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for Reconstruction and Development

## **EBRD Conference**

# **Debt Enforcement in Europe and Beyond The Road to Successful Reform**

**6 December 2019**

## **Discussion Paper**

Building an Effective  
Debt Enforcement Framework

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## Executive summary

Effective and reliable enforcement frameworks are of fundamental importance to the availability of credit, to economic development and to resolving high levels of non-performing loans (“NPL”) in the banking sector. This Discussion Paper examines three common themes from a study finalised in 2019 by the European Bank for Reconstruction and Development (“EBRD”), DLA Piper (Ukraine) and a consortium of national legal firms led by DLA Piper of the enforcement framework for secured and unsecured commercial claims in Albania, Croatia, Cyprus, Greece and Ukraine (the “EBRD Study”): (1) Creation and Perfection of Security Interests by Registration, (2) Digitalisation and Technology and (3) Judicial and Extra-Judicial Enforcement Mechanisms.

Country examples provided below are indicative and further details, including recommendations in relation to specific issues found in national frameworks and international best practices are contained in the Discussion Paper and the EBRD Study. A comparative table with an overview of the national frameworks of Albania, Croatia, Cyprus, Greece and Ukraine is at Annex 1 to this Discussion Paper.

### *Theme 1: Creation and Perfection of Security Interests by Registration*

*Modern secured transactions legislation should aim to set low requirements in terms of formalities, content and costs for execution of a security agreement and allow for the creation of a security interest over all types of present and future assets to secure a wide range of debts.*

The findings of the EBRD Study reveal some challenges in respect of the availability, range and extensiveness of security interests, in particular:

- *Legal prohibitions on the types of persons who can be beneficiaries of security interests in relation to immovables and who can purchase land in an enforcement sale.* For example, in Ukraine, there is a statutory prohibition on non-banking entities and foreign investors taking security over or purchasing agricultural land plots and in Albania, a prohibition on foreign buyers purchasing land;
- *Practical limitations on taking security over certain kinds of assets.* For example, in Albania, lands plots are considered undesirable collateral because of uncertainties caused by the restitution process in relation to property nationalised under the former socialist regime;
- *Absence of or uncertainty relating to the financial collateral regime.* Ukraine does not have a financial collateral regime and in Albania and Croatia the existing regime is new and is not applied in practice;
- *Legislative gaps in relation to the extensiveness of security interests.* Uncertainties relate to whether some forms of security capture future assets, whether existing mortgages extend to after-acquired property and to the overall concept of the floating charge; and
- *Unclear interaction between competing security interests.* For example, in Croatia notwithstanding any registration of an account pledge, an unregistered private deed known as a ‘debenture bond’ containing a promise to pay the holder may, in practice, be

presented for payment to a government agency and paid in priority to any account pledgee party to a pledge agreement registered with the same government agency.

*A centralised and easily accessible registration system for registration of security supports asset-based lending since it plays an important role in determining the existence and therefore the priority of any security interests.*

Registration of security interests in the countries covered by the EBRD Study has its own set of challenges, which are as follows:

- *Decentralisation of registries.* For example, in Greece, registration must take place at the seat of the pledgor at the time of registration of the pledge. This issue may be addressed through an interconnected electronic registry system;
- *Costs and lack of clarity relating to the role of the notary.* For example, execution of mortgages in Greece is beset by high notarial costs, while in Croatia the involvement of a notary confers benefits in respect of an expedited first stage enforcement procedure but it is not clear what level of notarial involvement is required by the legislation i.e. notarisation of a signature or solemnisation of the entire agreement before the notary;
- *Lack of formal recognition of the security agent structure in syndicated loans.* In Albania, Croatia and Greece there is no express legal recognition of the security agent and therefore parties rely on the parallel debt structure; and
- *Lack of formal recognition of subordination agreements.* For example, in Ukraine it is common for parties to enter into subordination agreements but their enforceability is uncertain.

## ***Theme 2: Digitalisation and Technology***

*Digitalisation and technology in the field of security registries, public auctions, and judicial processes encourage greater transparency, efficiency and accuracy of data.*

The findings of the EBRD Study reveal that a number of challenges remain in respect of this digital and technological transformation of enforcement frameworks:

- *Lack of digitalisation of judicial proceedings due to the absence of electronic filing of documents with the court and requirements for the court file to be in hard copy.* For example, Albania and Cyprus rely on a completely manual and paper-based court system, with a rudimentary level of information and communications technology. In Greece, the parties may be updated on the progress of their case electronically, but the electronic filing of legal documents before the Greek Courts remains optional, apart from recent changes which make it compulsory for administrative law cases;
- *Unsatisfactory transition from paper-based to electronic collateral registries,* resulting in dispersed and unlinked electronic, paper-based and hybrid collateral registries, which prevents lenders from effectively searching and registering security interests. For example, Greece lacks a digitalised registry for all kinds of assets. Croatia has a high level of digitalisation, but the online Land Registry has issues with the reliability of data;

- *Deficiencies in the existing online registries, which result in reduced functionality.* For example, the online Albanian Secured Charges registry has discrepancies in the description of secured movables;
- *Lack of online functionality relating to all aspects of the registry.* Only two countries (Croatia and Cyprus) permit electronic registration of security interests and in Croatia this is only with respect to registration of security over immovables. In Ukraine, registration of security interests in the Ukrainian Immovables Property Registry cannot be performed online due to the requirement for the authorised person to sign the application in front of the state registrar or notary. In the Albanian Secured Charges registry, it is not possible to register a secured charge electronically;
- *Incomplete or inaccurate information concerning existing security interests stored in registries.* In Croatia, there is a gap between the Land Registry status of real properties and the status in municipal cadastral records and/or actual condition, because the two systems have not yet been reconciled. In the Ukrainian Immovables Property Registry, inaccuracies result from the lack of rules for reinstating entries in scenarios where a court invalidates a title transfer to a third party without the mortgagee's consent;
- *High costs for creation, registration and enforcement of security interests in the form of (sometimes uncapped) percentage-based fees instead of fixed fees, which appears to be particularly an issue for security over immovables.* For example, in Greece, excessive percentage-based fees for the registration of mortgages have strongly affected market practice concerning the structuring of secured loans as parties try to structure these as bond transactions to benefit from exemptions for higher fees; and
- *Lack of digitalised public auction platforms for the sale of assets in enforcement proceedings.* For example, Albania does not have electronic auction systems for enforcement proceedings. Cyprus is in the process of developing a creditor led electronic public auction system and no electronic auction has taken place as at the date of this paper. While Croatia, Greece and Ukraine have digitalised public auction systems, market participants note that further improvements are needed.

### ***Theme 3: Extrajudicial and Judicial Enforcement Framework***

*Legal systems should provide for prompt, predictable and affordable enforcement procedures and remedies for the realisation of security interests, for maximisation of the recovery value of collateral and for encouraging provision of cheap credit. A reasonable balance between ease and speed of enforcement remedies for creditors, on one hand, and the protection of both the debtor and third parties is to the advantage of all involved stakeholders.*

The key challenges revealed through the findings in the EBRD Study in this respect are as follows:

- *Lengthy enforcement procedures and practical difficulties raised by the debtor in out-of-court enforcement procedures.* In all jurisdictions, enforcement proceedings are often delayed by debtors raising procedural and substantive objections, thereby forcing creditors into a judicial enforcement route. None of the jurisdictions covered, with the exception of Greece, have developed fast-track judicial enforcement procedures, although there have been efforts to simplify the process for enforcement of certain types of security interests. For example, in Cyprus the recent Mortgage Act has limited the

right of the debtor to file unsubstantiated appeals against enforcement notices provided and/or actions taken by secured creditors. In Albania, Croatia, Greece and Ukraine certain security instruments formalised before a notary have the status of enforceable deeds, which simplifies the enforcement process by removing the requirement to obtain a court judgment on the debt due and commencement of the enforcement procedure;

- *Infrastructural weaknesses in judicial enforcement proceedings* linked to a large number of enforcement cases, understaffed courts and lack of specialisation in commercial matters. For example, Albania, Cyprus and Greece lack specialised courts or divisions and judges for commercial disputes and the number of judges in Cyprus per capita is much lower than in other EU member states such as Croatia;
- *Lack of legal provisions permitting or encouraging out-of-court enforcement of secured assets.* For example, only judicial enforcement procedures are relevant in practice in Albania. While Ukraine allows out-of-court enforcement for both movables and immovables, extra-judicial enforcement of a pledge over movables by taking legal title discharges the security package of the secured creditor in its entirety, which discourages its use in practice. Until recently this also used to be the case for any out-of-court enforcement over immovables by taking legal title;
- *Lack of legal provisions permitting both public auctions and private sales.* For example, in Albania, all secured assets sold to third parties are required to be sold through public auction, and in Croatia and Cyprus, movables are allowed to be sold through private sale, but immovables are required to be sold through public auction;
- *High costs involved in judicial enforcement process,* due to the fees and expenses charged by the various parties involved in the process: courts, lawyers, notaries, appraisers and enforcement agents. For example, Albania has high costs due to the high level of remuneration for bailiffs, which is based on a percentage of the claim's value. In Croatia and Ukraine, there is a requirement for the party bringing the enforcement action to advance enforcement costs, without certainty of outcome and in Croatia the exercise by courts of the option to split enforcement proceedings into separate proceedings in each region where the collateral is located increases costs; and
- *Uncertainty regarding enforcement of security interests within insolvency proceedings.* For example, in Albania, the enforcement of secured assets within an insolvency proceeding is decided at the discretion of the administrator, and in Cyprus, although the law permits enforcement of security outside insolvency, the courts may order otherwise.

Overall, designing and implementing an effective debt enforcement framework for a national legal system continues to be a difficult task but it has to be addressed. It is up to lawmakers to fine-tune national enforcement systems with a view to delivering the best outcome for a rapid, efficient and effective resolution of commercial disputes, making use of new technologies and alternative dispute resolution mechanisms as applicable. Inevitably the choices made will determine the attractiveness of a particular jurisdiction for international investment and the extension of credit.

# 1. Introduction

## 1.1 Background

This Discussion Paper has been produced by the EBRD in connection with a technical assistance project (the “**Project**”), which analysed from 2017 to 2019 the enforcement framework for secured and unsecured commercial claims in five selected EBRD countries of operations: Albania, Croatia, Cyprus, Greece and Ukraine.<sup>1</sup> These jurisdictions recorded in recent years the highest level of NPL in the EBRD region.<sup>2</sup> Further, these states, with the exception of Croatia, rank lower in the World Bank Doing Business index in comparison to other European countries, in particular with regard to its enforcing contracts indicator, which measures the time and cost for resolving commercial disputes, and the quality and efficiency of judicial process.<sup>3</sup>

The purpose of the Project was to explore the link between high NPLs, namely bank loans which have not been repaid or which are unlikely to be repaid in full by the debtor and the performance of each country’s enforcement framework.<sup>4</sup> Specifically the Project sought to identify barriers to efficient, timely and transparent collection of secured and unsecured debt and to propose corresponding recommendations for reform.<sup>5</sup> In this paper, the term secured debt shall refer to debt that is secured by collateral on the basis of a security agreement. Reference to unsecured debt shall be used broadly to describe debt in relation to unsecured loans, trade debts and the uncollateralised part of a secured loan.

The aim of this Discussion Paper is to build on the individual country reports contained in the EBRD Study first, by identifying common issues and themes among the five countries assessed and second, by highlighting best practice and the potential for technology to support the development of more transparent and efficient security registration and enforcement procedures of secured and unsecured debt.

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<sup>1</sup> Special thanks to Dr Thomas Traschler for preparing a scoping paper and to counsel at Tashko Pustina Attorneys (Albania), Law Firm Glinska & Mišković (Croatia), Pamboridis LLC (Cyprus), Karatzas & Partners Law Firm (Greece) and DLA Piper (Ukraine), for their work on the EBRD Study which formed the basis for this paper and for updating the information contained in this paper: <<https://www.ebrd.com/insolvency-sector-assessment/enforcement-study.pdf>> accessed 27 November 2019. The Legal Transition Team would also like to thank Olexander Droug, Marek Dubovec, Shreya Garg, Mary Mitsi and Oleksii Sobolev for their invaluable contributions.

<sup>2</sup> See the Vienna Initiative, ‘NPL Monitor for the CESEE region (H1 2019)’ <<http://npl.vienna-initiative.com/assets/Uploads/2019/06/c3676d2ea8/npl-monitor-2019-H1.pdf>> accessed 26 November 2019. The NPL ratio as of September 2018 was the following: Albania (12.9), Croatia (10.2), Cyprus (21.1), Greece (44.1) and Ukraine (54.3).

<sup>3</sup> World Bank Doing Business Report 2019, accessible at <[https://www.doingbusiness.org/content/dam/doingBusiness/media/Annual-Reports/English/DB2019-report\\_web-version.pdf](https://www.doingbusiness.org/content/dam/doingBusiness/media/Annual-Reports/English/DB2019-report_web-version.pdf)> accessed 27 November 2019. In the World Business 2019 Doing Business rankings for enforcing contracts, the Project countries ranked as follows: Croatia (25), Ukraine (57), Albania (98), Greece (132) and Cyprus (138). World Bank rankings for resolving insolvency are better in all countries, apart from Croatia (59) and Ukraine (145).

<sup>4</sup> Accessible at <<https://www.ebrd.com/insolvency-sector-assessment/enforcement-study.pdf>> accessed 27 November 2019.

<sup>5</sup> Similar country specific NPL studies have been conducted by the EBRD in Hungary, Mongolia, Serbia and Turkey, accessible at <<https://www.ebrd.com/what-we-do/sectors/legal-reform/debt-restructuring-and-bankruptcy/sector-assessments.html>> accessed 27 November 2019.

The Discussion Paper further aims to provide the basis for exchange between policy makers, practitioners and academics at a conference to be hosted by the EBRD on debt enforcement on 6 December at its London headquarters. It is anticipated that both the Discussion Paper and the lessons drawn at the conference will help the EBRD to develop a roadmap that may be used as a point of reference by policy makers and stakeholders engaged in reforms relating to debt enforcement.

The Discussion Paper is divided into the following sections, which are each devoted to one core challenge of reform: (1) Creation and Perfection of Security Interests by Registration; (2) Digitalisation and Technology; and (3) Extrajudicial and Judicial Enforcement Mechanisms. Each section is structured in three parts: an introduction, the findings of the EBRD Study, and a comparison with international best practice and national solutions. A comparative overview of the secured transactions regime, enforcement methods and institutional framework in each of the jurisdictions covered by the EBRD Study is set out in a table at Annex 1 to this paper.

Before beginning the comparative analysis of national enforcement frameworks in this paper, it is important first, to understand the connection between NPLs and debt enforcement and their relevance to the EBRD's mandate, second, the scope and limitations of the EBRD Study, since its findings inform this Discussion Paper and third the general challenges to an effective enforcement framework.

## 1.2 NPLs and Debt Enforcement

The development of resilient market economies that drive economic growth is central to the EBRD's mandate to foster the transition towards open market-oriented economies.<sup>6</sup> Yet high volumes of NPLs have had a negative impact on the financial resilience of market economies in the EBRD region. The reasons for excessive volumes of NPL are manifold and include economic stress, bad lending practices, lack of regulatory controls and discipline, but also importantly, ineffective NPL resolution tools in countries' restructuring, enforcement and insolvency regimes.

While the EBRD has conducted regular secured transactions assessments<sup>7</sup>, such assessments have involved a high level review of the practices and effectiveness of taking collateral across all of the EBRD countries of operations. There was, therefore, a need for a more detailed analysis of the selected high NPL jurisdictions, with an emphasis on the process for enforcement of debt, both secured and unsecured, the institutions involved and the interaction between enforcement of debt and insolvency law. The EBRD Study was the next logical step.

The reform of debt enforcement regimes has become a top priority for governments and policy makers committed to tackling the NPL problem. This is evident both at national and international level.<sup>8</sup> As part of the Vienna Initiative<sup>9</sup>, the EBRD has, together with other

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<sup>6</sup> Article 1 of the Agreement Establishing the European Bank for Reconstruction and Development: <https://www.ebrd.com/.../pdf-basic-documents-of-ebrd-2013-agreement.pdf> . See also 'The EBRD and transition' <https://www.ebrd.com/our-values/transition.html>

<sup>7</sup> The most recent EBRD secured transactions assessment was completed in 2014. A summary of results are available at: <https://www.ebrd.com/cs/Satellite?c=Page&cid=1395255781586&pagename=EBRD%2FPage%2FArchive>

<sup>8</sup> Nadège Jassaud and Kenneth H Kang, 'A Strategy for Developing a Market for Nonperforming Loans in Italy' IMF Working Paper <<https://www.imf.org/en/Publications/WP/Issues/2016/12/31/A-Strategy-for-Developing-a-Market-for-Nonperforming-Loans-in-Italy-42689>> accessed 26 November 2019; Sebastiaan Pompe and Wolfgang



international financial institutions, played a role in facilitating national NPL strategies, in countries such as Hungary, Serbia and Slovenia. Reforming enforcement frameworks is featured prominently on the agenda of the European Union. The European 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**") seeks to achieve a reduction in the high stocks of non-performing loans.<sup>10</sup> In particular, the proposed Directive stipulates two main objectives: first, to increase the efficiency of debt recovery procedures through the availability of a distinct common accelerated extrajudicial collateral enforcement procedure ("**AECE**") and second, to facilitate the development of secondary markets for NPL.

