

Bankruptcy Regimes during Financial Distress  
Simeon Djankov<sup>1</sup>

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**Abstract** A question frequently asked at the onset of economic crises is whether the existing bankruptcy regimes can adequately deal with the increase in corporate and bank failures. This paper describes how bankruptcy reforms developed, what bankruptcy regimes aim to achieve, how they achieve their goals in normal times, and what options policy makers have resorted to in previous systemic crises. It also provides a menu of choices on what policymakers can do in terms of bankruptcy reforms to alleviate the current crisis.

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<sup>1</sup> Chief Economist, Financial and Private Sector Development, The World Bank Group. Contact: [sdjankov@worldbank.org](mailto:sdjankov@worldbank.org). Special thanks to Neil Gregory, Suzanne Smith, Mahesh Uttamchandani and Justin Yap for comments on an earlier draft.

## Introduction

A question frequently asked at the onset of economic crises is whether the existing bankruptcy regimes can adequately deal with the increase in corporate and bank failures. Bankruptcy is never a popular reform, and governments typically get to it when the courts are already clogged with insolvency cases. By the time a reform is completed, more interventionist options (for example, the use of asset-management companies) are needed.

Historically, bankruptcy originated in dealing with moneylenders, the precursor to financial institutions. In medieval Italy moneylenders conducted their trade from benches set up in town squares. When a moneylender became insolvent, his bench was broken—sometimes over his head. This custom became so associated with insolvency that *banca rotta*, Italian for “broken bench,” eventually became *bankrott* in German, *banqueroute* in French and *bankrupt* in English.

During financial crises in the Middle Ages, the incidence of bankruptcies by moneylenders increased, and with this, the need for an organized procedure. But it wasn't until 1706, after the Glorious Revolution, that the first bankruptcy statutes were drafted in England. These became the basis for the first bankruptcy law. Both the origin, and the subsequent waves of reforms in bankruptcy law, came out of the need to deal with systemic distress.

The purpose of this paper is to describe how bankruptcy reforms developed (section 2), what bankruptcy regimes aim to achieve (section 3), how they achieve their goals in normal times (section 4), and what options policy makers have resorted to in previous systemic crises (section 5). Section 6 provides suggestions on what policymakers can do in terms of bankruptcy reforms to alleviate the current crisis. Section 7 concludes.

## 2. Bankruptcy Reforms

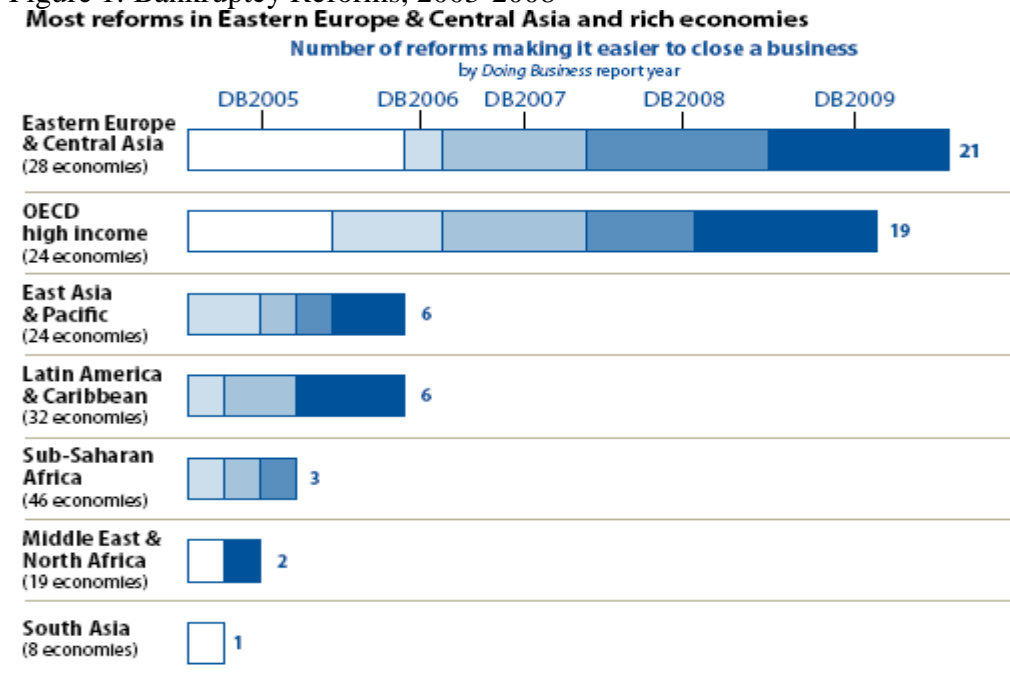
The penalty for declaring bankruptcy in Ancient Rome was slavery or being cut to pieces. The choice was left to the creditor. By the Middle Ages, the treatment of insolvent debtors had softened considerably. In Northern Italy, bankrupt debtors hit their naked backside against a rock three times before a jeering crowd and cried out, “I declare bankruptcy.” In French medieval cities, bankrupts were required to wear a green cap at all times, and anyone could throw stones at them. In England, bankrupt debtors were thrown into prison, were often pilloried, and occasionally had one ear cut off.

