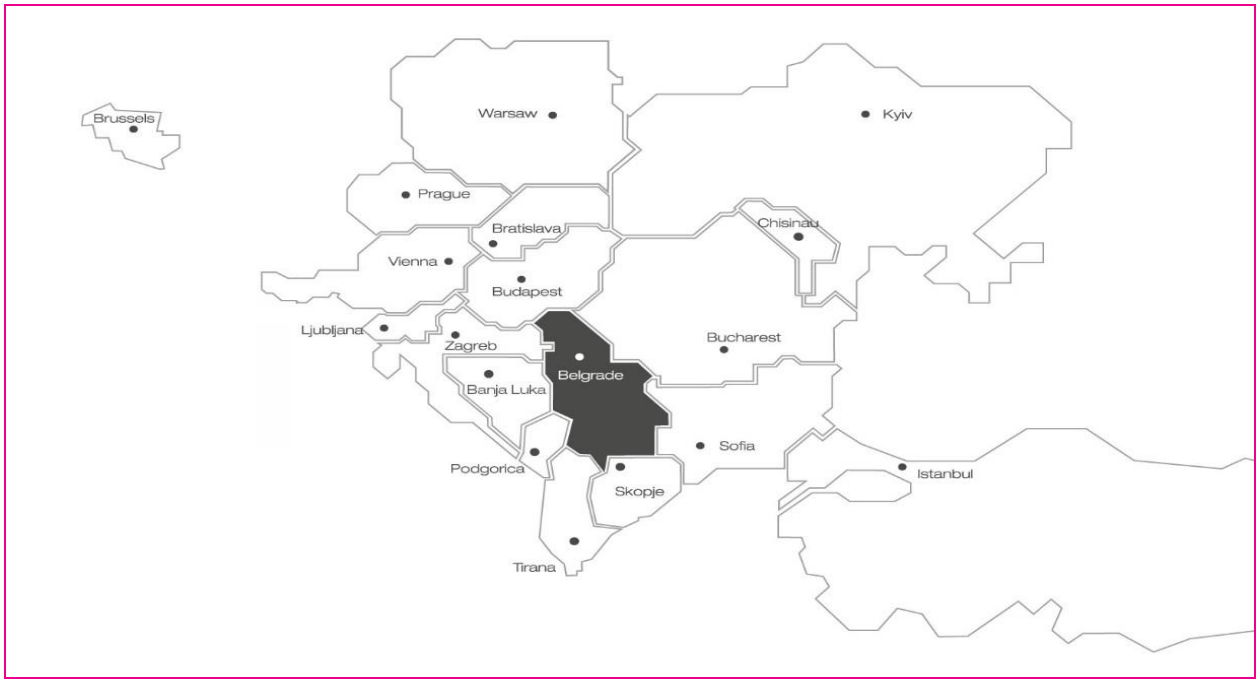
Draft for review of the authorities
EBRD-SRB/43008
30 August 2018

STUDY ON ACCOUNT BLOCKING IN WESTERN BALKAN COUNTRIES AND ITS IMPACT ON FINANCIAL RESTRUCTURING AND REORGANISATION

Country Report – Serbia



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for Reconstruction and Development

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Project funded by

THE GOVERNMENT
OF THE GRAND-DUCHY OF LUXEMBOURG
Ministry of Finance

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1. Executive Summary[1]

Under Serbian law, there are three (3) enforceable instruments that incorporate cash sweeping and account blocking capacities: (i) bills of exchange; (ii) court decisions within enforcement proceedings; and (iii) tax and customs authority decisions.

Bills of exchange are the only instruments out of the three above that are regularly offered as collateral for creditors. The other two instruments either: (i) require court proceedings prior to cash sweeping and account blocking (i.e., court decisions within enforcement proceedings); or (ii) are instruments reserved for government authorities (i.e., tax and customs authority).

In fact, due to their direct cash sweeping and account blocking capabilities, bills of exchange have become the most popular security instrument among creditors in the Western Balkans and are widely used in every day commerce and financial transactions. If duly registered, bills of exchange can be directly enforced through the National Bank without initiating court proceedings.

Cash sweeping is a two-stage process. First, the proceeds on the debtor's bank account held at the bank to which bills of exchange are presented for enforcement are transferred to the creditor; if such proceeds are not sufficient to cover the creditor's claim in full, proceeds up to the value of the claim are transferred to the enforcing creditor from all other bank accounts of the debtor.

Account blocking is activated only if cash sweeping does not satisfy a creditor's claim in full. It consists of the blocking of all payments from the debtor's bank accounts and the transfer of all proceeds that go into such bank accounts to the enforcing creditor until the creditor's claim is satisfied in full.

However, while neighbouring countries - such as Slovenia - have introduced new legislation that has, to an extent, reduced the strength of bills of exchange (i.e., their ability to lead to direct cash sweeping and account blocking), their Serbian counterparts remain regulated by the former Yugoslavia's 1946 legislation.

In addition to Slovenia, Montenegro has recently abolished direct enforcement of bills of exchange. Namely, the strength of bills of exchange as an enforcement mechanism in Montenegro has been significantly reduced by a recent decision of the Montenegrin Constitutional Court which abolished provisions of the Montenegrin Enforcement Act that gave bills of exchange direct cash sweeping and account blocking powers. The Montenegrin Constitutional Court found direct enforcement of bills of exchange to be contrary to the Montenegrin Constitution, on a number of grounds including that it violated the debtor's basic right to property. The decision effectively requires bills of exchange to be enforced through court proceedings thus the Montenegrin Constitutional Court rendered enforcement of bills of exchange to be on equal footing with enforcement of any other monetary claim.

Despite recent amendments to the Payment Transactions Act (as defined below)[2], the current Serbian legislation gives the holders of bills of exchange great power

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[1] Terms are defined in Appendix 3 on page 55-56.