The impact assessment conducted by the European Commission prior to the proposed Directive concluded that an AECE mechanism would reduce the costs for resolving NPLs for secured creditors and would encourage banks to restructure, recover or dispose of their NPLs at an earlier date.<sup>11</sup> If implemented in its present form, the proposed Directive could introduce significant changes, especially in the 13 EU Member States which are recorded as not permitting any form of extrajudicial enforcement in relation to immovable assets such as land.<sup>12</sup> Nonetheless the impact of any AECE would depend on whether the market, primarily banks, is prepared to use it. As we have seen from the analysis of Croatia and Ukraine in the EBRD Study, the mere existence of an out-of-court enforcement route does not mean that it is frequently used in practice.

Debt enforcement is, of course, not only an avenue for resolving NPLs. It is also closely linked to the *availability of credit* and the overall performance of the economy. The positive impact of expeditious, predictable and cost-effective enforcement mechanisms on the credit risk taking behaviour of lenders, in attracting foreign investment and enhancing stability of financial system is supported by numerous empirical studies. There are several studies showing a direct correlation between creditor rights, and the cost and availability of credit, the general premise being that stronger creditor rights lead to lower costs and greater availability of credit.<sup>13</sup> Further,

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Bergthaler, 'Reforming the Legal and Institutional Framework for the Enforcement of Civil and Commercial Claims in Portugal' IMF Working Paper <<https://www.imf.org/en/Publications/WP/Issues/2016/12/31/Reforming-the-Legal-and-Institutional-Framework-for-the-Enforcement-of-Civil-and-Commercial-43497>> accessed 26 November 2019; Shteryo Nozharov, 'Economic growth and the reform of the judicial system of Bulgaria in the period 2000-2015' MPRA Paper <<https://econpapers.repec.org/paper/pramprapa/72919.htm>> accessed 8 November 2019.

<sup>9</sup> The Vienna Initiative is a framework for safeguarding the financial stability of emerging Europe that was launched at the height of the global economic crisis in January 2009. The EBRD, EIB, European Commission, IMF, and the World Bank played a key role in the creation and further development of the Vienna Initiative, which has recently focused on NPL resolution in the region.

<sup>10</sup> European Parliament, 'Proposal for a Directive on credit servicers, credit purchasers and the recovery of collateral' (2018) <<https://eur-lex.europa.eu/legal-content/en/TXT/?uri=CELEX%3A52018PC0135>> accessed 28 November 2019

<sup>11</sup> European Commission Impact Assessment, Part 1, The development of secondary markets for non-performing loans by removing undue impediments to loan servicing by third parties and the transfer of loans accompanying the Proposal for a Directive of the European Parliament and of the Council on Credit Servicers, Credit Purchasers and the Recovery of Collateral, page 10.

<sup>12</sup> European Commission Impact Assessment, Part 2, Accelerated Extrajudicial Collateral Enforcement accompanying the Proposal for a Directive of the European Parliament and of the Council on Credit Servicers, Credit Purchasers and the Recovery of Collateral, Annex 5. It is interesting to note that 24 out of 28 EU Member States apparently allow out of court enforcement of non-possessory security over movables, albeit in some of these countries it may be subject to some restrictions.

<sup>13</sup> John Armour and others, 'How do creditor rights matter for debt finance? A review of empirical evidence' in Frederique Dahan (ed), *Research Handbook on Secured Financing in Commercial Transactions* (Edward Elgar Publishing 2015); Rainer Haselmann, Katharina Pistor and Vikrant Vig, 'How Law Affects Lending' (2010) 23 *The*

there are studies that link effective judicial systems and institutional performance to increased financial stability, economic development and foreign direct investment.<sup>14</sup> These are all reasons to revisit the topic of debt enforcement. As highlighted by the EBRD Study, Albania, Croatia, Cyprus, Greece and Ukraine have, over the years, taken steps to enhance their secured transactions law, their institutional framework and other enforcement related aspects. While these measures have been generally perceived as a move in the right direction, there is still ample room for improvement, as will be shown in this paper.

### 1.3 Scope of Discussion Paper and EBRD Study

This Discussion Paper draws on the findings of the EBRD Study and it is therefore essential to understand the methodology for the EBRD Study. The sole focus of the EBRD Study was the enforcement of business loans, but special attention was devoted to the broader picture of enforcement, including the secured transactions regime in each of the countries. The EBRD Study thus examined a range of selected topics including security registration and perfection fees, registration system, available security, enforcement of secured and unsecured loans, the impact of insolvency proceedings on enforcement and the availability of a specific regime for financial collateral. One of the challenges of the EBRD Study was the distinctiveness of each country's legal regime and system for debt enforcement. Albania is a former socialist country and Ukraine a former communist country and both have relatively new legal systems. Croatia is part of the Roman-Germanic group of jurisdictions; Cyprus is a mixed common and civil law jurisdiction but follows English common law in matters of commercial law<sup>15</sup> and Greece is a member of the Napoleonic group of jurisdictions.<sup>16</sup> The EBRD Study thus comprises five separate national reports.

The EBRD Study relied primarily on two evaluation methods to identify legislative gaps or deficiencies in the enforcement system of the selected jurisdictions. The first was a systematic examination of the law on the books based on a review of national legislative acts and, parliamentary material, EU legislation, and judicial decisions and academic analysis. The second method was an empirical questionnaire aimed at capturing market practice, which

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Review of Financial Studies 549; Kee-Hong Bae and Vidhan K. Goyal, 'Creditor Rights, Enforcement, and Bank Loans' (2009) 64 *Journal of Finance* 823; Simeon Djankov, Caralee McLiesh and Andrei Shleifer, 'Private credit in 129 countries' (2007) 84 *Journal of Financial Economics* 299; Rafael La Porta and others, 'Legal Determinants of External Finance' (1997) 52 *Journal of Finance* 1131.

<sup>14</sup> Gianluca Esposito, Sergi Lanau and Sebastiaan Pompe, 'Judicial System Reform in Italy: A Key to Growth' IMF Working Paper <<https://www.imf.org/external/pubs/ft/wp/2014/wp1432.pdf>> accessed 26 November 2019; Kenneth W. Dam, 'The Judiciary and Economic Development' U Chicago Law & Economics, Olin Working Paper No 287 <[https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=892030](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=892030)> accessed 26 November 2019; Marina Dakolias, 'Court Performance Around the World: A Comparative Perspective' <<http://documents.worldbank.org/curated/en/639261468758377643/Court-performance-around-the-world-a-comparative-perspective>> accessed 26 November 2019; OECD, 'Judicial performance and its determinants: a cross-country perspective' OECD Economic Policy Papers No 05 <<https://www.oecd.org/eco/growth/judicial-performance.htm>> accessed 26 November 2019; OECD, 'What makes civil justice effective?' OECD Economic Policy Papers No 18 <<https://www.oecd.org/eco/growth/judicial-performance.htm>> accessed 26 November 2019; Armando Castelar Pinheiro and Célia Cabral, 'Credit Markets in Brazil: The Role of Judicial Enforcement' IDB Working Paper No 104 <[https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1814648](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1814648)> accessed 26 November 2019

<sup>15</sup> Nikitas E. Hatzimihail, 'Cyprus as a Mixed Legal System' (15 July 2013), *Journal of Civil Law Studies*.

<sup>16</sup> Philip R. Wood, *Comparative Law of Security Interests and Title Finance* of the Law and Practice of International Finance Series (3<sup>rd</sup> edn, Sweet & Maxwell 2019).

collected the responses of representatives from the business community, legal, and enforcement professionals and national authorities.

Recourse to official statistics and empirical data was limited given the paucity of reliable and comparative data. Data for enforcement proceedings is often aggregated for natural and legal persons. In other words, data does not distinguish between businesses and consumers and this makes it difficult to draw any conclusions in relation to the enforcement framework for businesses. Data is also frequently decentralised and held, for example, at local court level and does not include information on aspects important for evaluation of an enforcement regime, such as return to creditors or costs of the proceedings, although the countries covered by the EBRD Study all apply to a certain extent tariffs for enforcement officers or insolvency office holders engaged in the disposal of assets. In the limited instances where enforcement is conducted out-of-court by private sale, no aggregated data is available. Furthermore, data is rarely gathered in automated or digital form. It should be noted that limitations in the quality of data in relation to insolvency proceedings have led within the EU to a number of EU requirements for Member States, including the requirement to establish national insolvency registries<sup>17</sup> and, most recently, to collect at national level sufficient data to monitor the performance of preventive restructuring proceedings under the new EU insolvency directive.<sup>18</sup> There is no comparable EU or other international initiative yet for data relating to enforcement proceedings, although there is an EU proposal to collect data in relation to the use of the AECCE out-of-court contractual based enforcement mechanism in the Proposal for the Directive.<sup>19</sup>

The Discussion Paper considers a number of selected issues that arise when a creditor obtains a security interest in an asset and seeks to enforce its security interest in Albania, Croatia, Cyprus, Greece and Ukraine. Clearly, there is a wide variety of solutions for the problems found in the EBRD Study, and it is unfeasible to describe them all. Accordingly, the analysis aims to show evolutionary trends and developments in the field of secured transactions and insolvency law followed by different legal regimes based on the civil and common law tradition, which face similar problems. The analysis is necessarily high level and readers are encouraged to refer to the full country reports contained in the EBRD Study for further explanations or detail where required. The EBRD Study was completed in February 2019. In some countries, there may have been changes in legislation. Croatia is planning to introduce a new Enforcement Act. In Greece new legislation is at the time of this paper being considered by the Parliament, which would introduce compulsory mediation for certain categories of civil and commercial claims in line with the Italian system.<sup>20</sup>

#### 1.4 Challenges to an effective enforcement framework

Legal systems around the world of both common law and civil law differ significantly in how they deal with the substantive and procedural protection of rights of debtors and creditors at the

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<sup>17</sup> Article 24 of the Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings.

<sup>18</sup> Article 29 of the Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132.

<sup>19</sup> See Article 33 of the Proposal for the Directive.

<sup>20</sup> Italian mediation law dated 4 March 2010 (as amended) stipulates compulsory mediation in the form of a first meeting for civil and commercial cases relating to a number of categories of claims including insurance, banking and financial agreements. Security agreements are excluded from its scope.

enforcement stage. Even within the same legal tradition enforcement models may be quite different. In other words, there is no global common standard, model law, or a set of principles relating to enforcement of debt.<sup>21</sup> In any case it has been argued that the true credentials of any legal regime are proven only when it comes to enforcement.<sup>22</sup>

National rules of enforcement are coloured by local legal culture and attitudes towards the law, its judges and its officers. They also reflect the policy aims of the legislator and where exactly the legislator has sought to strike the balance between debtor and creditor rights. This may depend in turn on the dynamics of the local business and banking environments. While the purpose of secured credit is to protect the lender from financial loss in circumstances where the debtor is unable to pay, not all enforcement frameworks provide a smooth path for enforcement by the secured lender. Fewer differences among national rules of enforcement arise arguably in relation to unsecured debt, where all creditors are required to pursue a judicial route. On top of this, significant differences persist concerning the acceptance and availability of alternative dispute resolution methods to resolve any dispute connected with debt enforcement.

Thus, the most challenging part when designing and implementing an effective debt enforcement framework for a national legal system is that there is no such thing as a one-size-fits-all approach. Rather, one has to carefully pick and choose the “right” enforcement model that delivers the best outcome for a balanced, transparent, speedy and effective resolution of disputes dependent on the legal, economic and political premises of the relevant jurisdiction. Inevitably, the choices made will determine the attractiveness of a particular jurisdiction for international investment and extension of credit.

Nowadays, there is also no doubt that a discussion about enforcement cannot take place without stressing the relevance of modern technology, which is just as significant for a successful reform project as a sound legal framework. Technology has become an inseparable part of commercial transactions and the legal profession and its influence is growing. Smart contracts and distributed ledger technologies are set to revolutionise secured transactions and insolvency law in the foreseeable future. Meanwhile digitalisation offers many opportunities for significantly reducing the cost, time and difficulties associated with registration of security interests and the collection or enforcement of loans.<sup>23</sup> Today, security interests can be fully registered

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<sup>21</sup> Eric Dirix, ‘Remedies of Secured Creditors Outside Insolvency’ in Horst Eidenmüller and Eva-Maria Kieninger (eds), *The Future of Secured Credit in Europe* (De Gruyter 2008); Moritz Brinkmann, ‘The position of Secured Creditors in Insolvency’ in Horst Eidenmüller and Eva-Maria Kieninger (eds), *The Future of Secured Credit in Europe* (De Gruyter 2008); José M Garrido and Edwin E Smith, ‘Comparative Approaches to the Enforcement of Secured Credit in Insolvency’ in Spyridon V Bazinas and Orkun Akseli (eds), *International and Comparative Secured Transactions Law: Essays in honour of Roderick A Macdonald* (Bloomsbury Collections 2017); Louise Gullifer and Orkun Akseli (eds), *Secured Transactions Law Reform: Principles, Policies and Practice* (1st edn, Hart Publishing 2016); Frederique Dahan, ‘The EBRD’s Experience in Secured Transactions Reform: How Can Outsiders Help?’ in Orkun Akseli Louise Gullifer (ed), *Secured Transactions Law Reform* (Hart Publishing 2016); Rolf Stürner, ‘Principles of Effective Enforcement Feasibility Study’ <<https://www.unidroit.org/english/governments/councildocuments/2016session/cd-95-13add-02-e.pdf>> accessed 15 October 2019; Philip R. Wood, *Comparative Law of Security Interests and Title Finance* (3rd edn, Sweet & Maxwell 2019).

<sup>22</sup> Philip R. Wood, *Comparative Law of Security Interests and Title Finance* (3rd edn, Sweet & Maxwell 2019)

<sup>23</sup> Teresa Rodríguez de las Heras Ballell, ‘A technological transformation of secured transactions law: visibility, monitoring, and enforcement’ (2017) 22 *Uniform Law Review* Charles W. Mooney, ‘Fintech and Secured Transactions Systems of the Future’ *Law and Contemporary Problems* <<https://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=4854&context=lcp>> accessed 20 November 2019; Teresa Rodríguez de las Heras Ballell and Jorge Feliu Rey, ‘Modernisation of the Law of Secured Transactions in Spain’ in Orkun Akseli Louise Gullifer (ed), *Secured Transactions Law Reform* (Hart Publishing 2016).

*electronically* to become effective against third parties. Creditors may file a claim against a debtor and pay court fees *online*. Also, upon a debtor's default, secured assets can sometimes be enforced and auctioned via *electronic* platforms.

The integration of technology is critical for any legal system, whether developed or less developed. Technology is well suited to enhance the quality and efficiency of judicial institutions by reducing the workload of overburdened court systems, supporting better case management practices and in jurisdictions which require a public auction for the enforcement of certain types of security interest, facilitating the sale of assets. Particularly, digitalisation is an effective response to deficiencies found in some emerging markets where the rule of law is weak and legal institutions cannot properly fulfil their function. It is an effective instrument for instilling trust and transparency since it is less prone to human error or manipulation.

When examining enforcement frameworks, one has to take into account the work of the International Institute for the Unification of Private Law (the “**UNIDROIT**”), the United Nations Commission on International Trade Law (the “**UNCITRAL**”), the World Bank (the “**WB**”), the Organisation for Economic Co-operation and Development (the “**OECD**”), and the Hague Conference on Private International Law (the “**HCCH**”), which have touched upon the topic by developing conventions, model laws, principles, benchmarks and legislative guides on the global harmonisation of procedural law, alternative dispute resolution, secured transactions and insolvency law.<sup>24</sup> This body of guidance is expected to expand further following the initiative of UNIDROIT to establish a working group for the development of Principles of Transnational Civil Procedure related to effective enforcement, which will focus on enforcement frameworks and the harmonisation of such frameworks across borders.<sup>25</sup> While recognising the global significance and relevance of these international best practice instruments, it is essential to acknowledge that debt enforcement can and should be understood within the broader national landscape. This is because enforcement involves various fields of law, including procedural law, constitutional law, contract law, secured transactions law, insolvency law, and alternative dispute resolution. Any reform strategy must consequently consider numerous pieces of interacting national legislation.

It is hoped that the following comparative analysis will provide useful examples of how national enforcement systems can be structured and reformed with the purpose of increasing the efficiency of enforcement procedures. While the issues identified are not radically new, and even less so from a global secured transactions law reform standpoint, they deserve special attention given the high levels of non-performing loans in the jurisdictions included in the EBRD Study.

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<sup>24</sup> EBRD Core Principles for a Secured Transactions Law (the “**EBRD Core Principles**”), the World Bank Principles for Effective Insolvency and Debtor Creditor Regimes (the “**WB Principles**”), the UNCITRAL Legislative Guide on Secured Transactions (the “**Legislative Guide**”), the UNCITRAL Guide on the Implementation of a Security Rights Registry (the “**UNCITRAL Guide**”), the UNCITRAL Model Law on Secured Transactions (the “**Model Law**”), the UNCITRAL Model Law on Secured Transactions Guide to Enactment (the “**Guide to Enactment**”), and the UNCITRAL Legislative Guide on Insolvency Law (the “**Insolvency Guide**”), the World Bank Doing Business Report (the “**WB Doing Business Report 2019**”) especially concerning Enforcing Contracts and Getting Credit; OECD, ‘Judicial performance and its determinants: a cross-country perspective’; OECD, ‘What makes civil justice effective?’.