The English bankruptcy law of 1732 was the first modern bankruptcy law. The United States introduced its first bankruptcy law in 1800, copying the English law. France, Germany, and Spain adopted their first bankruptcy laws in the early nineteenth century. Imprisonment still featured as a common punishment, and bankruptcy was seen a means to liquidate financially distressed companies and distribute their remaining assets among creditors. A rudimentary rehabilitation procedure—designed to reorganize the debt of a bankrupt firm so that it could continue operating—was developed in Austria in 1914 but was rarely used. Similar procedures were introduced in Spain in 1922, in South Africa in 1926, and in Belgium, France, Germany, Netherlands, and the United States in the 1930s.

A modern reorganization procedure did not appear until 1978, when Chapter 11 was adopted in the United States. This reform was prompted by the mass wave of corporate insolvencies after the first oil crisis. In the next 30 years a wave of bankruptcy reforms brought reorganization procedures to Italy in 1979, France in 1985, the United Kingdom in 1986, New Zealand in 1989, Australia and Canada in 1992, Mexico in 2006, Colombia in 2007, and the Czech Republic in 2008.

In the past five years, the World Bank’s *Doing Business* project has documented the reforms in bankruptcy regimes around the world. Eastern Europe has had the most reforms making it easier to close a business, especially in speeding bankruptcy proceedings (figure 1). High-income OECD economies follow close behind, focusing more on empowering creditors. Elsewhere in the world reform has been moving more slowly. The 10 reforms in Latin America, Africa and South Asia have ranged from introducing stricter deadlines to establishing specialized bankruptcy courts. In 2006 Burundi enacted its first bankruptcy law, setting clear time limits for procedures. In the Middle East and North Africa only Tunisia and Saudi Arabia have reformed (World Bank, 2009).

Figure 1: Bankruptcy Reforms, 2003-2008



Note: A reform is counted as 1 reform per reforming economy per year.  
Source: *Doing Business* database.

Expanding creditors’ rights has been the most popular reform feature over the past 5 years (figure 2). Seventeen economies have empowered creditors: China, the Czech Republic, Denmark, Finland, France, Hungary, Indonesia, Italy, Korea, Poland, Portugal, Puerto Rico, Romania, Serbia, Slovakia, the United States and Vietnam. Giving creditors more say in the process speeds the resolution of bankruptcy and is likely to result in the

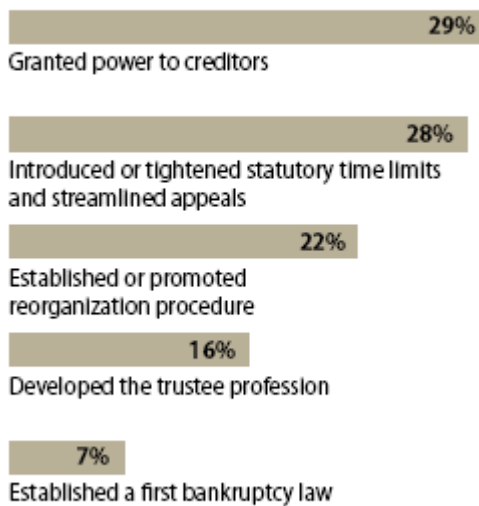
continuation of the business. Allowing creditors a greater role in decision making increases the recovery rate.