[2] Official Gazette of the Republic of Serbia, Nos. 43/2004, 62/2006 and 111/2009.

over the debtor's financial standing and the viability of its business, by giving bills of exchange the power to impact the debtor's cash flows.

The interference caused by cash sweeping and blocking of the debtor's future cash flows has an evident adverse effect on the debtor's business. For example, suppliers may be reluctant to proceed with their agreements if chances of recovery are low or non-existent, while employees may not receive their salaries.

The debtor's resulting illiquidity may also impact its counterparties, if their income relies on revenue generated from doing business with the debtor. Besides, the enforcement of bills of exchange could also trigger a downward spiral for the debtor's business, as other creditors may try to enforce their own bills of exchange before the debtor's cash reserves are depleted.

The chances of successful work-outs are also considerably hindered (if not rendered impossible) by the effects of enforcement of bills of exchange. For a debtor's business to be restructured, it must be viable in the first place. No viability is possible once bills of exchange have been enforced.

As opposed to out-of-court restructuring, court reorganisation based on a plan or arrangement with creditors is less exposed to unilateral creditor action. The entire reorganisation process is carried out within formal bankruptcy proceedings, during which a moratorium (i.e., automatic stay) halts actions by creditors to collect their claims from the debtor.

In contrast, voluntary out-of-court restructurings are not protected against unilateral creditor action throughout the process. Due to their voluntary nature, such restructurings are only obligatory for creditors wishing to participate, leaving the non-participating creditors free to enforce the bills of exchange they hold.

Pre-packaged reorganisations based on pre-packaged plans are exposed to the devastating effects of bills of exchange only during the preparatory and negotiation phases, unless a stay is granted by the bankruptcy judge upon the debtor's request.

Therefore, in order to create a framework friendlier to out-of-court restructuring and reorganisation, the powers and capabilities attached to bills of exchange must be reduced and/or gradually removed.

Due to the vast popularity[3] of bills of exchange among Serbian creditors, any attempt to transition to a system where bills of exchange would not be capable of direct cash sweeping and account blocking should be undertaken in several phases, in order to avoid excessive market disturbance that may be caused by abrupt change such as recently has occurred in Montenegro[4].

- **Phase 1** – Elimination of direct account blocking and strengthening of other cash collateral instruments[5]

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[3] Market research evidences that over 90% of market participants request bills of exchange from their debtors. For further information, please see Section 4.11.1 below.

[4] Since September 2017, direct enforcement of bills of exchange is no longer possible in Montenegro due to such enforcement being declared unconstitutional. Further, all on-going proceedings before Central Bank of Montenegro (in charge for centralised cash sweeping and account blocking) were terminated and creditors were referred to enforcement before courts/bailiffs.

[5] For further details, please see Section 7.1 below.

In phase 1, account blocking would, through legislative reform, be eliminated as an inherent characteristic of bills of exchange, leaving bills of exchange as a tool that only has cash sweeping capabilities.

The current legislation should also be amended to provide for a functional bank account pledge, which creditors may view as a suitable substitute for bills of exchange (see paragraph 4.6 below for further analysis).

- **Phase 2** – Limitation of the capability of bills of exchange to directly sweep cash from a specific bank account only[6]

  Within 12 - 18 months of the introduction of a functional account pledge, the power of bills of exchange may be further reduced by limiting their cash sweeping capabilities to the debtor's account kept within the bank to which bills of exchange are submitted for enforcement, instead of cash sweeping across all debtor's bank accounts.

- **Phase 3** – Removal of the capability of bills of exchange to directly sweep cash from any bank account of the debtor[7]

  The final phase, to be implemented 12 - 18 months after the implementation of phase 2 and in parallel with extending the newly adopted[8] Financial Collateral Act to Serbian corporates (see paragraph 7 below for further analysis), would consist of eliminating the direct cash sweeping capabilities of bills of exchange. This would be achieved through the introduction of a requirement that bills of exchange only be enforced through a court ruling, rather than directly. Effectively, this change would place bills of exchange on an equal footing with other monetary claims (e.g., claims arising out of ordinary commercial agreements).

Deadlines for implementation of phases 2 and 3 are only suggested periods and are to be discussed with the regulators taking into account the duration of the legislative reform process, the immense popularity of bills of exchange, and the time required for account pledges to become market practice.

Defined terms are in Appendix 2 on pages 55 and 56.

2. Study Background and Methodology

Moravčević Vojnović i partneri AOD in cooperation with Schönherr (the "**Legal Consultant**") has been engaged by the European Bank for Reconstruction and Development ("**EBRD**") to prepare a study on the impact of bills of exchange (in particular, their cash sweeping and account blocking capabilities) on out-of-court work-outs (i.e., voluntary restructuring and consensual financial restructuring) and reorganisation of corporate debtors in the Republic of Serbia, Montenegro, the Federation of Bosnia and Herzegovina, the Republic of Srpska and FYR Macedonia.

The main objective of this study is to analyse the impact of cash sweeping and account blocking on out-of-court restructuring and reorganisation in Serbia, with a

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[6] For further details, please see Section 7.2.1 below.

[7] For further details, please see Section 7.2.2 below.

[8] Adopted by the Serbian Parliament on 8 June 2018 and published in the Official Gazette of the Republic of Serbia, no. 44/2018.

view to identifying ways to improve the environment for, and remove the obstacles that the capabilities of bills of exchange pose on, out-of-court restructuring and reorganisation, and making specific recommendations to tackle the identified shortcomings and impediments.

The manner in which publicly available data is collected and processed in Serbia, made it difficult to find examples and sources to support our statements throughout the study. For example, while there is publicly available information regarding the number of consensual financial restructurings and reorganisations for a given period, the relevant regulator did not analyse the cause of these work-outs.

The study also incorporates feedback from key market participants (i.e., commercial banks and companies operating in Serbia that responded to a questionnaire, that is attached as Appendix 2, see pages 21 and 22). The study has been prepared with a view to further discuss with the regulators, primarily the National Bank and the Ministry of Finance, a potential cooperation on the gradual removal of cash sweeping and account blocking from the current legislation.