<sup>25</sup> Rolf Stürner, ‘Principles of Effective Enforcement Feasibility Study’ <<https://www.unidroit.org/english/governments/councildocuments/2016session/cd-95-13add-02-e.pdf>> accessed 15 October 2019

## 2 Creation and registration of security interests

### 2.1 General

This section shall focus on the obstacles of taking security in Albania, Croatia, Cyprus, Greece and Ukraine. It is generally accepted that the objective of a modern secured transactions law is to promote low-cost credit by enhancing the availability of secured credit. To achieve this, the creation of a simple and clear framework that allows borrowers and lenders to obtain a security interest in a wide and efficient manner is essential.

Ideally, modern secured transactions legislation should aim to set low requirements in terms of formalities, content and costs for the creation of a security agreement and allow for the creation of a security interest over all types of present and future assets to secure a wide range of debts. This will increase the availability of credit at low cost and stimulate national economies. Some jurisdictions have, however, been historically resistant to the concept of universal security, setting limitations on the extensiveness of security interests and requiring a certain degree of specificity in identifying any underlying or future secured assets. Another key element of a modern secured transactions law is the ability to create non-possessory security over movable assets, in order to permit the grantor to continue to use the assets in the day-to-day operations of its business. Previously in many civil law jurisdictions the traditional pledge required an actual transfer of the asset from the pledgor to the pledgee, which was not practical since it deprived the pledgor of the ability to use the asset. The development of non-possessory security and consequential requirement for notification to third parties has led to the establishment of registries for movables in *some* civil law jurisdictions, such as for example Belgium and Spain.<sup>26</sup> Others such as the German and Austrian legal systems have resisted introducing a registry system for mobile assets which follows the principle of publicity by registration. All systems have, however, recognised the need to register ownership and security interests in relation to land.

Registration supports asset-based lending since it plays an important role in determining the priority of any security interests. It is a recognised method of publicising the existence of a security interest and achieving effectiveness against third parties. However, in some national systems registration may not be necessary or even possible in cases where the secured creditor is in possession of the asset. It is also not practical to register all types of assets covered by a security interest, for example the contracts or receivables of a business. Most jurisdictions follow the “first-in-time” principle with respect to registration, which provides that the first creditor to registry its security interest takes priority over any later registered security interest. This is closely connected to the principle that a secured creditor takes its security subject to any pre-existing registered security interests.

The EBRD Study highlights current practices and features for creating and registering certain types of security interests in the examined jurisdictions and a number of legal and practical barriers that are discussed below.

### 2.2 Findings of the EBRD Study

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<sup>26</sup> Giuliano G. Castellano, ‘Reforming Non-Possessory Secured Transactions Laws: A New Strategy?’ (2015) 78 *Modern Law Review*; D.J.Y. Hamwijk, ‘Publicity in secured transactions law: Towards a European public notice filing system for non-possessory security rights in movable assets?’ (University of Amsterdam 2014).

### 2.2.1 Creation of security interests

First, the EBRD Study reports a number of restrictions preventing creditors from taking security over certain categories of assets. It also notes common factors, which intervene in practice to limit the effectiveness of security interests. It is worth mentioning that these impediments are not always a result of an explicit prohibition in law, but often a consequence of gaps in legislation, ambiguous legal rules and a lack of jurisprudence or ineffective institutional intermediaries.

Examples of explicit prohibitions in respect of third parties arise both in relation to the identity of the party entitled to benefit from the security interest and the purchaser of an asset from an enforcement sale. For example in Ukraine, there is a statutory prohibition on non-banking lenders and all foreign investors taking security over or purchasing land plots dedicated for agricultural use<sup>27</sup>, and in Albania foreign buyers are not allowed to purchase land. Restrictions on the purchase of land by foreign buyers are present in other countries in the EBRD region, such as Moldova and Turkey and externally in larger economies, such as India, although may often be avoided by means of incorporation of local companies to purchase the assets.

Of all the gaps in legislation, the most striking relates to the absence of a specific regime for financial collateral in Ukraine. This is largely driven by the fact that most jurisdictions (Croatia, Cyprus and Greece) are EU Member States and have adopted the European Financial Collateral Directive into national legislation. While Albania has also followed the EU *acquis* in this area, Ukraine has not, although further legislation in relation to certain aspects of financial collateral reform is pending. Even where countries have financial collateral laws, there is a question about their usefulness in practice. In Albania and Croatia, the laws are reportedly not applied. In Greece, an economy largely based on non-listed companies and self-employed individuals, the national financial collateral legislation does not cover non-listed title securities and scenarios where the grantor of the security interest is a natural person, which reduces its overall range of application.

Other notable legislative gaps relate to the extensiveness of existing security interests. For example in Albania, unlike Ukraine, there is no concept of mortgage over a “business unit” and also no concept of a floating charge such as that which exists for Croatia, Cyprus and Greece. Mortgages over business units in Albania are thus achieved in practice by the cumbersome and costly process of mortgaging separate registered property items pertaining to the business. While Greece has adopted the floating charge, the floating charge does not capture all business assets, such as administrative permits due to their legal nature which may fall within the security over business unit recognised by some other European jurisdictions.

In addition to clear legislative gaps, all country reports in the EBRD Study cite areas of uncertainty in existing legislation. For instance, in Albania and Ukraine it is unclear whether some forms of security capture future assets. Under Albanian law it is not certain whether an existing mortgage can attach to after acquired property and under Ukrainian law there is doubt as to whether an existing mortgage over a business unit automatically captures assets acquired after execution of the security agreement. While Croatia introduced the legal concept of a floating charge in 2005, it is not widely used outside the retail sector due to unfamiliarity with the concept and the lack of case law. In Cyprus, while creditors can take a floating charge over immovable or movable property and floating charges are common securities, there are uncertainties with the office of the receiver. The legal rules for the appointment of receivers in Cyprus’ Companies Act are out-dated, causing delays to the enforcement process.

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<sup>27</sup> The Ukrainian parliament is as at the date of this paper considering a bill which may remove such restriction.

In terms of practical, rather than strictly legal limitations on security, this is perhaps best illustrated by the examples of Albania and Croatia. In Albania, land plots are, unlike in most other jurisdictions, often considered undesirable collateral because of the uncertainties caused by the restitution process in relation to property nationalised under the former socialist regime, as well as the previously mentioned restrictions on foreign buyers. In Croatia, there are also residual issues linked with state expropriation of private land and the lack of proper land registry records documenting change of ownership, which have a negative impact on the business environment.

Another interesting finding from the EBRD Study relates to the interaction between security interests and other “competing” quasi-security interests. In Croatia, the debenture bond trumps the account pledge, notwithstanding any earlier registration of the latter.<sup>28</sup> This is a feature shared by all states of former Yugoslavia, with slight jurisdictional variations.<sup>29</sup> Among debenture bond holders, priority is decided on a “first come first served basis”, which again conflicts with the “first-in-time” principle for the registration of security. A public institution, the Financial Agency, is responsible for seizing the funds available on a debtor’s account on behalf of creditors. It is paradoxical that the account pledge is registered with the same Financial Agency. In addition the account pledge has ceased to be enforceable in the debtor’s insolvency following introduction of the Enforcement over Monetary Funds Act. Thus, although it is common for international investors in Croatia to demand an account pledge, particularly in project finance transactions, in practice this form of security is worthless.

### 2.2.2 Registration of security interests

In all countries covered by the EBRD Study, registration is required for the main categories of movable and immovable assets. In each of the countries there are special registries for aircraft and ships. All countries follow the principle that timing of registration determines the priority of a secured creditor in respect of a particular secured asset (except in Croatia in relation to the account pledge because of the role of debenture bonds referred to above). In Greece, security interests created after 17 January 2018 are subordinated in any enforcement sale (outside insolvency) to certain preferential employee remuneration claims and any enforcement expenses rank *pari passu* with a number of statutory general privilege claims. The previous priorities regime which governs security created before 17 January 2018 is less favourable to secured creditors. In contrast to Greece, Albania, Croatia, Cyprus and Ukraine do not recognise the entitlement of any preferential creditors to be satisfied in priority to secured creditors out of the proceeds of an enforcement of security outside an insolvency procedure.

Another concern with respect to the economic accessibility of collateral registries is legal rules that hinder the registration of security interests. There are numerous examples identified by the EBRD Study. One is jurisdictional requirements for the registration of security interests. In Greece, registration must take place at the competent pledge registry, which depends on the seat

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<sup>28</sup> See the EBRD Study, section 3.3.4 of the Croatia country report, page 114. A debenture bond is a private deed solemnized before a public notary, under which the debtor provides consent for the seizure of funds on its accounts and for transfer of any available funds to a creditor for whose benefit the debenture bond was issued and which represents an enforcement order eligible for direct enforcement before the Financial Agency. Debenture bonds are a standard feature of all commercial loan transactions and are executed by the debtor in parallel to signing the loan agreement. Each repayment tranche under a loan agreement is typically secured by a separate debenture bond.

<sup>29</sup> See also the EBRD 2018 account blocking studies for Bosnia and Herzegovina, Republic of North Macedonia, Montenegro and Serbia available on: <https://www.ebrd.com/what-we-do/sectors/legal-reform/debt-restructuring-and-bankruptcy/sector-assessments.html>



of the pledgor at the time of registration of the pledge. Apparently this constitutes a significant deviation from the normal practice (where no central registry of movables exists) of registration with respect to location of assets. Another example undermining the economic accessibility of collateral registries can be found in Ukraine. The EBRD Study found that Ukrainian law provides for the automatic expiry of registration of a security interest over movables after five years, despite the fact that the term of financing may be longer, and requires the secured party to reregister its interest in order to uphold its validity and priority against third parties.

#### 2.2.2.1 Prescribed form of security documents

Prior to registration, security documents must be executed in the prescribed form. The notary plays an important role in all jurisdictions, excluding Cyprus, which follows the English common law jurisdictional model where the notary does not play an active role in formalisation of contractual agreements. In Albania, Croatia, Greece and Ukraine it is a legal requirement that any security over immovables is notarised. In practice, however, market participants avoid perfection by registration of mortgages in Greece due to excessively high notarial fees, while in Albania, Croatia Greece and Ukraine the involvement of a notary confers benefits in respect of ease of court (and availability of out-of-court) enforcement procedures.

For example, in Albania, while execution before a notary is optional for pledges and secured charges, in reality notarial deeds are most common since they provide the secured lender with the ability to request a writ of execution from the court without the need for a further court order. The notarial deed provides, in effect, sufficient proof that the debtor or grantor accepts the existence of the secured creditor's claim. In Croatia the position is similar in that security agreements which are entered into as solemnized private deeds in front of a notary constitute immediately enforceable deeds. In Greece mortgages over land must be notarised before a public notary, unlike pledges which can be created by means of a private document with a certified date. Nevertheless due to the high percentage based costs associated by public notaries, in practice parties either try to structure the loan as a bond transaction to benefit from capped notary fees or to apply to court for mortgage pre-notation, which results in creation of a provisional mortgage that can, before expiry of a three month period, be converted via a court process into a permanent mortgage. In Ukraine, mortgages created over immovables must be notarised, and pledges over movables are only required to be in writing and can be notarised voluntarily if the parties agree. However pledges must, like mortgages, take the form of a notarial writ to be capable of extrajudicial enforcement by way of notarial deed.

Of all of the countries covered by the EBRD Study, Croatia suffers the most from lack of legislative clarity regarding the prescribed form of security documents. In the face of legal uncertainty as to what is required the notarial form prevails for both security agreements relating to immovables and movables. However this is complicated by the fact that legislation is often silent on which form of notarisation is required, namely notarisation of a signature or solemnisation of the entire agreement before the notary, which triggers higher transactional costs. With respect to Ukraine, the EBRD Study notes that the law is not clear as to whether a court enforcement decision or notary writ are the only method for enforcing pledges over participatory shares or if other out-of-court-enforcement methods for pledges over corporate rights are also available, such as taking ownership title to any pledged participatory shares and/or private or public sale of such shares.

#### 2.2.3 Security agent and contractual subordination of claims

In Albania, Croatia, Greece and Ukraine there are no specific legal rules or recognition of a “security agent” in a syndicated loan structure, although Greece has recently made advances in recognising the ability of the bondholders’ agent to take security on behalf of bondholders and other creditors related to the bond loan, such as creditors from hedging transactions.<sup>30</sup> In these jurisdictions, parties rely on general contract law principles when using security agents in syndicated loan structures, but the validity of these contractual structures has not necessarily been tested before the courts.

While Croatia and Cyprus report no issues with respect to contractual subordination of claims among creditors and the borrower, in Albania, it is not settled whether the parties may modify a priority ranking by contract due to the absence of legislation and jurisprudence. In Ukraine, it is common for parties to enter into subordination agreements but there is still uncertainty concerning their enforceability in insolvency. In Greece the creditors can contractually agree on the ranking of their claims but such agreement is binding only between the parties and is not recognised by third parties including the notary public responsible for distributing the enforcement proceeds.

## 2.3 International standards and best practices

Against this background, one can observe considerable divergences from international standards relating to the creation and registration of security interests with respect to movables. This section analyses first, the collateral registry established in 1952 in the United States under Article 9 of the Uniform Commercial Code<sup>31</sup> (“**UCC**”) and second, the 2010 UNCITRAL Legislative Guide on Secured Transactions<sup>32</sup> (“**Legislative Guide**”) and the 2016 UNCITRAL Model Law on Secured Transactions<sup>33</sup> (“**Model Law**”), which provide an internationally recognised policy framework for an effective secured transactions regime.

### 2.3.1 Article 9 of the Uniform Commercial Code

Article 9 of the UCC represented a significant achievement in integrating different security devices into a single security interest with common rules governing creation, validity, perfection, priority and enforcement. This removed the requirement for separate filing systems and paved the way for the Article 9 registry model, which can be considered as one of the most influential registry models for secured transactions regimes.<sup>34</sup> The registry model has been used as a template for secured transactions law reform in a number of common law jurisdictions, including but not limited to Australia, New Zealand, Canada and Jersey and has influenced the drafting of international instruments and recommendations by UNCITRAL, the EBRD, and the Organization of American States (“**OAS**”). Accordingly, it seems worthwhile to discuss the primary features of the public collateral registry of the UCC. This will help to better understand

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<sup>30</sup> Under the parallel debt structure, the borrower typically undertakes in parallel to its debt obligation to the lenders a second, parallel obligation in respect of the entire amount of the same debt to the security trustee, thus allowing security to be created in favour of the security trustee.

<sup>31</sup> First adopted in 1951 by the National Conference of Commissioners on Uniform State Laws and the American Law Institute and subsequently amended.

<sup>32</sup> Accessible at <[https://www.uncitral.org/pdf/english/texts/security-1g/e/09-82670\\_Ebook-Guide\\_09-04-10English.pdf](https://www.uncitral.org/pdf/english/texts/security-1g/e/09-82670_Ebook-Guide_09-04-10English.pdf)>

<sup>33</sup> Accessible at <<https://www.uncitral.org/pdf/english/texts/security/MLST2016.pdf>>

<sup>34</sup> Peter Winship, ‘An Historical Overview of UCC Article 9’ in Gullifer L and Akseli O (eds), *Secured Transactions Law Reform: Principles, Policies and Practice* (1st edn, Hart Publishing 2016).

how it shaped the discussion of designing, developing and operating a registry. It is noted that possession of the collateral by the secured lender renders unnecessary any registration of the security interest under Article 9. The core characteristics of the registry are as follows.

First, the registry mechanism under Article 9 of the UCC is based on a functional understanding of security interests. Thus, the legal treatment of a security interest does not depend on its legal nature as long as its primary goal is to secure an obligation or put differently, substance trumps form.<sup>35</sup> Second, Article 9 UCC follows a unitary approach and thus applies to all types of secured creditors, all types of grantors and all types of present and future assets. Third, the main purpose of registration under the UCC is to make the security interest effective against other creditors and third parties. Registration does not therefore determine the creation of the security interest. Each state operates a separate registration office, thus the Article 9 model is not a centralised registration system. Registration is achieved by simply filing a notice with minimal information, i.e. the name of the debtor, the name of the secured creditor, and a description of the asset. Registrations are indexed by reference to the identity of the grantor and grantee of the security interest. There are no formal or substantive checks on the entered information by the registry staff. Fourth, the UCC regime applies a first-to-file rule. Thus, the creditor first to file has priority over subsequent registered creditors and over unregistered interests. It is apparent that many of these characteristics are reflected in the aforementioned secured transaction principles of international organisations.

It is important to remember that the Article 9 registry system dates back to 1952 and was designed as an entirely paper-based system. Advance registration was intended to deal with the delays in registration of security interests resulting from such paper-based approach. Given the minimal information required for filing a notice, advance filing to secure priority is not only an option but also market practice. The Article 9 system is no longer up to date in terms of technology and is undergoing at present significant changes to introduce electronic registration and searches.

### 2.3.2 Legislative Guide and Model Law

The Legislative Guide builds on the foundations of Article 9 by following a “unitary, functional and comprehensive approach” to secured transactions law, which in many countries is dealt with in a fragmented way in numerous laws.<sup>36</sup> It is supported by a leaner document, the Model Law, which is intended to assist states to implement the recommendations set out in the Legislative Guide and a separate set of guidance related to implementation of a security interests registry.<sup>37</sup> The Legislative Guide recommends that security interests can be created and acquired by all natural and legal persons.<sup>38</sup> In relation to beneficiaries of security interest, it states that with the intent to promote secured credit,<sup>39</sup> there should be no restrictions on the type of secured creditor that can obtain a security interest.