Reforms expanding the powers of creditors have been most concentrated among OECD high-income economies. Finland gave creditors the right to set up a creditors' committee to advise the administrator. France and Korea now allow the creditors' committee to vote on the reorganization plan. Denmark encouraged creditors to report to the court any trustee actions that appear to delay the process. The court can then replace the trustee if it decides—based on the creditors' reports—that the trustee is incompetent.

Figure 2: What Reforms Have Been Popular

**Top 5 reform features in closing a business**

Reforms Including feature since DB2005 (%)



*Note:* A reform may include several reform features.  
*Source:* Doing Business database.

Several economies, including Finland and France, granted higher priority to creditors in bankruptcy claims. France gave a “supersecured” position to creditors that lend money to distressed companies, giving them priority over previous secured creditors. That makes it easier for such companies to obtain new loans and continue operating.

OECD high-income economies have also promoted reorganization. Finland, France, Italy and Korea made reorganization more accessible to troubled companies. Italy now allows distressed companies to seek an agreement with creditors before entering formal bankruptcy and with no prerequisites. That permits the companies to continue operating.

### 3. What Do Bankruptcy Regimes Aim to Achieve

Even with a single creditor, the need for a bankruptcy procedure is clear: contracting parties cannot foresee all problems likely to arise through the duration of their business dealings. With multiple creditors, and especially with multiple classes of creditors, a functioning bankruptcy regime becomes even more important, as coordination issues

grow exponentially (Hart, 2002). While a debtor and a creditor could agree to restructure a contract in case of unforeseen events, it is nearly impossible to do so if the debtor has to convince several creditors.

Beyond a coordination function across multiple creditors and stakeholders (workers, the tax authority, suppliers), a good bankruptcy procedure maximizes the total value (measured in money terms) available to be divided between the debtor, creditors and possibly other stakeholders. Specifically, a firm should be reorganized, sold for cash as a going concern, or closed down and liquidated piece-meal according to which of these generates the greatest total value.

The second goal of bankruptcy is to preserve the absolute priority of claims (that is, senior creditors are paid off first, then junior creditors, and finally shareholders). Adhering to absolute priority of claims has advantages. First, it helps to ensure that creditors receive a reasonable return in bankruptcy states, which encourages them to lend. Second, it means that bankruptcy and non-bankruptcy states are not treated differently: contractual obligations entered into outside bankruptcy are respected inside bankruptcy.

However, an argument can be made against absolute priority. If shareholders receive nothing in bankruptcy, then management, acting on behalf of shareholders, will have an incentive to “go for broke”: they will do anything to avoid bankruptcy, including undertaking highly risky investment projects and delaying a bankruptcy filing. For this reason, a bankruptcy regime may reserve some portion of value for shareholders. For example, the resolution of Long Term Capital Management in 2002 left equity holders a 10% share.

### 3.1 Bankruptcy Procedures

There are three procedures used in the resolution of insolvency. Foreclosure is a debt enforcement procedure aimed at recovering money owed to secured creditors. Foreclosure does not protect unsecured creditors, who must rely on separate insolvency proceedings to recover the amounts owed them. In some countries, an insolvent company (or unsecured creditors) can cause a stay of foreclosure proceedings by initiating a reorganization or liquidation procedure, while in other countries, a reorganization or liquidation filing does not stop foreclosure. In the latter case, liquidation procedures may take place in tandem with or after foreclosure.