3. Legal Framework

This section provides an overview of the legal framework relevant for the purpose of this study.

3.1 Legislation on cash sweeping and account blocking

The legal framework governing cash sweeping and account blocking is not encapsulated in a single law, but is spread over several statutes, bylaws and regulations. These are, specifically, the following:

- The **Payment Transactions Act** (*Zakon o platnom prometu*) regulates collection within enforcement proceedings and therefore represents the key piece of legislation governing cash sweeping and account blocking. The Act provides, among others, that bills of exchange can be directly enforced through the National Bank only if they have been duly registered in the Bills of Exchange Register kept with the National Bank.

  In particular, the Act regulates the following aspects of cash sweeping and account blocking:

  - the instruments capable of cash sweeping and account blocking;
  - the rights and obligations of the parties involved in proceedings for the enforcement of the instruments capable of cash sweeping and account blocking;
  - the legal requirements for proceedings for the enforcement of the instruments capable of cash sweeping and account blocking; and
  - the collection process within proceedings for the enforcement of the instruments capable of cash sweeping and account blocking.

- The Payment Transactions Act is supplemented by the **Decision on the Manner of Enforcement of Claims by Debiting a Client's Account** (*Odluka o načinu vršenja prinudne naplate s računa klijenta*), adopted by the National Bank, which regulates the technical aspects of enforced collection from debtors' bank accounts. These include: (i) electronic messages exchanged between the National Bank and the bank(s) where debtors' accounts are held; (ii) software

used to carry out the enforced collection; and (iii) the type of information that the bank(s) holding the accounts and the National Bank exchange in the course of enforcement proceedings.

- Bills of exchange are regulated by the **Bills of Exchange Act** (*Zakon o menici*). Since 2005, the enforcement of registered bills of exchange in respect of all debtors' bank accounts has been centralised and carried out by the Enforced Collection Division of the National Bank.

  The Bills of Exchange Act regulates:

  - different types of bills of exchange;
  - formal requirements for their validity;
  - bills of exchange authorisation letters;
  - transfer of bills of exchange; and
  - mutual rights and obligations of rightful holders of bills of exchange, issuers and drawees.

- The **Enforcement and Securing of Civil Claims Act** (*Zakon o izvršenju i obezbeđenju*) regulates the process in which court decisions within enforcement proceedings (*rešenje o izvršenju*) are issued by the competent court[9].

3.2 Out-of-court restructuring legislation

Companies facing bankruptcy or financial difficulty have various work-out procedures available to them, which vary in terms of the level of regulation (ranging from voluntary, informal processes to those that are formal, regulated and supervised).

The informal work-out method has its legal basis in general civil law. Namely, the **Obligations Act** (*Zakon o obligacionim odnosima*), which is underpinned by the freedom of contract, serves as the legal basis for contractual parties to both agree and amend their respective rights and obligations. Thus, parties wishing to rearrange their contractual rights and obligations may do so at any time, in accordance with the Obligations Act and within the boundaries of the Serbian legislation applicable to their relations (e.g., foreign exchange transactions).

The recently adopted **Consensual Financial Restructuring Act** (*Zakon o sporazumnom finansijskom restrukturiranju*) sets out an incentive-based legal framework to support voluntary consensual financial restructuring of the rights and obligations of creditors and distressed debtors.

The Chamber of Commerce and Industry (*Privredna komora Srbije*) supports the framework as an institutional mediator. A designated mediator is appointed to each restructuring case. The Consensual Financial Restructuring Act incorporates certain internationally accepted financial restructuring principles or practices, such as standstill agreements, creditor cooperation, acting in good faith, as well as a range of measures through which creditor-debtor relations can be redefined (e.g. debt-to-equity swap, claim/debt assignment).

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[9] Enforcement of registered bills of exchange in Serbia is not subject to court procedure; instead, they are enforced directly through the National Bank.

3.3 Court reorganisation legislation

Reorganisation in bankruptcy is a court supervised process that may be undertaken in the two forms available under the **Bankruptcy Act** (*Zakon o stečaju*). The Bankruptcy Act provides that reorganisation may be undertaken either through reorganisation plans (*plan reorganizacije*), which are part of formal bankruptcy proceedings and are enforceable by court; and pre-packaged reorganisation plans (*unapred pripremljen plan reorganizacije*), which involve a mixed procedure consisting of out-of-court negotiations and judicial approval of the plan.

4. Bills of exchange

4.1 Introduction

The Bills of Exchange Act does not provide a definition of a bill of exchange. However, a definition may be inferred from prevailing legal theory and legal doctrine, which define bills of exchange according to their features and elements stipulated in the Bills of Exchange Act.

Therefore, bills of exchange are described as security instruments based on which their issuer unconditionally instructs a third party to pay the monetary amount stated in the bill of exchange to its rightful holder, or undertakes to itself pay such amount to the rightful holder of the bill of exchange.

The most common type of bill of exchange on the market is the registered blank bill of exchange. Its popularity is attributed to the flexibility it provides to the creditor. As their name suggests, blank bills of exchange do not include any information regarding the debt on the face of the document. Such information, and other information required by the Bills of Exchange Act to ensure the validity and enforceability of the bill of exchange is filled in by the authorised creditor at the moment of its enforcement. The authorisation is proved by the authorisation letter issued by the debtor to the creditor at the time of issue of the blank bill of exchange.

Bills of exchange and the accompanying authorisation letters are customarily registered with the Bill of Exchange Register. This is because, under the Payment Transactions Act, only registered bills of exchange and authorisation letters[10] can be used for cash sweeping and account blocking without initiating court proceedings.

The registration of the bill of exchange and the accompanying authorisation letter is initiated by the debtor, who submits an application to its bank. The latter then notifies the National Bank, which registers the bill of exchange and the accompanying authorisation the following day.