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<sup>35</sup> Michael Bridge and others, ‘Formalism, Functionalism, and Understanding the Law of Secured Transaction’ [1999] McGill Law Journal.

<sup>36</sup> Spyridon V Bazinas, ‘The UNCITRAL Legislative Guide on Secured Transactions’ in Gullifer L and Akseli O (eds), *Secured Transactions Law Reform: Principles, Policies and Practice* (1st edn, Hart Publishing 2016).

<sup>37</sup> UNCITRAL Guide on the Implementation of a Security Rights Registry, 2014.

<sup>38</sup> Recommendation 2(b), Chapter I, Legislative Guide.

<sup>39</sup> Paragraph 37, Chapter II, Legislative Guide.

Further, the Legislative Guide recommends that the law should provide that a security interest may encumber any type of asset, including future assets, or assets that the grantor may not yet own or have the power to encumber and that the exceptions to the kind of assets over which security may be created ‘*should be limited and described in the law in a clear and specific way*’.<sup>40</sup> As is evident from the Legislative Guide and Article 7 of the Model Law, the international standard in relation to the scope of obligations recommends that a *security interest may secure one or more obligations of any type, present or future, determined or determinable, conditional or unconditional, fixed or fluctuating*.<sup>41</sup> The Legislative Guide thus recommends that in order to simplify the creation of a security interest in all assets of an enterprise, where the provider of credit is financing the ongoing operation of the enterprise, a single-document, all-asset security agreement may be permitted.<sup>42</sup> Such all-asset security arrangements are not novel, and exist in concepts such as an enterprise mortgage which encumbers all assets of an enterprise (sometimes including even immovable property) including, incoming cash, new inventory and equipment and future assets of an enterprise.<sup>43</sup>

With regard to the form of security agreements, Article 6 of the Model Law and the Legislative Guide recommend that they should be concluded in or evidenced in writing with an exception where the agreement between the parties is accompanied by a transfer of actual possession of the encumbered asset to the secured creditor, in which case it can be oral.<sup>44</sup> This imposes minimal formalities on the creation of the security interest, thus ensuring lower costs and greater flexibility compared with jurisdictions where a notarial form is required. Under both the Legislative Guide and the Model Law registration is not required for the creation of a security interest.<sup>45</sup> The Legislative Guide further recommends that the registry is searchable by the name of the grantor of the security rather than by reference to the asset.<sup>46</sup> In relation to the priority of security interests, the Legislative Guide recommends the first-in-time principle, which means *inter alia* that ‘*as between security interests that were made effective against third parties by registration of a notice, priority is determined by the order of registration, regardless of the order of creation of the security interests*’.<sup>47</sup>

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, the Legislative Guide recommends that the registry for registering all types of security interest in all movable assets should be centralized and consolidated.<sup>48</sup> The registration system should if possible be electronic to enable notices to be stored in electronic form and permit users to access the registry record by electronic means.<sup>49</sup> Security should be notice based and, in the case of movables, provide for effectiveness against third parties by either registration of the encumbered asset (without transfer of possession) or by the secured creditor’s possession.<sup>50</sup>

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<sup>40</sup> Recommendation 17, Legislative Guide.

<sup>41</sup> Recommendation 16, Chapter II, Legislative Guide.

<sup>42</sup> Paragraph 63, Chapter V, Legislative Guide.

<sup>43</sup> Paragraph 64, Chapter V, Legislative Guide.

<sup>44</sup> Recommendation 15, Chapter II, Legislative Guide and Paragraph 33, Chapter II, Legislative Guide.

<sup>45</sup> Recommendation 33, Chapter III, Legislative Guide.

<sup>46</sup> Paragraph 32, Chapter IV of the Legislative Guide.

<sup>47</sup> Recommendation 76(a), Chapter V, Legislative Guide.

<sup>48</sup> Recommendation 54(e), Chapter IV, Legislative Guide.

<sup>49</sup> Recommendation 54(j), Chapter IV, Legislative Guide.

<sup>50</sup> Recommendation 37, Chapter III, Legislative Guide.

## 2.4 Cross-jurisdiction analysis

It is noted that some developed jurisdictions do not necessarily comply with the Legislative Guide and Model Law. German law, for example, does not recognise the concept of a non-possessory pledge over movables and relies instead on non-possessory transfer of title, which is not subject to registration.<sup>51</sup> In Germany, there are no registries for security interests other than security over real estate. Market participants appear nonetheless generally satisfied with the existing system and discussions regarding reform tend to arise in the context of proposals relating to international harmonisation of secured transactions law. In England and Wales, by contrast, while a pledge requires possession, security over movables may be created in the form of a charge or mortgage which is registrable against the name of the company pursuant to the Companies Act 2006, in effect a “debtor registry system”, such as that which exists for Cyprus. Specific asset registries such as for land function as registries of title as well as security interests. One of the defining characteristics of English security is the ease with which it permits a single security to cover present assets and future assets.<sup>52</sup>

The Legislative Guide provides further guidance on subordination agreements and security agent structures. It recommends that subordination agreements should be recognised and be permitted<sup>53</sup> and should continue to apply in insolvency proceedings of a grantor.<sup>54</sup> In relation to third-party effectiveness being possible without direct custody of the asset by the secured creditor, the Legislative Guide confirms that possession may be effected through third-party custody for the following reason, “*The possibility that possession of the encumbered asset by the secured creditor may be exercised through the custody of an agent or representative enhances the efficiency and effectiveness of possessory security interests by permitting creditors to delegate custodial responsibility without prejudice to the rights of third parties.*”<sup>55</sup>

## 2.5 Conclusion and Questions

The findings of the EBRD Study demonstrate that there is room for improvement in all countries in relation to the creation and perfection by registration of security interests, particularly in Albania, Croatia, Greece and Ukraine. Legislative gaps and uncertainties reduce the value of security and, by implication, contribute to the higher cost of credit. Registration systems for movables and immovables exist in all countries covered by the EBRD Study but are hampered in some cases a lack of reliability and limited digitalisation (see section 3 (*Digitalisation & Technology*) below). This deficiency is problematic and further exacerbated by high, percentage-based costs for the perfection of security interests. Thus, it seems critical for the assessed jurisdictions to address these weaknesses so as to give creditors practical access to as wide a range of assets as possible. This should have the desired effect of both reducing the cost of taking security and increasing the availability of credit.

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<sup>51</sup> Julia Rakob, ‘Germany’, Harry C. Sigman and Eva-Maria Kieninger (eds.) *Cross-Border Security over Tangibles* (Sellier European Law Publishers 2007)

<sup>52</sup> Michael Bridge, ‘England and Wales’, Harry C. Sigman and Eva-Maria Kieninger (eds.) *Cross-Border Security over Tangibles* (Sellier European Law Publishers 2007)

<sup>53</sup> Paragraph 128, Chapter V, Legislative Guide.

<sup>54</sup> Paragraph 130, Chapter V, Legislative Guide.

<sup>55</sup> Paragraph 58, Chapter III, Legislative Guide.

As noted by local counsel in several countries covered by the Study, the existing registration systems for immovables and movables cannot provide a full picture of the debtor's assets. While an immovables registry typically covers title in addition to security, apart from rare cases there are no title registries for movables other than for certain high value and identifiable assets like ships. Indeed for a class of changing movables such as book debts it is wholly impractical to have a title registry. In effect a potential secured creditor needs to search beyond any registry to get a true picture of the debtor's assets. In this respect the potential secured creditor is in the same position as an unsecured creditor pursuing a claim against the debtor.

- 1. Which type of collateral should or should not be available as security? What are the practical and historical reasons for any restrictions on collateral in the assessed jurisdictions?*
- 2. What should be the minimum requirements in terms of formalities for taking (and enforcing) security? What should the role of a civil law notary be in the creation of a security agreement?*
- 3. Should civil law jurisdictions appropriate the concept of a floating charge? What are the difficulties arising in the enforcement of floating charges?*
- 4. How centralised should the registration system be? To what extent should there be separate registries for movable and immovable assets or special registries for certain categories of assets, e.g. ships and aircraft?*
- 5. What is the best reference point for a registration system: the assets or the grantor of security?*
- 6. What is the right approach to the financing of registries? Should registries be private or state-owned entities? Are registry fees a potential source for revenue or should fees only entail what is necessary to provide a good service to the general public?*

### **3. Digitalisation & Technology**

#### **3.1 General**

The essential role of technology and digitalisation in the field of enforcement has already been highlighted in terms of encouraging greater efficiency, accuracy of data and transparency. It is also a key topic in the examined national legal systems. The EBRD Study reports that these legal systems significantly lag behind in enhancing enforcement mechanism by modern technology. Three aspects are particularly noteworthy in the EBRD Study. The first concerns the general low degree of digital transformation of judicial proceedings. The second more specific one is the yet unsuccessful attempt to transition from paper-based to a fully electronic collateral registry mechanism. The third aspect relates to the lack of digitalised public auction procedures in the enforcement framework of all countries apart from Croatia, despite the existence in all five jurisdictions of the requirement to hold an enforcement sale by way of public auction.

These three aspects shall now be discussed in more detail, although the emphasis will be on the difficult process of transitioning from paper-based to electronic registries and the innovative potential of electronic public auctions in jurisdictions which restrict private sales.

#### **3.2 Findings of the EBRD Study**

##### **3.2.1 Lack of digitalisation of judicial proceedings**

Court systems are overloaded with cases and bureaucracy. This is the first common theme identified in the EBRD Study is acute to varying degrees in all of the countries surveyed, where enforcement proceedings are characterised by their excessive length, compared with other European countries such as Austria and Germany. The reasons for this are manifold. Partially this can be attributed to fewer and less qualified court staff, inefficient procedural rules, absence of specialised courts and judges, long court recesses and numerous appeals by debtors to mention a few factors. Cyprus in particular appears to suffer from a low number of judges relative to its population. As indicated in the Erotocritou Report of 2016, the number of judges in Cyprus per 100,000 habitants is 12, while in other EU Member States such as Croatia the number is between 40-50 judges per 100,000 habitants.

The unsatisfactory enforcement situation is aggravated by the low level of digitalisation in relation to court proceedings and electronic case management in all countries apart from Croatia, Greece (in relation to procedural updates and case progress only)<sup>56</sup> and in Ukraine where it is recent and is working in testing mode. Lack of digitalisation is signalled by the absence of electronic filing of documents with the court and the requirement for the court file to be in hard copy. In certain jurisdictions with electronic filing, such as England and Wales, parties can issue proceedings and file documents in electronic form 24 hours a day every day all year round, including outside normal court working hours.<sup>57</sup> The electronic filing system typically requires registering an account on a relevant website, since submission through ordinary email is not accepted. This in turn enables documents to be uploaded to the account and parties are able to

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<sup>56</sup> A proposal for electronic filing of legal documents before the Greek courts was approved by the Hellenic parliament on 24 October 2019.

<sup>57</sup> See the Electronic Practice Direction 510 – The Electronic Working Pilot Scheme: <https://www.justice.gov.uk/courts/procedure-rules/civil/rules/part51/practice-direction-510-the-electronic-working-pilot-scheme> for details of how electronic filing has been introduced in certain types of proceedings in England and Wales.

access documents relating to the case, thereby supporting the efficient management of the case by all concerned. The system will usually generate an automatic email when documents are submitted and may be used by the court to inform parties of any steps they need to take in advance of the next court hearing.

In Cyprus however the state still relies on an entirely manual and paper-based court system, with a rudimentary level of information and communications technology.<sup>58</sup> Consequently, according to the EBRD Study, the digitalisation of court proceedings is a top priority for the purpose of lowering the workload of courts and reducing the length of enforcement proceedings. Digitalisation is also a priority for other EBRD countries of operations such as Armenia, which is planning with donor support to introduce a fully digitalised justice system in the next few years. In countries, such as Armenia, the inefficiencies of the paper-based court system are increased by the lack of official standard forms or templates.<sup>59</sup>

### 3.2.2 Transition to electronic registries for secured transactions laws

Apart from the digitalisation of enforcement proceedings more generally, the transition from paper-based to a fully electronic registry mechanism is the second common theme identified by the EBRD Study. The EBRD Study observes that the majority of jurisdictions still operate a system of dispersed and unlinked electronic, paper-based and hybrid collateral registries, which prevents lenders from effectively searching and registering security interests. Secured creditors must search through a number of different registries, most of which do not allow online searches.

Greece is faced with a lack of digitalised and electronically available registries for all kinds of assets. In Albania and Ukraine, there is a move towards digitalisation of registries but this is not yet complete and the difficulties for creditors in Albania are compounded by the fact that there are multiple and separate registries for movables.<sup>60</sup> With regard to Ukraine, the Ukrainian Immovable Property Registry is accessible online. In addition, the Ukrainian registry for security over movables called the State Registry of Encumbrances over Movable Property became publically and electronically available from April 2019. In Cyprus, similarly to England and Wales, mortgages are perfected with the Lands Office and certain charges created by a company are required to be registered with the registry of the Registrar of Cyprus Companies and Official Receiver which is available in electronic form. Croatia has a high level of digitalisation; both the Land Registry and the FINA Registry are available on-line, but the Land Registry is decentralised and there are issues with the reliability of data in such registry. There are also a number of other specialised registries.<sup>61</sup>

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<sup>58</sup> SRSS and EC Functional Review of the Courts System of Cyprus, technical Assistance Project 2017/2018 IPA, Ireland available at [http://www.supremecourt.gov.cy/Judicial/SC.nsf/9c88e6190990f07fc22583530034b198/15536820389ECD97C225839A00300FB5/\\$file/Functional%20Review%20of%20Courts%20System%20of%20Cyprus%20\(IPA%20Ireland\)%20-%20Final%20Report%20March%202018.pdf](http://www.supremecourt.gov.cy/Judicial/SC.nsf/9c88e6190990f07fc22583530034b198/15536820389ECD97C225839A00300FB5/$file/Functional%20Review%20of%20Courts%20System%20of%20Cyprus%20(IPA%20Ireland)%20-%20Final%20Report%20March%202018.pdf) accessed 28 November 2019

<sup>59</sup> The EBRD is leading at present a project to assist with operationalisation of the new Armenian Insolvency Court, established in January 2019.

<sup>60</sup> Albania operates the following registries: the Immovable Property Registry, the Commercial Registry, the Secured Charge Registry, the Joint Stock Registry, the Albanian Civil Aircrafts Registry, and the Albanian Ship Registry.

<sup>61</sup> Croatia operates the following registries: Land Registry, FINA Registry, Ship Registry, Aircraft Registry, the Central Depository and Clearing Company Inc. and Trademarks Registry.



Even where an individual registry is available online, there may be issues which reduce its functionality. In the case of the online Albanian Secured Charges registry, which is administered by a private legal entity on concession basis, market participants note discrepancies in the descriptions of movables which have been secured and that the search functions impede creditor access to information. For example, in respect of a share charge, it is only possible to search the registry by the name of the shareholders who have pledged their shares in a company and not the company itself. It is also not possible for a secured charge to be registered electronically. The following three aspects are particularly noteworthy and deserve further attention:

#### 3.2.2.1 Partial implementation and migration to electronic registries

*First*, some of the registry systems are not fully operational yet, despite the fact that a significant amount of implementation time has passed. For example, in Albania the registration of all current immovable assets as well as the digitalization of the immovable assets registry has not yet been concluded. Even when already operating, these registry mechanisms provide a limited degree of usability and functionality concerning the search ability, registration of security interests, and retrieval of a debtor's personal information.

Not all functions may be available online. Only two countries (Croatia and Cyprus) permit electronic registration of security interests and in Croatia such electronic registration is only partially available for security over immovables. For example, registration of security interests in the Ukrainian Immovables Property Registry cannot be performed online due to the requirement for the authorised person to sign the application in front of the state registrar or notary. The State Registry of Encumbrances over Movable Property, which covers registration of only security interests (and not title), is now electronic and available online since completion of the EBRD Study but its technical operation needs further improvement and similar to the Ukrainian Immovables Property Registry it does not permit e-registration. This concern regarding limited utility is re-enforced by the problem that the information concerning existing security interests stored in the registries is often incomplete, out-dated or entirely absent. For example, in Croatia there is a gap between the Land Registry status of real properties and the status in municipal cadastral records<sup>62</sup> and/or actual condition, because the two systems have not yet been reconciled.

In addition, the EBRD Study notes that due to the relics of the socialist system the Croatian land registry may not be accurate in certain cases where a change of ownership has been affected by expropriation for the public good. This problem is further ameliorated by the fact that Croatia still recognises non-registered ownership of land. Albania faces similar issues with respect to expropriation of property under the former socialist regime and lack of registration of immovable property interests. Another example can be found in Ukraine. The law underpinning the Ukrainian Immovable Property Registry lacks rules for reinstating entries in scenarios where a court invalidates a title transfer to a third party without the mortgagee's consent. Thus, the registry may not accurately reflect the status of ownership in some cases. In Croatia, parties need to be careful with the release of one security interest within the same registry folder at the FINA Registry since the entire folder is typically deleted even where the remaining security package ought to stay in place. This requires in practice multiple registrations of individual security folders. In summary, the implementation and migration to electronic registries has not been completed to a sufficient extent.

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<sup>62</sup> The cadastre supports the land registry system in many economies. The International Federation of Surveyors in its Statement on the Cadastre defines the cadastre as "normally a parcel based and up-to-date land information system containing a record of interests in land (e.g. rights, restrictions and responsibilities)."