Foreclosure can be an entirely out-of-court procedure, in which a receiver steers the company to a sale of assets (either piecemeal or as a going concern). Indeed, the appointment of such a receiver can be part of the debt contract. In other countries, a court oversees foreclosure, although it is typically less involved than in bankruptcy. Some countries allow a creditor to take security over an entire business—known as a “floating charge.” Australia, Singapore and the United Kingdom depend on foreclosure proceedings to resolve insolvency: and creditors get over 90 cents on the dollar, on average.

Liquidation is the procedure of winding up a company under court supervision. In principle, it may lead to a sale of the business as a going concern, and does not necessarily result in the piecemeal sale of its assets. Denmark, the Netherlands and Sweden resolve insolvency primarily through the use of liquidation procedures. Creditors get over 90 cents on the dollar.

Reorganization is a court-supervised procedure aimed at rehabilitating companies in financial distress. It is not available in all countries. Reorganization protects the company while it attempts to rehabilitate itself; once reorganization begins, creditors generally may not enforce their claims against the company. The current management of the business may or may not retain control of the company during reorganization. Japan, Norway and the United States have well-functioning reorganization regimes.

In 2004, Brazil introduced a re-organization procedure that helps viable enterprises stay alive and gives secured creditors more influence over the process. The time to go through bankruptcy has fallen from 10 years to 4. The reform faced its first test in June 2005, when the Brazilian airline carrier Varig filed for bankruptcy. In little more than a year the airline's assets were sold to a new owner and bankruptcy was completed in another year.

### 3.2 Bank Insolvency

Unlike corporate bankruptcies, where either creditors or management may initiate the process, bank insolvency is typically an administrative process. It is initiated by regulators, for example the FDIC in the United States, if the relevant authority believes that the bank is not being operated in a safe and sound manner, or that the bank is unlikely to meet its deposit obligations.

As receiver or conservator, the regulator collects information from the bank, its depositors, and other creditors; determines the validity of claims; and disposes of the assets and pays off or transfers the liabilities. Once the receiver or conservator is appointed, there is no mechanism for creditors, management, or shareholders to participate in the decision-making process beyond filing claims and providing requested information.

The claims of insured depositors are usually settled by transferring the deposits to another bank at par value and are made immediately available. Both uninsured depositors and creditors, once their claims have been approved by the regulator, are given receivership certificates. These are paid in cash as it becomes available through sale of assets, or earlier through advanced dividends. The timing and amount of any dividends are determined by the regulator and may be spread over several months or years.

## 4. How Successful They Are in Normal Times

To judge how efficient bankruptcy regimes may be in times of systemic distress, it is useful to know how well they perform in normal times. Not well. A recent study of 88

high- and middle-income countries finds that bankruptcy procedures for corporates are time consuming, costly, and inefficient (Djankov et al, 2008).

Only 36% of the countries achieve the efficient outcome of keeping the business as a going concern. Between the transaction costs of debt enforcement, the delay cost of the proceedings, and the loss from reaching the wrong outcome, a worldwide average of 48% of the business's value is lost in debt enforcement. On average, the bankruptcy cases take 2.64 years to resolve. And this on a simple case (an insolvent downtown hotel), with only one secured creditor. The average case takes longer, costs more and has a smaller chance of successful outcome.

There is large variation among countries in time, cost and efficiency. In fourteen countries (all of them rich), insolvency takes less than a year to resolve, but in countries like Chile, the Czech Republic, Ecuador, Indonesia, and the Philippines, it takes more than five years. The costs are not enormous on average, but in seven countries, typically those with long proceedings, they consume over 30% of the estate, with the dominant cost being attorney fees. In Singapore, the Netherlands, and Japan, only about 5% of the bankruptcy estate is spent in debt enforcement. In Romania, less than 11% of the estate is left, in present value terms, by the end of debt enforcement. In Turkey, less than 7%.