Prior to further elaborating on bills of exchange, it is important to explain why they are more relevant for this study than the other two enforceable instruments that have cash sweeping and account blocking capabilities (i.e. court decisions on enforcement and tax and customs authority decisions), and to further describe these features.

[10] Bill of exchange authorisation letters are only required for blank bills of exchange.

4.2 Bills of exchange in comparison to other instruments capable of cash sweeping and account blocking

Although cash sweeping and account blocking are inherent features of court decisions on enforcement and tax and customs authority decisions as well, bills of exchange are the only instruments authorising regular creditors to perform direct cash sweeping and account blocking.

In contrast to court decisions on enforcement, which are also available to regular creditors, bills of exchange do not require prior court proceedings; instead they authorise the creditor to sweep cash and block the debtor's bank accounts directly (through the National Bank).

On the other hand, while tax and customs authority decisions are also capable of direct cash sweeping and account blocking, they are not available to regular creditors.

Therefore, compared to the other two instruments, bills of exchange have the greatest impact on out-of-court restructuring and/or reorganisation, as they constitute a direct and common practice and are available to all creditors.

4.3 Key features of bills of exchange - cash sweeping and account blocking

4.3.1 Cash sweeping

Cash sweeping is the first measure applied by the National Bank against the debtor's cash assets when enforcing bills of exchange. Cash sweeping is a two-stage process.

Firstly, all funds held in the debtor's bank accounts kept with the bank to which bills of exchange are submitted for enforcement are transferred to the benefit of the enforcing creditor.

Secondly, and only if the first step does not cover the entire creditor's claim, all funds held in all the debtor's bank accounts at the time of commencement of the enforced collection are transferred to the account of the enforcing creditor.

4.3.2 Account blocking

Where cash sweeping fails to satisfy in full the claim under the bill of exchange, the National Bank activates the account blocking measure, which involves (i) prohibiting the debtor from disposing of any future income transferred to its bank accounts; and (ii) automatic transfer of such proceeds to the enforcing creditor.

4.3.3 A breakdown of cash sweeping and account blocking

Cash sweeping and account blocking may be broken down into the following key components:

	Cash Sweeping	Account Blocking
Legal basis for implementation	Both cash sweeping and account blocking are implemented based on the enforcement of bills of exchange.	
Form	Transfer of all funds held in a particular bank account (i.e. bank account kept with the commercial bank to which bills of exchange are submitted for enforcement), if collected funds are insufficient for satisfaction of the entire claim; transfer of all funds held in all debtor's bank accounts to the account of the enforcing creditor.	• Debtor prohibited from disposing of any future proceeds paid into his bank accounts; and • Automatic transfer of any future proceeds paid into the debtor's bank accounts to the enforcing creditor.
Implementation	Automatic implementation by the National Bank when enforcing bills of exchange.	Automatically implemented by the National Bank if cash sweeping fails to satisfy in full the claim under the bills of exchange.
Termination	Automatically terminated when: (i) claims covered by the bills of exchange have been satisfied in full; or (ii) all funds held in all bank accounts of the debtor have been transferred to the enforcing creditor to satisfy the claims under the bills of exchange, and the enforcement process has transitioned to the account blocking phase due to the insufficiency of the swept funds to cover the entire claim under the bills of exchange.	In the ordinary circumstances, automatically terminated where the claim under the bills of exchange being enforced has been satisfied in full; In consensual financial restructuring – automatically terminated once the parties to the consensual financial restructuring have submitted a standstill agreement to the competent enforcement bodies. The account blocking implemented by non-participating creditors remains in force, as the standstill agreement is not binding on such creditors; In reorganisation – automatically terminated once bankruptcy proceedings have been opened (reorganisation is carried out in bankruptcy proceedings).

4.4 Applications of bills of exchange

The legal regime regulating bills of exchange and the ease and efficiency of their enforcement have led to their use as:

- *payment instruments* – bills of exchange are easily enforced and transferred; thus market participants often use them as payment instruments. A creditor holding bills of exchange may transfer them to its own creditors instead of payment.
- *credit instruments akin to "I owe you" documents* – the bill of exchange binds its issuer, or a third party drawing it, to pay the amount stipulated on the bill of exchange, as a result of which it is often used as a substitute to immediate payment. In particular, the issued bills of exchange compel the debtor to repay to the creditor the monetary claim evidenced by them.
- *collateral* – Serbian legal regime sets out simple perfection requirements, efficient enforcement and independence of bills of exchange from the underlying legal grounds applicable to secured claims. Due to this, bills of exchange are most commonly used as collateral for securing monetary receivables.

4.5 Bills of exchange as collateral

The principle that bills of exchange are independent from the underlying legal ground of the claim secured by them[11], prescribed by the Bills of Exchange Act, as well as their above referenced qualities regarding perfection and enforcement, have greatly contributed to the widespread use of bills of exchange as collateral in Serbia.

The use of bills of exchange as collateral is also attributed to their comparable advantage over other collateral instruments (i.e., considerably greater efficiency of enforcement compared to other types of collateral, such as mortgages or pledges).

Other types of collateral typically involve higher costs, greater uncertainties and longer enforcement periods. On the contrary, the enforcement of registered bills of exchange in Serbia is a straightforward process, which requires very limited involvement on the part of either the creditor or the debtor.

Their widespread use as collateral is evidenced by 90% of market participants demanding bills of exchange as the instrument for securing their claims.

In particular, out of the 15 banks and 10 companies that completed the questionnaire, 100% of the banks and 80% of the companies surveyed stated that they required bills of exchange from their debtors/counterparties as collateral.

4.6 Inoperability of account pledge contributing to the use of bills of exchange as collateral

The absence of other reliable security instruments for cash assets under Serbian law is another factor that significantly contributes to the widespread use of bills of exchange.