### 3.2.2.2 Costs of registration (and perfection)

*Secondly*, aside from these aspects, the EBRD Study highlights the role of legal rules pertaining to the registration of security interests. This is an issue, which is of considerable practical importance to both lenders and borrowers because they eventually bear all costs and expenses arising from the creation, registration and enforcement of security interests. One manifestation of this concern mentioned in the EBRD Study is uncapped percentage-based fees instead of fixed fees, which create unnecessary barriers for an efficient credit market. Greece is a fine example, because excessive percentage-based fees for the registration of mortgages have strongly affected market practice concerning the structuring of transactions. In particular, as mentioned above secured loans in Greece are frequently structured as bond transactions to benefit from the exemption on full registration fees for mortgages. Moreover, creditors use mortgage pre-notation instead of taking fully perfected mortgage security to avoid excessive notary's fees (see section 2.2.3 above).

### 3.2.3 Lack of development of digitalised public auction platforms

All countries, including Cyprus, require public auctions to some extent for the sale of assets in enforcement proceedings. In Albania there is no electronic auction systems for enforcement proceedings. In Cyprus, the newly amended Mortgage Act provides for the possibility of electronic auctions at the creditors' election but the electronic auction system is not yet operative. The Cyprus Minister of Finance has recently issued a decree by which an electronic auction system comes into effect, however no electronic public auction has taken place as at this date. Croatia, Greece and Ukraine meanwhile have digitalised public auction systems but market participants in Croatia and Ukraine note that improvements are required to address weaknesses in such systems. In Croatia, the state already operates an electronic public-auction system for both real and personal property. However, according to the EBRD Study, a lot remains to be done to improve the overall functionality, security and usability of such system since sales of immovables and movables remain low.

Further in Croatia, there have been issues with parties not being able to view the immovable assets being auctioned. This illustrates the need for any auction technology to be supported by a robust administrative infrastructure. In Ukraine, enforcement authorities use a specialised electronic trading venue, SETAM, for the sale of the debtor's property in enforcement proceedings but market participants confirm difficulties with the operation of the system in practice, including cases where it was not possible to receive confirmation from the system of receipt of payment of a guarantee bond, essential for participation in the trading session. In Greece electronic auctions were introduced in September 2017 onwards and are considered to produce satisfying results. In conclusion, it can be seen that the use of technology in these legal systems is still in its infancy and offers room for improvement. The EBRD Study therefore notes the great potential of incorporation of electronic platforms into national legal systems.

## 3.3 International standard and best practices

### 3.3.1 Security registries

Security registries store critical information about existing or potential security interests in movable or immovable assets, thereby creating legal certainty and transparency of security interests for debtors and creditors. Typically, registration of security interests fulfils three purposes: (i) providing secured creditors with a method of achieving third-party effectiveness of

security interests, (ii) allowing interested parties to gather reliable information about the existence of prior security interests or other encumbrances, and (iii) establishing ranking and priority among these rights based on the time of registration. As a result, in terms of enforcement and secured transactions law, the creation of an effective and accessible registration mechanism is of great importance for virtually any legal system.

An international consensus has evolved with regard to the question of how an effective registration mechanism could be designed to fully support the aforementioned core functions of collateral registries. Even though the technical details of collateral registry design and operation may vary, most if not all of them are structured around the following high-level principles.<sup>63</sup>

First, a registry mechanism for security interests should be centralised, efficient and transparent. Second, it should be fully operational and integrated in a sense that all information stored is accurate, complete and reliable in relation to the existence and priority of secured interests, and the debtor's information. Third, the registry mechanism should permit private and legal entities to register and search security interests online. Fourth, access to the registry should be economically and technically feasible. Put differently, it is of considerable importance that the services of the registry provide for an acceptable user experience and are available at low costs. Fifth, the registry mechanism should provide for notice-based registration without a condition for the inspection of documents while at the same time providing debtors with sufficient safeguards to rectify any errors in the registration. Sixth, a clear and comprehensive framework for establishing priority among secured and unsecured creditors on the basis of a first-to-file priority system should underpin the registry system. Seventh, the registrar of the registry mechanism should remain impartial and not become involved in disputes between the parties.

### 3.3.2 Digital public auction platforms

The development of digital public auction platforms is a new and expanding area. To a large extent the introduction of digital public auction platforms has built on the success of digital public procurement systems. Digital procurement proved that it was economically viable to run digital markets for the purchase of public services and suggested that such benefits could be extended to the sale of publically regulated assets.

A number of countries are experimenting in the area of digital public auctions (Chile for example) or have started exploring their potential (Kyrgyz Republic). Most recently Ukraine has been successful in launching the digital platform 'ProZorro Sale' (described below) which provided an efficient means of selling the assets of a large number of banks in liquidation. In Croatia a digital public auction platform for the sale of enforcement assets has been assisted by the technology and infrastructure of the Croatian Financial Agency.

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<sup>63</sup> UNCITRAL Guide on the Implementation of a Security Rights Registry (2013); IFC Secured Transactions Systems & Collateral Registries Toolkit (2010); OAS Model Registry Regulations under the Model Inter-American Law on Secured Transactions (2009); WBG Doing Business Report 2019 – Getting Credit strength of legal rights index; EBRD Publicity of security rights: guiding principles for the development of a charges registry (2004); EBRD Publicity of security rights: setting standards for charges registries (2005); See also Marek Dubovec and Harry C Sigman, 'Some Thoughts (and Facts) about the Process of Secured Transactions Law Reform, with Special Emphasis on Registration, the Key to Achievement of Reform's Goals' in Spyridon V Bazinas and Orkun Akseli (eds), *International and Comparative Secured Transactions Law: Essays in honour of Roderick A Macdonald* (Bloomsbury Collections 2017), 159-160; Rob Cowan and Donal Gallagher, 'The International Registry For Aircraft Equipment—The First Seven Years, What We Have Learned' (2014) 45 UCC Law Journal.

The implementation of electronic sale platforms in enforcement procedures, which would otherwise require a live public auction, offers many advantages to interested parties. A fully electronic and accessible platform improves the geographical reach and efficiency of sale processes, maximising the opportunity for higher prices by reducing transactions costs and tapping into a larger market. But this is not the only reason. Electronic platforms significantly increase transparency, competition and accountability. In other words, they form an essential pillar to entrench strong, credible public institutions in regions where the rule of law is weak. Electronic platforms have the future potential to aggregate data on sale of assets in enforcement proceedings, which may help to determine the value or price at which similar assets should be sold.<sup>64</sup> To realise these benefits, legal reform involving technology integration plays an increasingly fundamental role in the work of the EBRD and other international financial institutions.

Part of the development of an electronic sales platform depends on allowing different sales techniques depending on the type of asset and market context. This is illustrated by the example of ProZorro Sale set out below at paragraph 3.4.2. As a practical matter details concerning the auction should be set down in secondary legislation to permit amendments to be made easily where required to fine-tune the process. In Croatia, which operates a digital public auction platform for the sale of assets, the legislation which lays down the rules governing electronic auctions lacks flexibility, prescribing the auction threshold and containing rigid rules about the maximum number of times the auction may be run (twice). Legislation should also allow creditors to redeem the asset being auctioned in discharge of the secured debt. This is possible in all countries covered by the EBRD Study and, with the exception of Greece, this can be achieved without the requirement to advance new moneys. Redemption of secured assets is a recognised principle of the Cape Town Convention on International Interests in Mobile Equipment<sup>65</sup> and is particularly important in circumstances where there is no third party buyer or liquid market for the secured asset.

### 3.4 Cross-jurisdiction analysis

Against this background, it is apparent that the examined registry systems in the EBRD Study significantly lag behind in the process of transitioning from paper-based to fully electronic registry systems due practical, legal and technical limitations. There is also room for improvement in the design of public auction registries. Thus it is useful to examine first, some recent examples of well-functioning registries and second, an example of a digital public auction platform.

#### 3.4.1 Registry systems

This section provides a brief introduction to some international and national security registries following most, if not all of the above mentioned principles. Although these registries still differ in some aspects, such as in terms of state-owned versus non-state-owned, scope of security interests, and legal tradition among other matters, the comparison will provide valuable contrasts and insights. Specifically, it is hoped that the comparative analysis will shed light on practical and policy questions that arise when designing and implementing secured transactions laws.

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<sup>64</sup> T.R.M.P. Keijser, 'The potential impact of technology on the enforcement of security interests' in 'Onderneming en Digitalisering' (Enterprise and Digitalization) (Kluwer, 2019).

<sup>65</sup> Article 9 (Vesting of object in satisfaction; redemption) of the 2001 Convention on International Interests in Mobile Equipment.

#### 3.4.1.1 The Aircraft Registry of the Cape Town Convention

The first example that has to be noted is the Aircraft Registry of the Cape Town Convention.<sup>66</sup> It is a useful example of a specialised collateral registry not only because it is based on the UCC but also because it encompasses many, if not all of the features recommended by the UNCITRAL Registry Guide. On top of this, it is also very interesting from a technological and legal standpoint.

The registry runs entirely electronically and the registrar is obliged to use best practices in the field of electronic registry design and operation to avoid any potential liability to third parties. This high standard is particularly noteworthy because unlike many other national collateral registries the aircraft registry is run by a private company rather than a state office. Particularly, Aviareto Limited, a private company in Ireland has been selected to operate and manage the aircraft registry following a competitive tender process. Since March 2006, the Registry has been operating on a not-for-profit basis under the supervision of the International Civil Aviation Organization (“ICAO”), which also determines the registration fees. In 2019, more than one million registrations with half a trillion dollars’ worth of assets have been so far registered – an impressive number that underlines public confidence in the smooth operation of the registry so far and proves the feasibility of the international registry design concept. In this respect, the most striking feature is that the registry operates under an international treaty, and applies only to a specialised asset category, namely aircraft objects as defined under the Convention and Protocol. It is the first of its kind in history of secured transactions law.

Registration requirements are straightforward. International interests in aircraft objects as defined under the Convention must be registered to be effective against third parties. International interests are searchable by any member of the public. The aircraft registry is a notice-based registry underpinned by a first-to-file priority rule. Similar to the UCC, it is also possible to register a prospective interest in an aircraft object.

#### 3.4.1.2 Belgian registry under the Belgian Pledge Act

The most recent example of a national electronic registry, which aims to comply with international best practice, can be found in Belgium. Belgium has recently amended its secured transactions legislation. The Belgian Pledge Act of 11 July 2013 entered into force in January 2018 and establishes a fully electronic Pledge Registry for movable assets. Creditors must register a security interest in the Pledge Registry to make it effective against third parties. The Belgian Pledge Registry is a centralised nationwide registry. It is interesting in many aspects. One of them is the fact that it is also based on modern technology and strives to set a new standard for the operation and design of electronic registries. The second one is that although the international standards concerning secured transactions law reform worldwide have inspired the Belgian Pledge Registry, the Belgian legislator has made some key policy decisions that considerably deviate from the aforementioned model of the UCC and international instruments.

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<sup>66</sup> The Cape Town Convention and its related Aircraft Protocol are international instruments, which establish a uniform legal regime for the creation, registration, and protection of international interests in aircraft objects. Creditors holding an international interest can rely on a swift and effective system of remedies exercisable in the event of the debtor’s default or insolvency. The Cape Town Convention also has protocols and related registries for railway rolling stock and space assets. An extension of the Cape Town Convention to mining, agriculture and construction sectors equipment is under negotiation.

Many of these deliberate choices are the result of the European legal tradition in property law. Thus, it is worthwhile to discuss some central aspects of the registry in more detail.<sup>67</sup>

First, like many national legal systems based on the civil law tradition, the Belgian Pledge Act is based on a formal instead of a functional understanding of security interests. Therefore, while security interests must be registered to obtain third party effectiveness, retention of ownership ordinarily enjoys super-priority without registration (although they may be registered as well). Second, the Belgian Pledge registry is special because it applies a modification of the first-to-file priority system. While priority among creditors is determined by order of registration in line with international model laws, security interests registered on the same day enjoy the same priority under the Belgian Pledge Act. Third, under the Belgian Pledge Act, the registry is designed to focus exclusively on security interests that actually have been validly created. For this purpose, creditors are asked to submit a more comprehensive set of information upon registration of security interest than under the UCC. The submission of correct information is further facilitated by a number of legal rules. For example, a registration becomes invalid if personal details are incorrect. Also, a secured creditor is liable for all damages resulting from the submission of incorrect data.

It is important to stress that creditors are, however, not required to submit the underlying security documentation or similar evidentiary material and that there is no intervention of a registrar. Thus, unlike the UCC or the Aircraft Registry, the Belgian registry takes a middle ground between the document- and notice-based approaches to registration. The effect is that registration may only take place after the conclusion of the security agreement between the creditor and debtor given the need for precise information. Arguably, this approach provides a higher degree of reliability and trustworthiness; and reduces the workload of creditors because they do not have to verify the validity of each security interest individually. Fourth, it is important to point out that registration of a security interest under the Belgian Pledge Act expires ten years after it has been entered into the system. This is a considerably longer period than in Ukraine (five years for a pledge over movables) but it nevertheless implies some limitations of the registration system. Fifth, the Belgian Pledge registry is quite extensive in its scope and covers security interests in aircraft and motor vehicles. There is only a separate registry for ships in Belgium. Sixth, access to the registry is open to the public although a Belgian electronic identity card is required to prevent misuse of data which limits access to international creditors. Seventh, registrations are indexed by reference to the identity of the grantor of security and not by reference to the secured asset, which some local counsel in the EBRD Study, for instance in Croatia and Greece, consider would be a more useful point of reference for creditors. Further, registration may be searched by a chosen or automatically assigned registration number.

### 3.4.2 Digital Auction Platforms

#### 3.4.2.1 ProZorro Sale

Internationally there are a number of positive and successful examples of how digital platforms, in particular electronic auctions, can enhance the collection of NPL in the EBRD region. A recent and very successful example can be found in Ukraine where the EBRD was able to build on its project with the Ukrainian authorities, which established in 2014 an e-procurement system replacing an old paper-based public tender system, by reversing the “purchasing” platform into a

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<sup>67</sup> Joke Rachel Baeck and Lize Heytens, ‘Setting a new standard for the harmonization of secured transactions law: the new Belgian Pledge Registry’ (2019) 24 Uniform Law Review; Eric Dirix, ‘The New Belgian Act on Security Interests in Movable Property’ (2014) International Insolvency Review.

“sales” platform. This created an electronic auction platform, generally referred to as ProZorro.Sale, for the disposal of assets of 88 banks which were declared insolvent by the National Bank of Ukraine and transferred to the Ukrainian Deposit Guarantee Fund (“DGF”) during the 2014-17 crisis.<sup>68</sup>

ProZorro Sale has used a number of recognised auction techniques, such as the conventional technique of rising bids and the so-called ‘Dutch auction’ where the auctioneer begins with a high price and reduces this over time until the intervention of a successful bidder. ProZorro Sale has also innovated to develop new auction models for state property, such as leases of land, sale of renewable energy certificates, mineral extraction licences and leases of railcars. Based on research by the Kyiv School of Economics on sale of NPLs under the DGF’s management<sup>69</sup>, ProZorro Sale has developed a new ‘Hybrid Dutch’ model that is aimed at reducing the effects of asymmetric information and stimulating competition, thereby increasing the final sale price. It consists of up to three stages. In the first stage, a so-called ‘descending clock auction’ is deployed where the auctioneer begins with a high asking price and lowers it until a participant accepts the price, or it reaches a predetermined reserve price. The auction proceeds to the second stage if a participant accepts the price. At this stage, bidders are invited to submit sealed-bids above the reserve (stopping) price of the clock stage. In the third stage, any winner of the first clock stage is informed of the amount of the sealed bids and is given a chance to submit a bid at least 10% higher than the highest sealed bid. This model was applied to the sale of the DGF’s assets and its effects analyzed by the Kyiv School of Economics in April 2019<sup>70</sup>. For the period from 31 October 2016 until 25 July 2018 it is estimated that the auctions recovered 22% of the face value of the loans transferred to the DGF. This recovery rate is lower than the exemplary recovery rates of public asset management companies in Indonesia (31.4%), Malaysia (34.1%) and South Korea (29.2%) after the 1997 Asian financial crisis but is more than satisfactory when compared to other countries with similar NPL levels. The ProZorro Sale project has also paved the way for innovation in the area of insolvency proceedings where the Cabinet of Ministers of Ukraine is planning the introduction of an electronic system for the organisation of electronic auctions for the sale of the property of an insolvent debtor. ProZorro Sale may serve as a model for future reform, including in Moldova where the Central Bank faces a similar task of disposing of the assets of a number of banks in liquidation. It has been successful in putting academic theory into practice, using the latest open source technology which does not expose the government to commercial information technology vendors. Ukraine has therefore demonstrated that it is possible to create a market for the sale of state assets and public service can be collaboratively and effectively delivered in a private market place.

### 3.5 Conclusion and Questions

This part examined some of the significant issues involved in modernising registry mechanisms for security interests and has stressed the critical need for integrating modern technology in judicial proceedings and enforcement sales to allow for a more rapid, transparent and efficient enforcement process. Globally and nationally, there is sufficient legal guidance in terms of which characteristics a modern efficient registry should contain or how technology can enhance

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<sup>68</sup> ProZorro.Sale is an EBRD funded project established by the Ukrainian Ministry of Economic Development and Trade of Ukraine, Transparency International Ukraine, Deposit Guarantee Fund, the National Bank of Ukraine and Ukrainian electronic platforms.

