantee Fund	17, Sichovykh Striltsiv Str., Kyiv, Ukraine
4.	National Depository of Ukraine	17/8, Nyzhniy Val Str., Kyiv, Ukraine
5.	National Securities and Stock Market Commission	Building 30, 8, Moskovska Str., Kyiv, Ukraine
6.	National Commission for the State Regulation of Financial Services Markets	3, Borysa Hrinchenka Str., Kyiv, Ukraine
7.	Supreme Court of Ukraine	4, P. Orlyka Str. Kyiv, Ukraine
8.	Financial Sector Reform Project Management Office (supported by EBRD)	9 Instytutska Str., Kyiv
II. Associations		Contact details
1.	Association of Ukrainian Banks	15 Yevhena Severstiuka Str. office 703, Kyiv, Ukraine
2.	Independent Association of Banks of Ukraine	72 Velyka Vasylkivska Str., office 96, Kyiv, Ukraine
3.	Professional Association for Capital Market and Derivatives	18\7, Kutuzova Str., office 205, Kyiv, Ukraine
4.	Notary Chamber of Ukraine	7A, Antonovycha Str., Kyiv, Ukraine
5.	European Business Association	1A Andriyivsky Uzviz, Kyiv, Ukraine
6.	American Chamber of Commerce in Ukraine	12 Amosova Str., 15 Floor, Kyiv, Ukraine
7.	USAID (U.S. Agency for International Development) in Ukraine	4 Igor Sikorsky Str., Kyiv Ukraine
III. Banks		Contact details
1.	Raiffeisen Bank Aval	9, Leskova Str., Kyiv, Ukraine
2.	Citi Ukraine	16G Dilova Str., Kyiv, Ukraine
3.	Credit Agricole Bank Ukraine	42\4, Pushkins'ka Str., Kyiv, Ukraine
4.	Alfa-Bank Ukraine	4-6 Desiatynna Str., Kyiv, Ukraine
5.	Oschadbank	12G, Hospitalna Str., Kyiv, Ukraine
6.	UkrEximBank	127, Antonovycha Str. Kyiv, Ukraine
7.	IFC	1, Dniprovskiy Uzviz, 3rd Floor, Kyiv, Ukraine
8.	World Bank (in branch in Ukraine)	1, Dniprovskiy Uzviz, 2nd Floor, Kyiv, Ukraine

9.	OTP Bank, Ukraine	43, Zhylianska Str., Kyiv, Ukraine
10.	Ukrsibbank	2/12 Andriivska St., Kyiv, Ukraine
11.	Piraeus Bank MKB	8 Illinska Str, block 7, city of Kyiv, 04070, Ukraine
12.	Pravex-Bank	Klovskiy Spusk, 9/2, Kiev, Ukraine
13.	Ukrgazbank	1, Str. Yerevanska, Kyiv, 03087, Ukraine
14.	Ukrsotsbank	29 Kovpaka str., Kyiv, 03150, Ukraine
15.	Familnyi	Avenue Holosiivsky, 26, Kyiv, Kyivs'ka, Ukraine
IV. Financial Advisors		Contact details
1.	Deloitte Ukraine	48, 50a, Zhylyanska Str, Kyiv, Ukraine
2.	Ernst & Young	19, Khreshchatyk Str, Kyiv, Ukraine
3.	KPMG	32/2, Moskovska Str., Kyiv, Ukraine
4.	PricewaterhouseCoopers Audit	75, Zhylyanska Str, Kyiv, Ukraine
5.	Grant Thornton Ukraine	60 Sichovykh Striltsiv Str., Kyiv, Ukraine
6.	BDO Ukraine	201/203, Kharskivske Shosse, Kyiv, Ukraine
7.	Baker Tilly	28 Fizkultury Str., Kyiv, Ukraine
V. Others		Contact details
1.	Secretariat within Financial Restructuring Law 2017	72, Velyka Vasylkivska Str., office 96, Kyiv, Ukraine