#### 4.1 The Case Study

The insolvency case taken to benchmark the efficiency of bankruptcy regimes is simplified as much as possible, so as to abstract from coordination and valuation issues. It focuses primarily on legal and administrative efficiency. In the past, the (assumed) business has always turned a profit, covering all costs and regularly paying its loan. However, recently the business is experiencing an unexpected operating loss due to worsened industry conditions – much like what is happening now with many construction sector firms or export oriented businesses. The management expects that, in the next 2 years, the business can cover its operating expenses from projected revenues (and so does not need additional cash to operate), but will not make enough money to pay back the bank. As a consequence, the business is about to default.

Under this scenario, the incentive of all parties is to keep the business operating as a going concern and avoid piecemeal sale, or delay it in the hope that the business's fortunes change. Since the business is experiencing a temporary downturn, the economically efficient outcome is also to keep it a going concern. The efficient strategy is to turn the business over to the main creditor, and to let it run or sell it as a going concern. If the bankruptcy regime does not allow this, however, the bank will pursue the next available option that maximizes its own expected recovery net of costs.

#### 4.2 Efficiency of Bankruptcy Procedures

Under the case facts above, foreclosure procedures are roughly as efficient as liquidation procedures among rich countries, but reorganization is the most efficient procedure. The main reason is that reorganization preserves the business as a going concern 80% of the time, compared to 63% for foreclosure and 71% for liquidation. Still, the top performers

– Singapore, Hong Kong (China), Australia and the United Kingdom – keep the business as a going concern with efficient foreclosure procedures (table 1).<sup>2</sup>

Table 1: Where is the Recovery Rate in Bankruptcy Highest?

Economy	Recovery rate (cents on the dollar)
Japan	92.5
Singapore	91.3
Norway	89
Canada	88.7
Finland	87.3
Ireland	86.6
Denmark	86.5
Belgium	86.3
United Kingdom	84.2
Netherlands	82.7

Source: <http://www.doingbusiness.org/ExploreTopics/ClosingBusiness/>

Among lower middle income countries, reorganization is roughly as efficient as liquidation, but foreclosure is the most efficient procedure. These countries rarely manage to save the business as a going concern, so the speed and lower cost of foreclosure are conducive to efficiency. For upper middle income countries, the most efficient procedure is liquidation. Overall, the most efficient procedures line up along a diagonal, with the richer countries doing better at procedures involving higher levels of court intervention (this is consistent with the findings in Ayotte and Yun, 2009).

Foreclosure works well with “floating charge” debt securities, when the whole business is pledged as collateral, but poorly when only specific assets can be pledged. This result is consistent with the observation that the senior creditor has the socially optimal incentives to dispose of the business as long as he can gain control of it in default. In the same spirit, the efficiency of foreclosure rises when the senior creditor is allowed to take collateral in an out-of-court procedure.

For insolvency proceedings, relevant for middle income and rich countries, legal rules that require the company to suspend operations, or that allow suppliers and customers to rescind contracts while the company is in bankruptcy, reduce efficiency. Moreover, extensive appeal of judicial decisions during insolvency proceeding, and the failure to continue the proceeding during appeal, are both detrimental to efficiency. This finding is established also in Gamboa-Cavazos and Schneider’s (2006), who study bankruptcy reform in Mexico and find that much of its benefits in terms of faster resolution of bankruptcy and higher recovery rates for creditors derived from the curtailment of appeals.

<sup>2</sup> See also Couwenberg and de Jong (2008) for a description of the Dutch liquidation procedure and its efficiency.

Having specialized bankruptcy courts, of the type established in Korea and Thailand during the East Asian crisis, speeds up resolution. In smaller economies, where few bankruptcy procedures get initiated during normal times, it may be prudent to have such courts only temporarily, and then merge them back into the commercial courts. In poor countries, it is best to channel judicial reform to the regular courts, as otherwise resources may be insufficient and the demand for specialized courts is anyhow low.<sup>3</sup>

## 5. Dealing with Systemic Distress

When distress is widespread, there is a danger that it may be self-reinforcing. Firms may have low incentives to restructure because other distressed firms and consumers have low demand for their products. Also, distressed firms are unable to repay debts, maintaining pressure on banks, which in turn restrict new lending. Banks may become insolvent, reducing the incentive of borrowers to repay loans. In past crises, several policies have been undertaken to avoid this situation. These are the super-priority of fresh capital, prepack bankruptcy, super bankruptcy, and debt-to-equity conversions for troubled banks.