<sup>69</sup> Tymofiy Mylovanov et al, ‘Selling Toxic Assets in Ukraine. Overview of Current Situation and Suggestions for Improvement of the Auction Design’ Kyiv School of Economics (2017)

<sup>70</sup> Natalia Shapoval et al, ‘Selling non-performing loans: new evidence from Ukraine’ Kyiv School of Economics, (2019)

enforcement proceedings, but the challenge remains to adequately transplant and adopt it to the local circumstances of a domestic legal system.

1. *How can we close the apparent gap between theory and practice in the implementation of collateral registries in developing jurisdictions? What are the reasons behind the success and failure of transplanting modern registration systems into national legal systems?*
2. *To what extent are online registries and notice systems reliable? To what extent does technology reduce the risk of human error or external manipulation?*
3. *Should public access to collateral registries be restricted? If so, what are the most suitable tools to achieve this and which policy should be followed to balance the seemingly opposing goals of transparency and data protection?*
4. *Is a hybrid transaction and notice-filing system, such as in Belgium, superior to a UCC Article 9 notice-filing system as advocated by international standards?*
5. *Given the cross-border nature of financing, to what extent should countries in the EBRD region be working towards a harmonised approach to security registries? Is this achievable?*



## 4. Extrajudicial and judicial enforcement framework

### 4.1 General

Efficient, cost-effective, transparent and reliable enforcement mechanisms are key when evaluating the performance of economies and legal systems. *Secured creditors* have an interest in determining under what legal circumstances, in which time period, and at what cost they may recover the value of the secured claim through realisation of the collateral. Thus, it is important for jurisdictions to develop adequate enforcement mechanisms. Specifically, legal systems should provide for prompt, predictable and affordable enforcement procedures and remedies for the realisation of security interests. This will maximise the recovery value of the collateral to the advantage of both lenders and borrowers. Moreover, if a creditor is able to enforce its security without facing significant delay, costs, or unpredictable judicial risk and outcomes, the legal value of taking securities in general is enhanced. As a result, creditors will be more likely to provide more loans at reasonable credit rates.<sup>71</sup> Also, *unsecured creditors* are dependent on an effective enforcement process, because they have to follow a court process in every jurisdiction due to the lack of a security agreement that shapes the enforcement procedure.

Accordingly, a reasonable balance between ease and speed of enforcement remedies for creditors, on one hand, and the protection of both the debtor and third parties is to the advantage of all involved stakeholders. It is, however, essential to note that there is generally no accepted or agreed enforcement model among the various legal traditions and families. Rather, the approaches to the topic of enforcement between common law and civil law systems, as well as within the different legal families themselves, differ remarkably. Despite the diversity of enforcement systems worldwide, the EBRD Study finds elements of the enforcement frameworks in Albania, Croatia, Cyprus, Greece and Ukraine unattractive for creditors and international investors. Specifically, length of enforcement proceedings is a big issue since these are correlated with higher enforcement costs and lower creditor recoveries. The frameworks do not create legal certainty and predictability, nor do they meet the market expectations of an effective system for the resolution of commercial disputes. The precise reasons for that and potential solutions to address these deficiencies are the focus of the next section.

### 4.2 Findings of the EBRD Study

#### 4.2.1 Limited extrajudicial enforcement of security

The EBRD Study observes that the examined legal systems show a trend towards a relatively restricted approach to enforcement both in terms of available remedies and alternatives to formal judicial proceedings. At one side of the spectrum is Albania, which in practice requires judicial enforcement and prohibits private self-help enforcement measures by banks.<sup>72</sup> In fact, in

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<sup>71</sup> John Armour and others, 'How do creditor rights matter for debt finance? A review of empirical evidence' in Frederique Dahan (ed), *Research Handbook on Secured Financing in Commercial Transactions* (Edward Elgar Publishing 2015); Rainer Haselmann, Katharina Pistor and Vikrant Vig, 'How Law Affects Lending' (2010) 23 *The Review of Financial Studies* 549; Kee-Hong Bae and Vidhan K. Goyal, 'Creditor Rights, Enforcement, and Bank Loans' (2009) 64 *Journal of Finance* 823; Simeon Djankov, Caralee McLiesh and Andrei Shleifer, 'Private credit in 129 countries' (2007) 84 *Journal of Financial Economics* 299; Rafael La Porta and others, 'Legal Determinants of External Finance' (1997) 52 *Journal of Finance* 1131.

<sup>72</sup> There is a theoretical possibility of out-of-court enforcement if, at the point of enforcement, the debtor accepts the debt by way of unilateral notarial deed, but this is not customary.

Albania all secured assets must, where sold to third parties, be auctioned through public or private bailiffs by means of public auctions. Greece is also towards this side of the spectrum, since enforcement sales must follow a court-led auction procedure, notwithstanding that certain types of security interests created in favour of credit institutions benefit from “fast-track” enforcement. In the middle of the spectrum are jurisdictions such as Croatia and Cyprus, which allow the private sale of movables but require immovables to be sold via public auction.<sup>73</sup> However Cyprus is arguably more creditor self-help orientated than Croatia since a mortgage over land may be realised by private sale if the first attempt to sell the property through public auction is unsuccessful. At the other end of the spectrum in terms of theoretical increased creditor self-help is Ukraine, which permits out-of-court enforcement for both movables and immovable. Yet in Ukraine the attractiveness of such out-of-court route in respect of movables is threatened by the law, which provides that extrajudicial enforcement of a pledge over movables by foreclosure will discharge the entire security package of the secured creditor and the entire debt obligation. This limitation also applied until last year to the extrajudicial enforcement of immovables. For all EU countries and Albania, out-of-court enforcement of financial collateral is permitted following implementation of EU Directive 2002/47/EC on financial collateral.

However, even if the black-letter of the law exceptionally provides for private enforcement in some of the assessed jurisdictions, in practice this is rarely a realistic option. The EBRD Study reports that there is little experience of out-of-court enforcement in Croatia. In Cyprus, local counsel observe that cooperation of the debtor is critical for any successful out-of-court enforcement. In all countries surveyed, enforcement proceedings are often delayed by debtors raising procedural and substantive appeals or challenges, thereby effectively requiring creditors to tread a judicial enforcement path. The EBRD Study suggests that the area of appeals and challenges should be considered more closely by legislators. First, debtors do not have to fear the application of any meaningful sanctions or bear significant costs. Second, the formal and substantive legal requirements for appeals are relatively low. Third, given that the enforcement processes in these jurisdictions already tend to be long and burdensome, debtors may leverage this to their advantage. For example, according to market participants in Ukraine, it is quite common that a debtor may appeal the underlying obligation at any time even after the enforcing party has called an event of default and commenced enforcement. This usually suspends the enforcement proceeding initiated by a creditor until the resolution of a debtor's claim by the court, which may delay the enforcement by at least for six months. Even within the enforcement process the debtor often asks the court for an independent valuation in respect of the collateral and Ukrainian law does not set a timeframe for conducting a valuation process, which is reportedly takes on average six to 18 months. The debtor may then appeal the valuation report on formal grounds, adding another six to 18 months of delay. The EBRD Study reports that the tendency to follow a judicial process is strengthened by the fact that a party may rely on the court's decisions when dealing with state authorities. Consequently, the ultimate result is that judicial enforcement is the primary and frequently the only way debt can be enforced.

It is, however, important to note that judicial enforcement per se would not constitute a critical issue if judicial remedies were efficient and predictable. Indeed, many other continental European legal systems primarily rely on judicial enforcement mechanisms that satisfy both the interests of debtors and creditors. But with regard to the examined jurisdictions, it becomes a

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<sup>73</sup> Croatia also allows, in theory, the creditor the option to commence (out-of-court) enforcement before a public notary in relation to enforcement of certain types of security interests which have the status of “authentic instruments” but, in practice, debtors commonly object to the public notary's decision and the process ends up in litigation before the courts.

delicate problem because the courts and other administrative institutions lack the capacity, infrastructure, financial resources and expertise to guarantee a satisfactory outcome of enforcement proceedings.

#### 4.2.2 Weaknesses in judicial enforcement proceedings

The EBRD Study observes that the efficiency of the judicial enforcement process in the examined jurisdictions is frequently unsatisfactory for lenders due to its complexity, slowness, non-transparency, expense and uncertainty. The common and most essential reasons for these drawbacks can be summarised as follows.

*First*, the EBRD Study reports that an escalating number of enforcement cases have overwhelmed the massively understaffed court systems, which not only know long court holidays but also lack specialisation to adequately handle the high volume of cases in an effective manner. There are often no specialised courts or divisions for commercial disputes in place. Albania, Cyprus and Greece lack such specialised courts or divisions and judges. As detailed in section 3.2 above, the overload of the judicial systems is closely linked to the jurisdictions' heavy reliance on paper-based instead of electronically supported court proceedings and electronic or at least electronically supported auctions are unheard in a couple of jurisdictions, which may have severe adverse effects on the enforcement stage. This is especially so if auctions are not adequately advertised and open for participation. The consequence is lower prices and lower prospects of sale.

*Second*, the EBRD Study notes that in all of the jurisdictions judicial enforcement is extremely costly due to the fees and expenses charged by the various parties involved in the process: courts, lawyers, notaries, appraisers and enforcement agents. Thus, percentage-based minimum fees or expenses are not only a pressing issue at the time of creation or registration but also at the enforcement stage. During the enforcement process, there is a significant risk of abuse and collusion between the various parties involved in the enforcement process to extract value from the security interest to the detriment of debtors and creditors. The EBRD Study also points to high enforcement costs, for example in Albania where bailiffs are remunerated on a percentage of the value of the claim.<sup>74</sup> In Croatia and Ukraine, the problem of enforcement costs is slightly different: it is not the amount of costs but rather the requirement to advance enforcement costs, although the EBRD Study finds that there are delays in Ukraine in payment by the State enforcement agency to enforcement professionals which holds up the process

*Third*, the EBRD Study mentions several other legal factors that are doing their part to increase judicial enforcement costs. One of these relates to the procedural law of the legal systems. Particularly, the rigid structure of proceedings, the lack of concentrated and continuous hearings, as well as the court time consumed by routine matters, are cost-driving factors. Also, the fact that debtor may significantly delay judicial enforcement by preventing effective delivery of critical documents, such as court summons. Further, minimum standards for court-administered sales concerning appraisal and minimum bidding requirements have to be mentioned as well. Another factor reported in the EBRD Study concerns the legal certainty and predictability of secured transactions laws in the examined jurisdictions. Creditors and debtors are often forced to work around legislation that is ambiguous, unclear and may have significant gaps that have not been yet resolved by jurisprudence. This lack of legal uncertainty and predictability invites litigation by all interested parties, causes delays and increases dependency on professionals.

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<sup>74</sup> Bailiffs are paid a fixed fee for claims up to approximately EUR 4,000. For claims above this amount, they are paid a percentage of the value claim, but which cannot exceed 5.5% of the claim value.

It can be seen that constructing a workable enforcement system is a complex topic and must be addressed from various angles.

#### 4.2.3 Interaction between enforcement and insolvency

Enforcement and insolvency may coincide since enforcement action is usually a response to non-payment by the debtor, which may no longer be financially viable. The EBRD Study therefore also explores the relationship between enforcement and insolvency and more precisely the impact of commencement of proceedings on any enforcement process. It considers topics such as treatment of secured creditors in insolvency proceedings, whether enforcement actions by secured creditors are subject to a general moratorium on enforcement proceedings against the debtor, and the involvement of secured creditors in insolvency proceedings.

It is notable that in all jurisdictions apart from Cyprus, once the grantor of security enters a formal liquidation-type procedure, the default position is that any secured assets are enforced within the insolvency proceedings by the insolvency practitioner. The practitioner then takes a percentage of any realisations from the secured asset before channelling the remaining proceeds to the relevant secured creditor. In a reorganisation-type procedure secured creditors are generally stayed from enforcing any security on the grounds that this may undermine the debtor's business.

In Albania, the commencement of a reorganisation or liquidation style procedure results in a stay on any enforcement, including any ongoing enforcement proceedings by secured creditors. While a secured creditor is entitled to request the separation of the secured asset from the insolvency estate, the administrator has a wide discretion to refuse such request where he reasonably believes that the value of the asset may increase in the future and the auction selling price could be higher. In Croatia, the applicable law states that any enforcement proceedings pending at the time of opening of bankruptcy proceedings shall be suspended and continued before the court conducting the bankruptcy proceedings, unless 'certain enforcement actions' have been taken before the new law entered into force. The lack of clarity in the legislation has been identified by market participants as a major source of delay since, in practice, the bankruptcy court seeks to take over any ongoing enforcement proceedings. While all security needs to be enforced within insolvency, creditors which retain title or ownership rights (known as 'exemption rights') over certain assets in the possession of the debtor are entitled to request the exclusion of such assets from the debtor's estate and to enforce their exemption rights in accordance with the general rules, as if the proceedings had not been opened (similar to under German law discussed at section 4.3 below).

Cyprus permits enforcement of security outside insolvency, however, it is subject to the order of the court which may require the security to be a part of the liquidation or winding up to result in favourable liquidation of the company's assets. In Greece, on declaration of bankruptcy by the debtor there is a moratorium on initiation and continuation of the individual enforcement of claims by creditors, including secured creditors in any pre-bankruptcy, bankruptcy liquidation or special administration procedure. Creditors whose claims are secured by a special privilege or security on a particular bankruptcy asset will generally be satisfied by the enforcement of the secured asset within the insolvency proceedings and will, in practice, only receive any proceeds at the end of the proceedings. In Ukraine, in the initial stage of the insolvency procedure, a moratorium on enforcement comes into effect by operation of law, for a period of 170 calendar days. If creditors fail to make a decision on whether the debtor should be put into rehabilitation or be declared bankrupt within such period, secured creditors may enforce their security.

However, if liquidation proceedings start within such period, all assets (including secured assets) may be sold by the liquidator. Further, in the course of the rehabilitation procedure, a secured creditor may request the court to terminate the moratorium provided that the security is not used in the implementation of the rehabilitation plan, or if the collateral is perishable.

#### 4.3 International standards and best practices

##### 4.3.1 Enforcement frameworks

Before discussing enforcement frameworks in more detail, it seems necessary to provide some clarifications with regard to the question of what is meant by the enforcement of secured and unsecured debt. A glance behind the meaning of *enforcing debt* in civil and common law jurisdictions reveals major differences that can be partly traced back to the diverging approaches to extra-judicial enforcement of secured debt.

###### 4.3.1.1 Civil Law

In civil law jurisdictions, the enforcement of secured or unsecured debt is in principle a two-step process. The first step ordinarily involves suing the debtor at the competent court for payment of the money due and requesting the debtor's submission to compulsory enforcement proceedings. This requirement is a reflection of the broader civil law philosophy that the supervision and control of the court guarantees the protection of the weaker parties' rights in unequal bargaining positions. The resulting judicial decision confirming the claim will constitute legal title for the second step, the actual enforcement process, which by default is overseen and controlled by a judge or judicial officer. If at all, the debtor and creditor may vary this enforcement process only to a limited extent depending on the type of debtor and nature of the asset, e.g. private sale and appropriation, and often, only after the debt has matured.

To accelerate the two-step process, some jurisdictions provide for alternatives to court judgments that qualify as a legal title. The most relevant one in the context of security interests is a notarial deed under which a debtor voluntarily submits to direct judicial enforcement of the claim following a default in repayment. The notarial writ carries the significant advantage to creditors of creating an advance legal title, thus avoiding the first step of the process. Owing to its advantages in comparison with judgments, use of a notarial writ for the enforcement of secured debt is common market practice where available, including in many of the countries covered by the EBRD Study. The important point to derive from this explanation is that civil law lawyers tend to mean the second step of the enforcement process when speaking about the enforcement of debt, whether secured or unsecured. In other words, enforcement means the enforcement of judgments or notarial deeds based on the applicable enforcement code without necessarily having regard to origin of the debt.

###### 4.3.1.2 Common Law

To the contrary, the terminological distinction between secured and unsecured debt is more relevant in the enforcement process of legal systems based on the common law. While the enforcement of unsecured debt is comparable in both legal traditions, the route of enforcing secured debt in common law jurisdictions is seen very differently in legal practice. In fact, it is often not qualified as a dispute by itself due to the self-enforcing character of security interests. Particularly, security agreements under English law clearly specify the process by which a security may be realised without resorting to the courts. Accordingly, the integration of

alternative dispute mechanism must be approached very carefully keeping in mind the underlying enforcement structure and legal culture.

Nevertheless, there is no ideal enforcement model, but some general recommendations for enforcement mechanisms can be derived from academic and practitioner discourse and international guidance. They shall now be examined.

To begin with, any enforcement framework should be designed with the goal of an efficient, cost-effective, transparent and reliable realisation of security interests in mind.<sup>75</sup> This will frequently involve the reform of national secured transactions and enforcement provisions for the purpose of providing more clarity, certainty and predictability to the legal enforcement proceedings. Secondly, effective enforcement laws should ensure that the value from realisation of secured assets is maximised to the advantage of both debtors and creditors.<sup>76</sup> This may, for example, be achieved by minimising both the involvement of judicial or administrative officials in the enforcement process, or alternatively by ensuring that courts possess the necessary training, skills, and financial resources. It is further essential that court systems be designed in a way that provides for transparency so that parties can trust in a fair, objective and efficient enforcement process. This objective may be pursued through setting up specialised administrative agencies or courts to effectively enforce security interests of creditors. Thirdly, any enforcement framework should at least to some extent recognise the principle of party autonomy in the context of secured transactions.<sup>77</sup> Thus, parties should have discretion to define and regulate the enforcement process according to their needs and purpose.