Although Serbian law, in theory, recognises the concept of account pledge, it is in practice inoperable. The Ministry of Economy and Regional Development has taken

[11] A principle also applicable to instruments such as bank guarantees.

the position that an account pledge covers cash assets only up to the amount of cash assets available in the debtor's account at the time of pledge perfection[12].

Consequently, the Business Registers Agency does not accept the registration of pledges over the accounts themselves. Any increase in the debtor's account balance is not covered by the account pledge, unless the pledge is re-registered.

Pledges over the available funds in the debtor's bank account, permitted by Serbian law, typically:

- provide very limited security to creditors;
- may be worthless if the amount in the debtor's bank account is insufficient;
- require the debtor’s approval to register a new pledge each time he receives financing;
- keep the debtor's funds blocked during the repayment of the financing; and
- are not immune from enforcement against cash assets initiated by other creditors.

It is the bills of exchange that have contributed to the inoperability of an effective system of account pledges. Currently, cash pledged as security to the benefit of a secured creditor may be transferred to the benefit of the creditor enforcing bills of exchange, effectively diminishing collateral value for the first creditor.

Over 60% of the 25 market participants interviewed have stated that they find account pledges to be inferior/less efficient than bills of exchange as security instruments over the debtor's bank accounts. At any rate, most market participants do not feel that account pledges could be an adequate replacement for bills of exchange[13].

The above is primarily due to the inoperability of pledges over bank accounts under Serbian law, and to the refusal of the Serbian Business Registers Agency to register such pledges.

4.7 Enforcement of bills of exchange

The enforcement of registered bills of exchange is initiated by a creditor presenting a completed and registered bill of exchange to any bank with which the debtor maintains a bank account. Thereupon, the enforcement process is handled by the bank and no further action is required of the creditor or the debtor.

Once a completed and registered bill of exchange is presented before a debtor’s bank, the bank verifies its validity and immediately sweeps the specified amount of cash from the debtor's bank account and transfers it to the creditor.

The enforcement process is completed within minutes if the funds the debtor holds in its account at the bank to which the bills of exchange are presented for enforcement are sufficient to cover the amount stipulated under the bills of exchange being enforced.

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[12] Registration in the Pledge Register kept with the Serbian Business Registers Agency.

[13] The statistics have been developed based on a questionnaire completed by 15 banks and 10 companies.

However, if there are insufficient funds in the debtor's bank account to satisfy a creditor's claim in full, the bank does not pay out any cash from the debtor's account to the enforcing creditor. Instead, it notifies the National Bank of the deficit in the debtor's bank account to the National Bank, which maintains a centralised register of all bank accounts in Serbia.

The National Bank then sweeps the required amount from the debtor’s Serbian Dinar accounts (RSD accounts), starting with the account with the highest balance. If the balance is insufficient, cash is then swept from all the debtor's RSD accounts.

If the funds available in all the debtor's RSD accounts are insufficient to cover the enforcing creditor’s claim, enforcement is then carried out on all the debtor’s foreign currency accounts.

If full repayment has not been achieved after all cash has been swept from all of the debtor’s bank accounts, the National Bank implements account blocking across all the debtor's bank accounts.

The debtor and its affiliates are prohibited from opening any new bank accounts until their existing ones have been unblocked (i.e., all the enforcing creditors have been satisfied in full).

The ranking of other types of collateral, such as pledges and mortgages, is determined based on the time of collateral perfection (i.e., registration in the relevant collateral register). In contrast, bills of exchange are ranked according to the time of enforcement initiation.

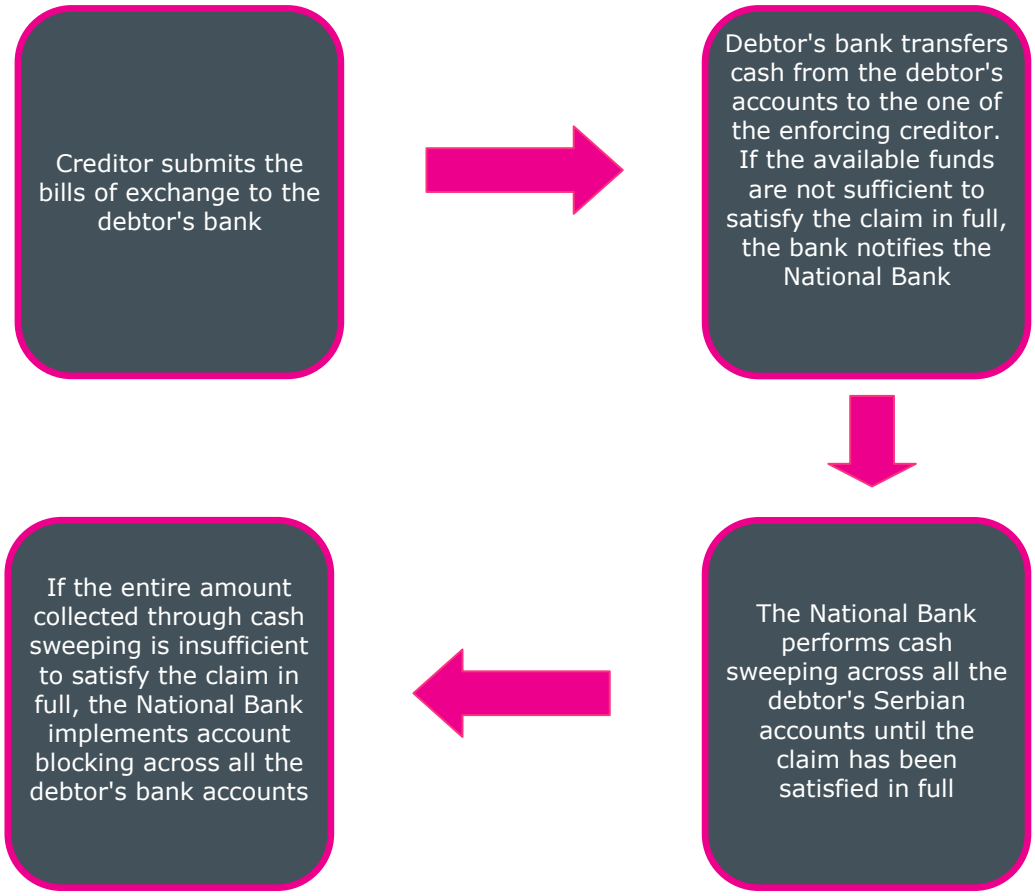
Provided there is sufficient cash available to satisfy in full the enforcing creditor's claim, the priority of claims between creditors with regard to the balance in a specific bank account is determined according to the time of submission of the bills of exchange to the debtor's bank.