### 5.1. Super-priority of fresh capital

Financing must be available during bankruptcy, otherwise businesses may not be able to come out of it. Without financing, bankruptcy could lead to liquidation—not a liquidation driven by market forces, but a fire sale due to the dislocation of the financial markets. In normal times, financial institutions would provide this financing. A solution is to reform the bankruptcy code and allow new capital to take priority over all old creditors, including secured ones. This gives an extra incentive to loan to distressed businesses (Hart, 2002).

In 2005, France adopted a new procedure that allows companies in financial difficulty to apply for bankruptcy protection before they are insolvent. The idea is to start reorganizing before it is too late. In addition, creditors that lend money to businesses that are in the pre-insolvency procedures will receive priority in the payment of claims, making it more likely that distressed businesses will get new loans.

### 5.2. Prepack bankruptcy

A prepackaged bankruptcy (a "prepack") calls for a firm to negotiate a reorganization plan with its creditors, and solicit acceptances of the plan, prior to filing for bankruptcy. The firm then files for bankruptcy and simultaneously files a plan of reorganization. Given the advance negotiation with creditors, a court hearing can be scheduled quickly, leading to a quick exit from bankruptcy. The recent bankruptcy of Chrysler in the United States is an example of a prepack.

Prepackaged bankruptcy is a hybrid of two methods of reorganizing distressed firms: workouts and bankruptcy. Prepacks combine the low costs of a workout with the benefits of formal reorganization. There are three reasons that firms might file a prepackaged

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<sup>3</sup> This point is made in Uttamchandani and others (2005) in the context of transition economies.

bankruptcy instead of completing an out-of-court workout: binding holdout creditors, avoiding cancellation of indebtedness income, and preserving the firm's net operating loss carry forwards.

First used in the Mexican crisis and expanded during the East Asian crisis, a variation of prepackaged bankruptcy are the so-called London rules. These apply during systemic distress and enable prepacks to work on a larger scale. Enhancements involve encouraging all (or most) financial institutions to sign on to these out-of-court accords under regular contract or commercial law. If so, agreements reached among the majority of creditors can be enforced on other creditors without going through formal judicial procedures.

### 5.3. Super Bankruptcy

Another approach, so far untested, is the adoption of "super bankruptcy," a temporary tool to be used when a country faces systemic bankruptcy brought on by huge macro-economic disturbances. This approach was advocated by Joseph Stiglitz during the early stages of the East Asian crisis (Stiglitz, 2002). The basic presumptions of the super bankruptcy are that management stays in place and that there is a forced debt-to-equity conversion. In a systemic crisis it can preserve the going concern value of firms by preventing too many liquidations and keeping in place existing managers, who most often will know best how to run the firms.

An important design issue is when to call for super-bankruptcy, that is, when is the crisis of a systemic nature, and who has the authority to call for such a suspension of payments. The evidence from East Asia suggests that adopting a temporary super-bankruptcy is unnecessary. Corporations and banks moved slowly to restructure outstanding debt, in the hope that economic recovery will obviate the need for write-offs (for banks) or surrendering of equity control (for large shareholders).<sup>4</sup>

### 5.4 Debt-to-equity conversions for troubled banks

Banks who enter into this bankruptcy procedure would have their debt converted to equity. This scheme allows the banks to convert debt (commercial paper, bonds and interbank lending with a maturity longer than three days) into equity. This would make them solvent and ready again to lend to customers. Also, it recapitalizes the banking sector at no cost to taxpayers. Second, it keeps the government out of the difficult business of establishing the price of distressed assets. If all of an institution's debt is converted into equity, its total value--its assets plus its going-concern value--remains the same. The bankruptcy changes only the legal nature of the claims on this value (Zingales, 2008).