In particular, legislators should allow commercial, sophisticated parties to agree on extra-judicial remedies subject to mandatory safeguards for debtors. This may not only reduce transaction costs but also lower the burden on overloaded institutions. For example, the law may provide the parties with discretion to agree in the security agreement on the realisation of the asset by public or private auctions or private sale – or allow the parties to agree after the default of the debtor to take the asset in satisfaction of the underlying debt. Fourthly, the remedial system in the enforcement process has to be structured and designed in a way that protects the rights of debtors and creditors in a fair and efficient manner.<sup>78</sup> This implies both limiting the debtor's option to obstruct the enforcement process without a legitimate interest and preventing creditors from intentionally abusing their legal rights to the detriment of the debtor's interests. Fifth, the enforcement system must work well both in and outside insolvency proceedings if it is to be effective.<sup>79</sup> It is critical that fundamental principles such as the preferential treatment of secured creditors in comparison to unsecured creditors are upheld in insolvency proceedings. Such preferential treatment in insolvency is what drives a creditor to take security in the first instance and offers some protection for the repayment of its loan.

#### 4.3.2 Alternative dispute mechanisms

It is essential to recognise that, globally, a trend can be observed to strengthen private resolution of commercial disputes and to reduce litigation before the courts. Interestingly, this statement is true for both developed and developing national legal systems. In jurisdictions where the rule of

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<sup>75</sup> UNCITRAL Legislative Guide on Secured Transactions, 2009.

<sup>76</sup> Recommendations 131(ff), Chapter VIII, Legislative Guide.

<sup>77</sup> Recommendation 10, Chapter I, Legislative Guide.

<sup>78</sup> Recommendations 131(ff), Chapter VIII, Legislative Guide.

<sup>79</sup> Recommendations 12(ff), Chapter XII, Legislative Guide.

law is weak and enforcement processes before the courts tend to be long and burdensome, the rationale for using alternative dispute resolution (ADR) appears more obvious. Yet in national legal systems with well-functioning enforcement systems ADR may provide a more cost-effective route than litigation. ADR, in particular mediation and arbitration, is nowadays a recognised method for resolving commercial disputes and is used increasingly over the last decades at both national and international level.<sup>80</sup>

Secured transactions are at the crossroads of various interests, which creates additional challenges for ADR, especially when it comes to the rights of third parties. Types of disputes which may occur in relation to the enforcement of security include disputes related to the value or marketing of the secured asset or the order and extent to which all security interests are enforced. The increased regulation of security interests constitutes an impetus for the further homogenisation of secured transactions through model laws which, in its turn, may lead to the an increase in the use of ADR. The UNCITRAL Model Law on Secured Transactions explicitly recognises in the form of a general carve-out provision the use of ADR, including arbitration, mediation, conciliation and online dispute resolution for the resolution of enforcement disputes.<sup>81</sup> Similarly, the OAS Model Inter-American Law on Secured Transactions provides in Article 68 for the application of arbitration in case of a dispute between the parties arising out of the interpretation and fulfilment of a security interest.<sup>82</sup> The cross border enforcement of arbitral awards has historically been more established, with the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards. Recently the United Nations has developed and adopted the Singapore Convention on Mediation to give similar cross-border effect to mediation settlement agreements, which do not have the status of enforceable judgments pursuant to national law.

In the United States, the use of ADR tools and techniques in relation to bankruptcy-related disputes is encouraged.<sup>83</sup> Nevertheless the role and function of ADR in the field of secured transactions is a largely unexplored area. It therefore seems sensible at the outset to draw some distinctions between the various ADR routes and in particular between arbitration and mediation.

#### 4.3.2.1 Arbitration

Each of the countries covered by the EBRD Study are signatories to the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards. Arbitration is reportedly used in Cyprus and Ukraine to resolve disputes arising under loan and security documents, although its use is not extensive. In Cyprus, cooperative banks may, pursuant to the Cooperative Societies Act, elect whether to submit a dispute to arbitration or to the courts and arbitration proceedings commenced by cooperative banks are considered relatively efficient. In Ukraine, the banking association has a forum for resolving debt related disputes by arbitration.

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<sup>80</sup> Orkun Akseli, 'Mediation in disputes arising in the context of the enforcement of security interests' (2017) 22 Uniform Law Review 747; Maya Boureghda Chebeane, 'Alternative dispute resolution (ADR) and secured transactions' (22) Uniform Law Review 773; Rafal Morek, 'To compel or not to compel: Is mandatory mediation becoming "popular"?' (*Kluwer Mediation Blog*, 2018) <<http://mediationblog.kluwerarbitration.com/2018/11/19/to-compel-or-not-to-compel-is-mandatory-mediation-becoming-popular/>> accessed 26 November 2019.

<sup>81</sup> Art 3(3) of the UNCITRAL Model Law on Secured Transactions: 'Nothing in this Law affects any agreement to use alternative dispute resolution, including arbitration, mediation, conciliation and online dispute resolution.'

<sup>82</sup> Article 68 of the OAS Model Inter-American Law on Secured Transactions: 'Any controversy arising out of the interpretation and fulfillment of a security interest may be submitted to arbitration by the parties, acting by mutual agreement and according to the legislation applicable in this State.'

<sup>83</sup> Elizabeth S. Stong, 'Some Reflections from the Bench on Alternative Dispute Resolution in Business Bankruptcy Cases'.

There may nonetheless be local law limits on the type of disputes which can be resolved by arbitration. In Ukraine, disputes with respect to certain types of security instruments such as mortgages and/or security under consumer loans cannot be resolved by arbitration due to procedural limitations. In Cyprus, 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 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.

The long duration of arbitration proceedings, the lack of any platform to resolve small claims<sup>84</sup> together with the low number of arbitration safe seats in emerging markets would appear to limit the impact of arbitration on mainstream enforcement proceedings in the EBRD region.<sup>85</sup> While some of these deficiencies could potentially be addressed by introducing fast-track proceedings, relying on e-arbitration, or selecting a sole arbitrator rather than three arbitrators to resolve the dispute where suitable, for example for less complex cases, many aspects remain problematic given the specificities of secured transactions law. First, arbitration seems to be only a realistic alternative in scenarios where the applicable secured transactions legislation permits extra-judicial enforcement as an alternative to judicial enforcement, or the judicial system itself is considered dysfunctional<sup>86</sup> and the parties have specified arbitration in the underlying contract. On the contrary, in jurisdictions where judicial intervention is indispensable to enforce a security interest, arbitration as a means of dispute resolution offers no real advantage over the traditional route. The second concern is the question of how arbitration can sufficiently address the protection of third party rights and proprietary interests, for example, whether arbitral tribunals have the power to order interim measures, to request evidence in possession of a third party, or to issue an injunction or the attachment of funds.

In practice, arbitral tribunals have limited authority over third parties unless such parties voluntarily submit to arbitration. In order to solve this problem, there are some proposed solutions. Some argue that arbitration and secured transactions laws have to be tailored to the specific needs of finance transactions. Others claim that arbitration already encompasses the necessary tools to deal with third parties, i.e. multi-party arbitration and consolidation of procedures and that any arbitral tribunal will pay close attention to the decisions rendered by the competent court.<sup>87</sup> Unlike mediation settlement agreements, arbitration awards are easier to enforce due to the wide acceptance of the New York Convention 1958, especially where the debtor has assets in a number of countries.<sup>88</sup> Indeed, arbitration provides for an international and, what some parties would consider a-national forum for dispute resolution with specialised arbitrators that ensure neutrality. On the contrary, domestic courts may be characterised by a certain cultural bias.

#### 4.3.2.2 Mediation

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<sup>84</sup> For example, the London Court of International Arbitration only considers disputes over £100,000.

<sup>85</sup> See the Delos Guide to Arbitration Places accessible at <https://delosdr.org/index.php/gap/overview-methodology/>

<sup>86</sup> It may be noted here that this may not be true in all cases, as arbitration can be an appropriate method of dispute resolution even when a legal system functions properly.

<sup>87</sup> Charles Nairac and Jean-François Adelle, 'Using Arbitration to Resolve International Financing Disputes' (*Wolters Kluwer Blog*, 23th December 2016) <<http://arbitrationblog.kluwerarbitration.com/2016/12/23/using-arbitration-to-resolve-international-financing-disputes>> accessed 22 November 2019

<sup>88</sup> Cooperation of judges is needed for the enforcement of an arbitral award but judges can refuse enforcement only on the very limited grounds of public interest or procedural irregularity.



Apart from arbitration, mediation must also be considered as part of the ADR route. All of the countries covered by the EBRD Study recognise mediation. In Albania and Greece, a court stamp is needed for enforcement of a mediation settlement agreement, while in Cyprus and Ukraine, a mediation settlement agreement is deemed to be a contract and may only be enforced as a contract, in other words by commencing stand-alone proceedings on merits of the dispute between the parties. Croatia provides that a mediation settlement agreement is a directly enforceable deed, subject to satisfaction of certain conditions.

Unlike arbitration, which is by nature adversarial, the original premise of mediation is a voluntary process which parties can decide to leave at any time. Mediation is perceived by some commentators as a more appropriate way of dealing with conflicts and disputes than direct negotiation. The use of mediation may help to preserve the relationship between the parties and may support negotiations where enforcement is not the only route and full or partial restructuring of the underlying debt remains an option. For this reason, some commentators have referred to the benefits of mediation for reorganisation cases in insolvency proceedings where trade relationships need to continue to support the ongoing business.<sup>89</sup> Nonetheless, in some jurisdictions, such as Croatia and Greece, certain stakeholders within the legal community have resisted efforts by the country authorities to increase the use of mediation.

Mediation fees are more moderate and payment is generally by the hour. Court costs in the EBRD region are not typically high, thus the main motivating factors for using ADR rather than the courts relate not necessarily to lower costs but to concerns about slow court proceedings and possibly court independence and competence to adjudicate disputes. Arbitration is older and more established than mediation, which is not necessarily well developed in non-EU jurisdictions.

The rationale of allowing ADR as an alternative to civil litigation is its immense potential to increase efficiency in the resolution of commercial disputes, especially in jurisdictions with less developed, troubled or overburdened judicial enforcement systems.<sup>90</sup> Against the background of the EBRD Study, there is an argument that ADR could address many of the present deficiencies in the assessed jurisdictions by reducing the workload of overburdened courts, and thereby fostering a more cost-effective and speedier collection of loans. This is, for instance, suggested by both empirical data and practical examples at national level.<sup>91</sup>

At international level, there has been a push within the EU towards encouraging the use of mediation to promote the amicable settlement of disputes and thereby a balanced relationship between mediation and judicial proceedings following the EU Directive on mediation introduced in 2008.<sup>92</sup> Although the enactment of the EU Directive can be considered as a success by itself in promoting mediation as a measure of alternative dispute resolution, it is still far from achieving its objectives, in particular because it has been unable to gain any meaningful practical

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<sup>89</sup> Elizabeth S. Stong, 'Some Reflections from the Bench on Alternative Dispute Resolution in Business Bankruptcy Cases'.

<sup>90</sup> Paragraph 75, UNCITRAL Model Law on Secured Transactions Guide to Enactment (2017).

<sup>91</sup> Inessa Love, 'Settling Out of Court: How Effective is Alternative Dispute Resolution' (*The World Bank Group Viewpoint Note Number 329*, 2011) <<http://siteresources.worldbank.org/FINANCIALSECTOR/Resources/282044-1307652042357/VP329-Setting-out-of-court.pdf>> accessed 22 November 2019; European Parliament, 'Quantifying the cost of not using mediation – a data analysis' (2011) <<http://www.europarl.europa.eu/document/activities/cont/201105/20110518ATT19592/20110518ATT19592EN.pdf>> accessed 27 November 2019;

<sup>92</sup> 2008 Directive 2008/52/EC on certain aspects of mediation in civil and commercial matters.

relevance. In fact, mediation is used in less than one percent of the cases in civil and commercial litigation in the EU.<sup>93</sup> Thus, the overwhelming majority of cases still go to court.

EU Member States have chosen several different approaches to implementation of the EU Directive: (a) full voluntary mediation, (b) voluntary mediation with incentives and sanctions (c) required initial mediation session, and (d) full mandatory mediation. These four models offer different balances in terms of speed, costs, and practicability but only the required initial mediation session model can be considered a workable solution in practice. Specifically, the Italian mandatory mediation law is able to resolve around 150,000 disputes by mediation a year.<sup>94</sup> The law requires the litigants to attend an initial mediation session with a mediator in good faith for selected commercial disputes before the case can proceed to a trial, failure to do results in sanctions.

Interestingly, some jurisdictions outside Europe have also gone down the road towards some form of mandatory mediation for commercial disputes as a prerequisite for the commencement of judicial enforcement proceedings. Since voluntary pre-litigation mediation failed to obtain practical significance in Turkey following its introduction in 2012, the legislator decided to follow the Italian model and go one step further by making the entire mediation process mandatory for a number of labour disputes in 2017. This was trialled in respect of labour disputes and was regarded as a success<sup>95</sup>, thus mandatory mediation was extended following an amendment to the Turkish Commercial Code, as of 1 January 2019, to a number of other categories of civil and commercial claims including enforcement of all unsecured claims arising from commercial transactions. While secured claims technically fall outside mandatory mediation, they are indirectly caught by mandatory mediation in practice since debtors often make an objection to enforcement of the secured claim and this objection then requires mediation.

Critics of mandatory mediation fear that opportunistic debtors may see this as a welcome opportunity to further delay the enforcement process.<sup>96</sup> They raise the concern that mandatory mediation plays into the hands of strategic debtors who do not want to pay or who want to fraudulently transfer assets to others individuals and conceal their assets. They point out that the legal process of locating the assets of debtors and obtaining full disclosure – i.e. by obtaining a worldwide freezing injunction to prevent a debtor from disposing or concealing assets – is already associated with lengthy and costly proceedings.

Moreover, because of the prevalence of fully self-enforcing security interests in common law systems where a security agreement clearly sets out the process by which security may be enforced, mandatory mediation appears to be a very intrusive concept. On the contrary,

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<sup>93</sup> Leonardo d'Urso, 'Achieving a Balanced Relationship between Mediation and Judicial Proceedings in the European Union' (*Mediate.com Blog*, March 2017) <Achieving a Balanced Relationship between Mediation and Judicial Proceedings in the European Union> accessed 24 October 2019; European Parliament, 'A Ten-Year-Long "EU Mediation Paradox" When an EU Directive Needs To Be More' November 2018 <[http://www.europarl.europa.eu/RegData/etudes/BRIE/2018/608847/IPOL\\_BRI\(2018\)608847\\_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/BRIE/2018/608847/IPOL_BRI(2018)608847_EN.pdf)> accessed 24 October 2019.

<sup>94</sup> *Ibid.*

<sup>95</sup> Burcu Boso and Döne Yalçın, 'Turkey: Mandatory mediation on commercial disputes' (*CMS*, 21.12.2018) <<https://www.cms-lawnow.com/ealerts/2018/12/mandatory-mediation-on-commercial-disputes>> accessed 1 September 2019.

<sup>96</sup> Based on the EBRD's 2019 consultations with creditors and financial stakeholders in Turkey in connection with an EBRD report analysing the framework for the resolution of non-performing loans.

mandatory mediation appears less intrusive in civil legal systems where courts even in the presence of a notarial writ frequently play a larger role in the enforcement of secured debts. In any event, once a dispute has been decided by a court, mediation and arbitration would appear to have a very limited scope of application.

#### 4.3.3 Impact of insolvency

Certain international standards may be drawn from the UNCITRAL Legislative Guide on Insolvency Law and the World Bank Group Principles for effective insolvency and creditor/debtor regimes in relation to the interaction between insolvency and secured transactions law.<sup>97</sup> They specify some high level recommendations that can be summarised as follows:

First, it is important that the interplay between insolvency and secured transactions legislation is clear. Thus, first and foremost, insolvency law must create legal certainty and predictability.<sup>98</sup> In other words, insolvency law should stipulate how the commencement of insolvency proceedings affects the position of debtors and creditors, which must be based on clear and objective criteria. This will foster confidence in commercial transactions, promote economic stability and create an investment-friendly environment. Second, insolvency legislation should further build on maximising the value of the firm's assets.<sup>99</sup> This will be advantage to both debtors and creditors. At the same time, however, insolvency legislation must also take into account other key considerations. Third and particularly, asset maximisation shall not contravene or hinder a possible restructuring or reorganisation of the debtor's business as an alternative to liquidation.<sup>100</sup> It is widely accepted that the value of maintaining a viable business in part or as a whole is often greater than the value of selling the companies' assets individually. Fourth, national legal systems shall provide for the principle of equitable treatment of similarly situated creditors in their insolvency laws.<sup>101</sup> Fifth, like other judicial proceedings, insolvency frameworks should ensure the rapid, efficient, and impartial resolution of insolvencies.<sup>102</sup> Sixth, the insolvency law shall encompass safeguards that prevent the premature dismemberment of the debtor's assets by individual creditors seeking satisfaction of their claims. Seventh, the insolvency law should be transparent.<sup>103</sup> Thus, it should be clear how the insolvency law interacts with other areas of law such as labour law, contract law or tax law. Also, it should create incentives for debtors to provide full disclosure of their financial situation. Eighth, to ensure availability of secured credit, the insolvency law should contain clear rules as to the effect of insolvency proceedings on the rights of a secured creditor to enable them to quantify their risks for the purposes of making decisions in respect of extending credit.<sup>104</sup> Specifically, the insolvency law should state the debtor's estate should include any encumbered or secured assets and third party owned assets.<sup>105</sup>

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<sup>97</sup> UNCITRAL Legislative Guide on Insolvency Law, 2005.