Such priority is only exercised where the funds in the debtor's bank account against which the bills of exchange have been submitted are sufficient to cover the claim in full. Otherwise, the debtor's bank notifies the National Bank of the submitted bills of exchange and the National Bank then sweeps all cash from the debtor's Serbian accounts.

Therefore, where several creditors submit bills of exchange to different banks in which the debtor keeps its bank accounts, and such accounts hold insufficient funds to repay the respective amounts claimed by such creditors, priority is afforded to the bank that was the first to notify the National Bank of the bills of exchange presented to it for payment.

The aforementioned priority ranking is purely theoretical, due to the National Bank's centralised system. In practice, priority is most likely afforded to the creditor that was the first to present the bills of exchange to any of the debtor's banks.

4.7.1 Bill of exchange enforcement process



4.8 Comparative overview of bills of exchange in Serbia and in certain European Union Member States

In contrast to the Serbian legal regime, the Austrian, German and Slovenian legal regimes governing bills of exchange and their enforcement do not allow for direct cash sweeping across all bank accounts of a debtor, or equip bills of exchange with account blocking powers.

The enforcement of bills of exchange in the above-referenced jurisdictions does not result in the blocking of all the debtor's bank accounts, nor does it prevent the disposal of any future income, or allow automatic transfer of such incoming cash flows to the enforcing creditor.

Austrian law provides for the enforcement of bills of exchange in a two-step court procedure, which may be followed by cash sweeping.

The enforcing creditor must seek the competent court to issue a payment order based on the bills of exchange. Once the payment order has become final and binding, the creditor obtains an enforcement title, which may then be enforced through the competent enforcement court. Priority over cash assets is afforded to the creditor which first obtains a court seizure order based on the enforcement title.

If the funds available in the debtor's account are insufficient to satisfy the full amount indicated in the court order, unlike in Serbia, this does not give rise to account blocking. The debtor is not barred from disposing of the available funds in his accounts and no automatic transfer of debtor's future income is available to the enforcing creditor.

The court may issue an attachment order and instruct the transfer of the debtor's receivables to the account of the enforcing creditor, resulting in direct cash sweeping or account blocking. But the enforcement of bills of exchange under Austrian law does not in and of itself allow for direct cash sweeping or account blocking.

Similarly, Germany does not have a centralised system that permits direct enforcement of bills of exchange resulting in cash sweeping or account blocking. Instead, the enforcement of bills of exchange is secured through a court ruling or a comparable title such as a court settlement, writ of execution or notarial certification with submission under immediate execution.

A judgement or comparable title is required for the competent government authorities to implement any enforcement measure, including the freezing of debtor's bank accounts and the transfer of debtor's receivables to an enforcing creditor.

Account blocking is also possible. However, after receiving a judgment in court proceedings, the creditor must first apply to the court for a temporary freezing of debtor's accounts to ensure non-depletion of cash assets; once this has been granted, the creditor may apply for attachment and the transfer of the debtor's cash receivables to the creditor's account.

In contrast to Austria and Germany, Slovenia recognises some of the legal concepts applicable in Serbia. Specifically, under Slovenian law, bills of exchange that indicate the place of payment and the payee (domiciled bills of exchange) are deemed to include the debtor's authorisation to the creditor to issue a payment order to the debtor's bank and debit a specific bank account.

A Slovenian bank receiving bills of exchange from an enforcing creditor is only authorised and obliged to sweep cash from the debtor's account if the account holds sufficient funds to settle the full claim covered by the bill of exchange.

However, any further enforcement of bills of exchange under Slovenian law requires the enforcing creditor to initiate and conduct prior court proceedings.

Cash sweeping across all bank accounts of a debtor and transferring its future income to the benefit of the enforcing creditor requires a court ruling rendered in enforcement proceedings.

4.9 Recent changes in the Montenegrin legal framework

Until recently the Montenegrin legal framework for enforcement of bills of exchange permitted direct cash sweeping and account blocking based on bills of exchange.

On 29 September 2017[14], the Montenegrin Constitutional Court ruled that direct cash sweeping and account blocking based on bills of exchange is contrary to the fundamental principle of enjoyment of private property as direct enforcement (instead of regular enforcement through the court system) cannot be justified on the grounds of public interest. Furthermore the Constitutional Court found that direct enforcement does not provide sufficient protection for the debtor, due to the lack of legal remedies available to the debtor.

[14] Adopted on a session held on 29 September 2017, published in the Official Gazette of Montenegro no. 76/2017 on 17 November 2017.

On, *inter alia*, the above grounds, the Constitutional Court of Montenegro abolished provisions of the Montenegrin Enforcement Act which allowed for direct enforcement based on bills of exchange. Such decision renders the enforcement of bills of exchange to be the same as enforcement of any other monetary claim and requires the creditor to enforce its claims through the court/bailiff system.

In addition, on-going proceedings before the Central Bank of Montenegro (in charge of centralised cash sweeping and account blocking) were terminated and creditors were referred to enforcement before the courts/bailiffs.

4.10 Summary of key features of bills of exchange and their realisation

The table below describes and explains the key features of bills of exchange under Serbian law.