A more interventionist version is the government taking equity in these distressed banks. An example is the U.S. Reconstruction Finance Corporation, the RFC. The RFC, which operated from 1932 to 1957, loaned or invested more than \$40 billion to 5,685 banks, or 40 percent of all insured banks in the United States.<sup>5</sup> RFC's discretion to support banks

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<sup>4</sup> See Claessens, Djankov and Xu (2000) and Claessens, Djankov and Klapper (2003).

<sup>5</sup> Calomiris and Mason (2003).

was limited and to be eligible for this program, banks had to agree to limit dividends and devote earnings to retiring the stock of the bank—essentially, buying out the government’s position. The RFC, whose stock was senior to all other, could also only hold a maximum of 49 percent of the equity of a bank, which meant that there had to be some private funds.

## 6. What Can Governments Do?

In countries with better creditor rights and more efficient legal systems, filing for insolvency of distressed firms is higher (Claessens and Klapper, 2005) and so is the recovery rate (Djankov et al, 2008; Davydenko and Franks, 2008).

The first step that a government foreseeing a wave of corporate insolvencies can take is to check how efficient the normal bankruptcy process is. There is a main source of analysis on this: the Closing a Business section in the World Bank’s *Doing Business* report has extended the analysis of Djankov et al (2008) to 181 economies. This dataset is updated annually and gives benchmarks on the speed of resolving insolvency, the cost of procedures, and calculates an average recovery rate (table 2). For example, the Latvian bankruptcy procedure takes 3 years, and costs 13% of the value of the bankruptcy estate, so on average creditors recover 29 cents on the dollar. In neighboring Lithuania, the process lasts 1.7 years, and costs only 7% of the estate, so creditors recover 48 cents on the dollar.

Table 2: The Efficiency of Bankruptcy Regimes, by Region

Region	Time (years)	Cost (% of estate)	Recovery rate (cents on the dollar)
East Asia & Pacific	2.7	23.2	28.4
Eastern Europe & Central Asia	3.1	13.4	28.3
Latin America & Caribbean	3.3	15.9	26.8
Middle East & North Africa	3.5	14.1	29.9
OECD	1.7	8.4	68.6
South Asia	5	6.5	19.9
Sub-Saharan Africa	3.4	20.2	16.9

Source: <http://www.doingbusiness.org/ExploreTopics/ClosingBusiness/>

The second step is to see what reforms have been possible, at a short notice, during previous crises. Claessens et al. (2002) provide examples of such reforms from East Asian financial crisis, which include the passage of improved bankruptcy laws in South Korea, Thailand and Malaysia, and the formation of specialized bankruptcy courts in Indonesia and Thailand. Another success example comes from Colombian bankruptcy reform introduced in the midst of a major financial crisis in late 1999. Gine and Love (2008) show that the reform significantly improved the efficiency of the bankruptcy process by streamlining reorganization proceedings.

Five types of reform have been most effective in previous crises:

- Minimize dependence on the courts.
- Establish specialized courts.
- Limit appeals.
- Introduce time limits.
- Use the Internet to post decisions and publicize auctions.

#### Minimize dependence on the courts

One quick solution is to minimize the involvement of judges. In some economies with efficient bankruptcy, courts play only a limited role, if any. In Australia, Hong Kong (China), Singapore and the United Kingdom secured creditors can appoint a receiver to take control of a distressed company. This happens without any court involvement. The receiver then manages the company in preparation for selling its assets. More often than not the business is sold as a whole unit. The recent reforms in Georgia and Mauritius are based on the same idea.