<sup>98</sup> Recommendation 1(a) and (g), UNCITRAL Legislative Guide on Insolvency Law, 2005

<sup>99</sup> Recommendation 1(b), UNCITRAL Legislative Guide on Insolvency Law, 2005

<sup>100</sup> Recommendation 1(c), UNCITRAL Legislative Guide on Insolvency Law, 2005

<sup>101</sup> Recommendation 1(d), UNCITRAL Legislative Guide on Insolvency Law, 2005

<sup>102</sup> Recommendation 1(e), UNCITRAL Legislative Guide on Insolvency Law, 2005

<sup>103</sup> Recommendation 1(f), UNCITRAL Legislative Guide on Insolvency Law, 2005

<sup>104</sup> Paragraph 13, Chapter XII, Legislative Guide

<sup>105</sup> Recommendation 35, Chapter XII, Legislative Guide

It is further essential that security interests validly created before insolvency remain intact and are principally enforceable subject to a moratorium.<sup>106</sup>

#### 4.4 Cross-jurisdiction analysis

For the purpose of discussion, it seems useful to look at the various remedies available under national legal systems of different traditions. Thus, this section aims to provide a brief comparative overview of available remedies in civil and common law jurisdictions in order to bring the benefits of comparative legal study to bear on the enforcement of security interests and to make some high level observations about the impact of insolvency on the enforcement process.

##### 4.4.1 Available remedies before insolvency

As already mentioned, legal systems around the world differ remarkably when it comes to the enforcement of security interests. Generally speaking, common law systems seem to be more creditor-friendly and civil law systems more debtor-protective when it comes to enforcement. Some jurisdictions, such as the United States and England, are relatively liberal and provide a variety of judicial and extrajudicial remedies. Furthermore, they rely on a high degree of party autonomy and out-of-court remedies in the enforcement process. Others, such as Austria and Germany, take the opposite position. They are more restricted in terms of available remedies, and generally rely on formal proceedings and judicial oversight. For the purpose of this paper, we shall focus on the differences in enforcement of security interest in real estate between commercial parties where differences in the legal tradition become most apparent.

English and German law in principle encompass two categories of remedies for enforcing a security interest in real estate: remedies designed for the recovery of capital and remedies designed for the recovery of income. For example, the German legal system provides for judicial sale and the judicial appointment of an administrator. The latter is responsible to manage the land and to appropriate all interest towards satisfaction of the secured debt. Notably, both these enforcement proceedings require compulsory judicial intervention and an enforcement title. In most cases, a court judgement (based on the outstanding debt) or a notarial deed will constitute a valid enforcement title. Party autonomy plays a relatively minor role in Germany in comparison to England. Only after occurrence of default may the parties agree on additional enforcement measures.

In contrast, English law provides for the remedies of foreclosure, non-judicial, and judicial sale for the realisation of the mortgaged real estate. Notably, the remedy of foreclosure is almost non-existent in English practice due to the uncertainty and lack of finality of the proceeding. Concerning the recovery of income, English law permits the mortgagee to take possession of the land and to appoint a receiver, both without judicial involvement. Parties have significant power to regulate the enforcement process when it comes to taking possession and selling the property or appointing a receiver. For example, the parties may, among other things, agree on what constitutes a default, the conditions upon which the mortgagee may take possession of the property, and/or the precise powers of a receiver. But, to ensure the adequate protection of the mortgagor's and third parties' interest, English law provides for mandatory enforcement standards, i.e. the duty to act in good faith or to obtain the true market price when selling the

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<sup>106</sup> Recommendation 47, Chapter XII, Legislative Guide

estate. These standards are contained in general case law, but are also, often, included expressly in the security agreement.

In comparison, there is quite a significant gap concerning the question of how England and Germany deal with enforcement in real estate. Germany warrants the protection of the mortgagor and interested parties by mandatory formal proceedings and judicial oversight instead of enforcement standards. Party autonomy plays a limited role. Further, while English law reviews enforcement measures primarily ex-post and upon application on a case-by-case basis, German law always relies on ex-ante control of the enforcement process. It appears that the English enforcement system is designed to be less formal, less expensive, and a faster way to realise land. In addition, it places a lower burden on the courts than the German enforcement system. This reinforces the general perception that common law systems seem to be more creditor-friendly and civil law systems more debtor-protective.

#### 4.4.2 Available remedies after insolvency

When it comes to insolvency proceedings, the gap between enforcement practices under German and English law is less evident. Generally speaking, both jurisdictions recognise the principle of preferential treatment of secured creditors over unsecured creditors.

Under German law, the commencement of insolvency proceedings has the effect of an automatic stay on individual enforcement by creditors against the estate. Thus, creditors are required to resort to the collective enforcement regime provided by the insolvency laws. German law provides for a few exceptions to the automatic stay, especially with regard to secured creditors, including conditional sellers, lessors, and security interest holders. The various groups of secured creditors are treated differently in insolvency proceedings. For example, creditors formally vested with 'title' or 'ownership' of the secured assets, e.g. conditional seller and lessor, are granted a right to segregate the asset from the insolvent estate and are ordinarily not affected by a moratorium. To the contrary, a holder of a security interest such as a mortgagee is only entitled to demand satisfaction separate from the secured collateral from the insolvency estate.

Under English law the opening of insolvency proceedings, including administration or liquidation proceedings, generally requires creditors to pursue their claims through the prescribed insolvency procedure, but there are some significant differences. In liquidation proceedings, the effect of a stay on enforcement is stipulated in Section 130(2) of the Insolvency Act 1986. It provides that: '*... no action or proceeding shall be proceeded with or commenced against the company or its property, except by leave of the court and subject to such terms as the court may impose.*' On top of this, Section 127 of the Insolvency Act 1986 provides that any property dispositions after the commencement of proceedings are void unless approved by the court. Secured creditors are entitled to satisfy their claims out of their secured collateral outside liquidation proceedings. Similarly, a moratorium is also imposed upon all creditors in administration proceedings. Secured creditors are, however, generally not exempted from the moratorium. Rather, Paragraph 43 of Schedule B1 to the Insolvency Act of 1986 requires secured creditors to seek the consent of the insolvency administrator or permission of the court before enforcing or realising the secured collateral.

#### 4.5 Conclusion and Questions

It is a difficult task to find the right balance between protecting unsophisticated debtors from abusive creditors at one hand, and protecting creditors from opportunistic debtors at the other.

States have developed different ways of resolving the conflict between the fundamental right to have an effective remedy and the right to a fair and effective procedure. With regard to the EBRD Study, the assessed national legal systems tend to favour debtors over creditors by providing insufficient safeguards to prevent or sanction exploitative behaviour on the part of debtors. There are virtually no restrictions, sanctions or costs on the right to appeal. That, in turn, provides incentives for debtors to deny cooperation with creditors and exploit the legal system to prevent judicial and private enforcement.

For example, debtors may take advantage of the overloaded institutional systems and vulnerabilities in the enforcement process by preventing effective delivery of court summons, and lodging unsubstantiated substantive appeals and procedural objections with the sole purpose of denying realisation of the security in a timely manner. The problem is often further exacerbated by the fact that these legal systems do not allow for a collective or centralised enforcement process. In Croatia, for example, it is court practice to split enforcement proceedings between different courts depending on the location of assets which are subject to enforcement action. In conclusion, there is a need for further legal reform to ensure that potential abuse to enforcement procedures are limited and all interested parties are incentivised to take a seat at the negotiating table.

- 1. What should be the required steps to initiate enforcement proceedings? What remedies of judicial or extra-judicial nature should be available and to what extent should they be able to be modified by contract? Should the answer to the former question depend on the type of asset, i.e. movable versus immovable, the type of debtor, or the value of the claim?*
- 2. How does the enforcement process protect the rights of debtors and creditors and to what extent is this determined by constitutional requirements? What is the right balance between the legitimate creditors' and debtors' interests in the appeal process?*
- 3. Is there an actual or perceived gap between out-of-court enforcement against the debtor's will in civil and common law jurisdictions? To what extent should a civil or common law jurisdiction appropriate ideas from another?*
- 4. Can mandatory mediation become standard in a commercial and highly time-sensitive legal environment? To what extent, is the Turkish legislation evidence that it can work?*
- 5. What is the proper role of the Courts in national legal systems given the international trend of relying on alternative dispute resolution and private enforcement in both developed and less-developed jurisdictions?*

## ANNEX 1

### OVERVIEW OF SECURED TRANSACTION AND DEBT ENFORCEMENT FRAMEWORK IN THE COUNTRIES COVERED BY THE EBRD STUDY

#### 1. Securities and Registration

| Study Countries | Security registries                                    |  |   |   |   | Specialist registries |                   | Registration                       |   |  |                    |
|-----------------|--|--|---|---|---|-----------------------|-------------------|------------------------------------|---|--|--------------------|
|                 | Centralised registry for movable assets <sup>107</sup> | Centralised registry for immovable assets <sup>108</sup> | Electronic registry for movable assets <sup>109</sup> | Electronic registry for immovable assets <sup>110</sup> | Registry indexed against the pledgor <sup>111</sup> | Ship registry         | Aircraft registry | Notice based system <sup>112</sup> | Transaction based system <sup>113</sup> | Electronic registration <sup>114</sup> | Registrar approval |
| Albania         | ✓  | ✗  | ✗   | ✓ <sup>115</sup>  | ✗   | ✓                     | ✓                 | ✗                                  | ✓                                       | ✗                                      | ✓                  |
| Croatia         | ✓  | ✓  | ✓ <sup>116</sup>                                      | ✓   | ✗   | ✓                     | ✓                 | ✗                                  | ✓                                       | ✓                                      | ✓                  |

<sup>107</sup>The registry is centralised, covering the whole jurisdiction (as opposed to having separate registers in unconnected regional offices).

<sup>108</sup>The immovable property register is centralised (as opposed to having separate registers in unconnected regional offices).

<sup>109</sup> The register is available online and any third party can examine the register.

<sup>110</sup> The register is also available online and any third party can examine the register.

<sup>111</sup> The content of the registry can be indexed against the pledgor (using tax/business or personal identification number).

<sup>112</sup> In a notice filing system, there is no requirement to register the underlying documentation or even to tender it for scrutiny to the registry staff. All that needs to be registered is a notice that a security right may exist. Usually, the notice only provides minimal information, such as the identity of the parties and a general description of the encumbered assets.

<sup>113</sup> In a transaction filing system, the actual transaction (the actual security right) is filed in the registry. A transaction filing system traditionally requires that the actual security agreement (or a summary or a short form document) is tendered to the registry staff, who will usually carry out some form of check to ensure that the security right has been created.

<sup>114</sup> Pledges can be registered electronically i.e. no need to visit the registry.

<sup>115</sup> While the register is available online, it is not available for the entire country, as this depends on the cadastral zones where the registration of the immovable assets has been completed. In addition, only business units, apartments, or buildings may be verified, while information on lands or plots of lands, or other immovable assets such as agricultural lands, forests etc. are not accessible online. Only public notaries, or bailiff officers may access the online register, therefore public access is limited.

<sup>116</sup> It exists, but not very user friendly. Electronic registration is not possible.

|                |                  |   |                              |                              |   |   |   |  |                |                              |   |
|----------------|------------------|---|------------------------------|------------------------------|---|---|---|--|----------------|------------------------------|---|
| <b>Cyprus</b>  | ✓ <sup>117</sup> | ✓ | ✓                            | ✗                            | ✓ | ✓ | ✓ | ✗  | ✓              | ✓                            | ✓ |
| <b>Greece</b>  | ✗                | ✗ | ✗                            | ✗                            | ✗ | ✓ | ✓ | ✓ (only<br>pledge over<br>receivables<br>) | ✓              | ✗                            | ✓ |
| <b>Ukraine</b> | ✓                | ✓ | ✓ (partially) <sup>118</sup> | ✓ (partially) <sup>119</sup> | ✓ | ✓ | ✓ | ✓ (movables) <sup>120</sup>                | ✓ (immovables) | ✓ (partially) <sup>121</sup> | ✓ |

<sup>117</sup> Centralised at online Registrar of Companies website.

<sup>118</sup> The State Registry of Encumbrances over Movable Property is accessible online for general corporates and individuals, subject to their authentication with an electronic digital signature (e-signature). Electronic registration option is unavailable.

<sup>119</sup> The Immovable Property Register is accessible online for general corporates and individuals, subject to their authentication with an electronic digital signature (e-signature). Electronic registration option is unavailable.

<sup>120</sup> For registration of security over movable assets, a notice based system is available, whereas a registration of mortgage tends to follow a transaction based system.

<sup>121</sup> While the register is available online, electronic registration is available only for notaries, banks, or bailiff officers, which may access the online register. Accordingly, electronic registration is limited and unavailable for general corporates and individuals.



## 2. Enforcement and sale of collateral

| Study Countries | Out-of-court enforcement                  |                            | Financial collateral regime (outside insolvency) | Enforcement outside insolvency                        | Public auctions |            | Electronic Sales Platform | Organiser of public auction outside insolvency | Private sale |                                   |
|-----------------|---|----------------------------|--|---|-----------------|------------|---------------------------|--|--------------|-----------------------------------|
|                 | Movables                                  | Immovables                 |  |   | Movables        | Immovables |                           |  | Movables     | Immovables                        |
| Albania         | ✗   | ✗                          | ✓  | ✗ (subject to insolvency practitioner discretion)     | ✓               | ✓          | ✗                         | Court bailiff                                  | ✗            | ✗                                 |
| Croatia         | ✓   | ✗                          | ✓  | ✗   | ✓               | ✓          | ✓                         | FINA   | ✓            | ✓ (Only if agreed) <sup>122</sup> |
| Cyprus          | ✓   | ✓                          | ✓  | ✓ (for liquidation, subject to liquidator discretion) | ✓               | ✓          | ✗ <sup>123</sup>          | District Land's Office /Creditors              | ✓            | ✓ (Only if first auction fails)   |
| Greece          | ✗ (partially out-of-court) <sup>124</sup> | ✗ (partially out-of-court) | ✓  | ✗   | ✓               | ✓          | ✓                         | Notary public                                  | ✗            | ✗                                 |
| Ukraine         | ✓ <sup>125</sup>                          | ✓                          | ✗  | ✗   | ✓               | ✓          | ✓                         | Bailiff  | ✓            | ✓                                 |

<sup>122</sup> Only if agreed by the parties before the scheduled public auction.

<sup>123</sup> The electronic register for public auctions should be operational shortly.

<sup>124</sup> In cases of: i) registration of the security by means of a notarial deed, ii) enforcement under LD 1923, and iii) pledge enforcement, subject to Court permission for the sale of the assets through auction. Out-of-court enforcement is partial, as the proceedings remain subject to the court's supervision, although there is no requirement to obtain an enforcement title prior to the initiation of enforcement proceedings.

<sup>125</sup> Except participatory interest in the charter capital of limited liability company, which is disputable. The new LLC Act does not provide for such option, whereas general security law does so.

### 3. Institutional framework

| Study Countries | Commercial courts/ division | Electronic court case management system | Enforceability of ADR decisions |   | Bailiffs |        | Insolvency Practitioners |
|-----------------|-----------------------------|---|---------------------------------|---|----------|--------|--------------------------|
|                 |                             |   | Arbitral award                  | Mediation settlement agreement  | Private  | Public |                          |
| Albania         | x                           | x                                       | ✓                               | Court stamp needed for enforcement  | ✓        | ✓      | ✓                        |
| Croatia         | ✓                           | ✓                                       | ✓                               | Enforceable deed subject to satisfaction of certain conditions <sup>126</sup> | x        | ✓      | ✓                        |
| Cyprus          | x                           | x                                       | ✓                               | Enforceable as a matter of contract   | x        | ✓      | ✓                        |
| Greece          | x                           | ✓(partial) <sup>127</sup>               | ✓                               | Court stamp needed for enforcement  | x        | ✓      | ✓                        |
| Ukraine         | ✓                           | ✓                                       | ✓                               | Enforceable as a matter of contract   | ✓        | ✓      | ✓                        |

<sup>126</sup> Provided the following conditions are met: (i) the agreement is reached within the mediation procedure; (ii) the obligation imposed therein represents an obligation in respect of a certain type of activity (including monetary claims); and (iii) direct enforcement is accepted by the debtor i.e. the original agreement contains an enforcement clause.

<sup>127</sup> An electronic system has been established (solon), where the parties may be updated on the procedural aspects/process of their case (receive information on the hearing date, the issuance of a decision, information on whether the adjudicated claim was upheld or rejected etc.). However, the electronic filing of legal documents before the Greek Courts remains optional. A law providing for the exclusive electronic filing of legal documents solely in relation to administrative law cases has been approved by the Hellenic Parliament on 24 October 2019 (Greek law 4635/2019 published in the Official Government Gazette Issue A no. 167/30.10.2019).

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