Key Feature	Comment
Simple perfection steps	An application for registration of bills of exchange and any authorisation letters are submitted by the debtor to its bank, which verifies the validity of the application. The bank automatically notifies the National Bank of the issuance of bills of exchange. Provided the application satisfies legal requirements, bills of exchange and any authorisation letters are registered the following day in the Bills of Exchange Register
Efficient tool for sweeping cash from a particular bank account	If there is sufficient cash in the debtor's bank account against which the bills of exchange have been submitted, the bank performs cash sweeping from such account within minutes of the bills of exchange being submitted for enforcement
Efficient tool for cash sweeping across all debtor's bank accounts	If there is not sufficient cash in the debtor's bank account against which bills of exchange have been submitted to cover in full the claim under the bills of exchange, the National Bank automatically sweeps cash from all of the debtor's bank accounts in Serbia within 24 hours of being notified of the submitted bills of exchange
Limited involvement required of the creditor in the enforcement process	The creditor is only required to fill in the registered blank bills of exchange and submit them for enforcement to the debtor's bank
Account blocking capability	In case the total amount collected through cash sweeping across all debtor’s bank accounts in Serbia is not sufficient for

	repayment of the entire amount stipulated in the bills of exchange, all bank accounts of the debtor are blocked until the enforcing creditor's claim has been satisfied in full. Any amount credited to the debtor's account will be automatically transferred to the enforcing creditor and applied towards repayment of its claim
Safe and reliable form of collateral	The creditor is not required to prove the existence of a valid underlying obligation prior to enforcing a bill of exchange, nor can the debtor challenge the existence of such obligation. No court involvement is required
Priority between creditors is determined based on the time of submission of bills of exchange for enforcement	In practice, priority between enforcing creditors of the same debtor is determined according to the time of commencement of their respective enforcement proceedings (i.e., according to the time of submission of bills of exchange to the bank)

4.11 The effects of bills of exchange

4.11.1 Race between creditors and chain reaction

The ranking of creditors according to the time of enforcement of bills of exchange, cash sweeping and account blocking may combine to trigger a race between creditors to submit their respective bills of exchange in order to ensure better prospects of satisfying their respective claims.

Payment priority ranking may encourage first movers to race for the cash available in the debtor's bank accounts in Serbia. In addition, first movers may also reserve all future cash receivables of the debtor until satisfaction of their claims in full *via* account blocking.

The issues associated with first movers among creditors in submitting bills of exchange are not prevalent in Austria, Germany and Slovenia, since the legal regimes of these countries do not equip bills of exchange with the power of direct (i.e. without court proceedings) cash sweeping across all debtor's bank accounts, and/or account blocking.

Besides triggering a race between creditors, the payment priority ranking and the account blocking capability of bills of exchange also lead to creditor chain reactions: Once a creditor has enforced its bills of exchange, other creditors typically follow suit and initiate enforcement in order to reserve as much of the future cash flows to the debtor's account as possible.

4.11.2 Potential bankruptcy of a debtor

The chances of bankruptcy proceedings being initiated are increased once bills of exchange have been enforced and accounts have been blocked, as all payments from these accounts are hence prohibited, except those made in favour of the creditors enforcing their bills of exchange.

Grounds for opening bankruptcy proceedings will be satisfied in the event of non-payment of monetary claims within 45 days of their maturity, or a default on all payments for 30 consecutive days.

The opening of bankruptcy proceedings against the debtor is detrimental for the debtor's business as it could, *inter alia*, also trigger the revocation of the operating licenses for the debtor's business, where the debtor's business is subject to licensing requirements.

Specifically, the Capital Markets Act and the Payment Services Act govern certain regulated market activities, such as investment services and payment services. Under these Acts, the licenses granted for specific regulated activities are automatically revoked upon the initiation of bankruptcy proceedings over the licensed entity.

Based on the feedback received from key market participants, 60% of banks would initiate bankruptcy proceedings against a debtor whose accounts were blocked, while only 10% of Chamber of Commerce and Industry members would do the same.

However, there is little comfort for the debtor's business or his prospects of achieving successful out-of-court restructuring or reorganisation in the reluctance of non-bank creditors to initiate bankruptcy proceedings, as the state of being blocked, in itself, also leads to the demise of the business.

4.11.3 Deterioration of the debtor's business and businesses of its transacting counterparties

Due to the account blocking feature of bills of exchange, all payments from the debtor's bank accounts, other than those made in favour of the enforcing creditor, are suspended, which may have adverse effects on the debtor's business.

The discontinuation of the debtor's payments inevitably leads to his inability to acquire goods and services for its day-to-day business, as most suppliers are reluctant to supply goods/services where there is a risk of not being paid.

In most cases, businesses also cease operating due to employee work stoppages stemming from increasing uncertainty associated with account blocking.

In addition, suspension of payments by the debtor may also adversely affect the financial standing of the debtor's transacting counterparties, including the creditors who have not enforced their bills of exchange.

Furthermore, account blocking may lead to the debtor's transacting parties being unable to service their own debts, especially if their income heavily relies on revenue generated from doing business with the debtor.

While the surveyed market participants concur that enforcement of bills of exchange has adverse effects on the debtor's business, they fail to acknowledge that enforcement of such instruments also negatively impacts the prospect of achieving successful out-of-court restructuring and/or reorganisation of the debtor.

4.11.4 Fraudulent behaviour

Pursuant to the Payments by Legal Entities, Sole Proprietors and Non-Business Persons Act (*Zakon o obavljanju plaćanja pravnih lica, preduzetnika i fizičkih lica koja ne obavljaju delatnost*) [15], a debtor whose bank accounts are blocked is prohibited from assigning its claims/debts or setting off its rights and liabilities.

In practice, this prohibition leads to fraudulent behaviour by debtors, which devise various schemes to diminish the effects of account blocking. These schemes include, amongst others, debtors redirecting their cash receivables/liabilities to their affiliates through claim/debt assignment in order to circumvent the restrictions imposed on their bank accounts[16] or debtors operating through the bank accounts of related parties.