#### Establish specialized courts

Other economies—including the Dominican Republic, Georgia, Moldova, Tanzania, Thailand and Uganda—have made it easier to process bankruptcy cases by creating specialized commercial or even bankruptcy courts. Specialization increases efficiency. Judges can more easily gain expertise in bankruptcy and will be better equipped to deal with issues of insolvent businesses. Bosnia and Herzegovina, FYR Macedonia and Ghana have created bankruptcy sections within commercial courts, with specially trained judges and innovative management systems to deal with court backlogs.

Visaria (forthcoming) studies the establishment of specialized debt courts in India and finds that the establishment of such courts reduced delinquency in loan repayment by between 3 and 10 percent. Furthermore, interest rates on loans sanctioned after the reform are lower by 1-2 percentage points.

#### Limit appeals

Another solution is to limit procedural appeals. In El Salvador the wait for a first-instance court to hand down its decision in a debt enforcement case can last up to 3 years. Appeals may drag the litigation out for another year or more. In both El Salvador and Slovenia, where the initial decision can be appealed to 2 higher levels of courts, restricting appeals to just 1 would speed bankruptcy proceedings. In Spain appeals no longer suspend debt recovery.

Restricting the number of appeals, or allowing debt recovery to proceed even when there is an appeal, is a simple way to make bankruptcy more efficient. When used as a delay tactic, appeals reduce recovery rates, which depend on how quickly the business or its assets are sold.

#### Introduce time limits

FYR Macedonia, Poland, Portugal, Serbia, Slovakia, Spain and the United States have all either introduced or shortened statutory deadlines for bankruptcy proceedings. Imposing

time limits also makes bankruptcy cheaper: reforms in Bulgaria, Estonia and the United Kingdom have halved bankruptcy costs. Colombia's 2007 insolvency law tightens time limits for negotiating reorganization agreements. Before, the term allowed was 6 months, with a possible extension of 8 months. The new law limits the term to 4 months, and the extension to 2.

Use the Internet to post decisions and publicize auctions

Where court reform is difficult, reformers can take advantage of the Internet. Croatia has launched a website, called "Judges Web," where the court posts information on decisions in bankruptcy cases and announcements of asset sales. Assets are more likely to fetch a higher price, because detailed descriptions and even pictures can be posted for long periods. Before, sales would typically draw few buyers because they were advertised only on a certain day and in a certain newspaper. FYR Macedonia and Serbia have introduced similar websites.

Once the reforms in the courts have been exhausted, the third step is to consider how the normal bankruptcy procedure can be supplemented with out-of-court preparation of the case (as in the prepacks described in Section 5), or arrangement (as in the use of London rules). If a wave of corporate insolvencies comes, even well-prepared courts in countries with efficient bankruptcy regimes may be short-handed. Out-of-court negotiations among the debtor and creditors would greatly reduce the burden on judges.

Lastly, ask for expert advice. There are four specialized entities that provide advice on insolvency reforms: IFC's insolvency group; Insol, the international association of bankruptcy professionals; and the insolvency and creditor rights' chapters of the International Bar Association and the American Bar Association. These have the knowledge to provide country-specific reform advice.

Many reforms take time and would not be candidates for an in-crisis fix. For example, Poland's 2007 Law on Trustee Licensing tightened professional requirements for administrators to ensure they have the skills and education needed to oversee bankruptcy proceedings. Obtaining a trustee's license required an exam in economics, law, finance and management. But the reform took 3 years of public debate, and was achieved over the strenuous lobbying by the administrators' profession.

## 7. Conclusions

Reforming bankruptcy is difficult during normal times, with many lobbies (of judges, administrators and lawyers) poised to derail change. It is one of the reforms that are easier to do in crisis. However, policymakers have little time to focus on reform. This paper hence provides a menu of possible changes.

These reforms have proven in previous crisis situations to be easy to implement, and not time-consuming. Most improve the court procedures, some enhance out-of-court restructuring. Taken together, they make alleviate the burden on financial distress.

However, reforms of bankruptcy regimes do not resolve a financial crisis. They merely limit the losses. In crisis, bankruptcy reform needs to go hand in hand with counter-cyclical macroeconomic policies.

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