Such fraudulent behaviour of the debtors is frequently accompanied by a reluctance to share business-related information with their creditors as such information sharing could reveal the fraud.

4.12 Facts and figures

4.12.1 Questionnaires

A research conducted among market participants - 15 commercial banks and 10 companies, i.e. members of the Chamber of Commerce and Industry currently operating in the Serbian market - revealed the following:

- Over 90% of the market participants require their potential debtors to provide bills of exchange as collateral, failing which they are unwilling to provide financing. Yet, they are reluctant to depend solely on the bills of exchange for securing their claims and will also require other sources of security, such as mortgages, pledges or bank or personal guarantees.
- The payment of existing and future proceeds from the debtors' bank accounts is contributes to better recovery, although 40% of companies disagree with this view, as they find it to be detrimental to the debtor's day-to-day business and believe it may result in forced collection by other creditors.
- Bills of exchange are a convenient, swift and efficient security instruments, whose enforcement allows for collection against all cash assets of the debtor (i.e., by way of cash sweeping and account blocking) without prior court proceedings; at the same time, they enable enforcement against all assets of the debtor through court proceedings.
- The enforcement of bills of exchange does not necessarily secure a good rate of recovery. In particular, only 36% of market participants

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[15] Official Gazette of the Republic of Serbia, No. 68/2015

[16] Prohibiting the debtor from disposing of any future proceeds paid into its bank account; and automatic transfer of such proceeds to the creditor enforcing its cash sweeping/account blocking instrument.

find that enforcement of bills of exchange successfully secure 60% or more of their initial claim.

- Where bills of exchange are the only security available and there is cash in the debtor's bank accounts, 85% of commercial banks will generally enforce bills of exchange to satisfy their claims, but only after they have exhausted all other methods, including participating in out-of-court restructuring of the debtor.
- Commercial banks maintain a cooperative policy towards their debtors, whereby they tend to rely on the account blocking feature only if no other collection method is available (i.e. 60% of commercial banks will not typically enforce bills of exchange at the first sign of financial distress of the debtor). In comparison, only 20% of companies as lenders would enforce bills of exchange at the first sign of financial distress of the debtor, the remaining 80% finding that reducing the debtor's business operability and liquidity is not the best recovery option for the creditor.
- While 67% of commercial banks would not generally be among the first movers to enforce their bills of exchange, they would be inclined to enforce their bills of exchange if other creditors were enforcing or threatening to enforce. This is particularly the case where enforcement by other creditors has affected the financial and business standing of the debtor, which is determined on a case-by-case basis.
- 60% of commercial banks will generally initiate bankruptcy proceedings on the ground of the debtor's accounts being blocked, if, upon careful examination of the debtor's financial standing and his position vis-à-vis his other creditors, they determine that repayment prospects are low. On the other hand, 90% of companies in Serbia would not initiate insolvency proceedings against their debtors on these grounds[17].

4.12.2 Statistics

The table below, compiled from the publicly available information published by the National Bank in February 2017 and February 2018, offers a comparison between the 10 largest debtors in Serbia, in terms of the amounts required to release the debtor's accounts from blockade, including the duration of the blockade.

Company[18]	Amount blocked (approx. in EUR)		Duration of blockade (days)	
	February 2017	February 2018	February 2017	February 2018
Company no. 1	30,081,300	30,832,687	1.000	1.393
Company no. 2	26,739,837	27,576,931	700	1.093

[17] The statistics have been developed based on a questionnaire completed by 15 banks and 10 companies.

[18] Companies' names are not provided, as publishing them may be viewed as imprudent and does not add value to the study.

Company no. 3	26,465,504	27,127,155	2.935	3.328
Company no. 4	25,201,843	25,831,913	2.491	2.884
Company no. 5	23,968,850	24,567,651	769	1.162
Company no. 6	22,335,853	22,903,499	707	1.100
Company no. 7	22,036,337	21,279,583	1.961	1.590
Company no. 8	19,665,274	19,394,900	1.197	849
Company no. 9	18,828,293	17,174,921	456	2.017
Company no. 10	18,650,029	17,138,577	119	2.361

5. Out-of-court restructuring and reorganisation

Before analysing the impact of bills of exchange and account blocking on out-of-court restructuring and reorganisation in greater detail, we will attempt to explain the importance of these procedures and provide some background in form of the Serbian legislation regulating them and the internationally recognised standards applicable to such procedures, provided by:

- the World Bank's 'Principles for Effective Insolvency and Creditor/Debtor Regimes'[19];
- the European Commission's Recommendation 'On a new approach to business failure and insolvency'[20]; and
- the proposal for a Directive of the European Parliament and of the Council on Preventive Restructuring Frameworks, Second Chance and Measures to Increase the Efficiency of Restructuring, Insolvency and Discharge Procedure and Amending Directive 2012/30/EU[21].

5.1 Importance of out-of-court restructuring and reorganisation

The purpose of out-of-court restructuring and court reorganisation (in particular, based on the pre-packaged reorganisation plans) is to ensure that viable enterprises in financial difficulty are able to restructure at an early stage, with a view to preventing their liquidation in bankruptcy and thereby maximising the overall value to creditors, employees, owners and public revenue authorities[22].

In contrast to liquidation in bankruptcy, where the debtor's estate is sold or realised to satisfy the creditors' claims, the maximisation of value to creditors is achieved at an early stage of financial difficulty in out-of-court restructuring and/or reorganisation, by giving the debtor a chance to generate revenue by continuing to carry on its business.

This fundamental difference also ensures a positive impact on employment, the debtor's transacting counterparties and public revenue, which all benefit from the debtor remaining in business.

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19 http://pubdocs.worldbank.org/en/919511468425523509/ICR-Principles-Insolvency-Creditor-Debtor-Regimes-2016.pdf

20 http://ec.europa.eu/justice/civil/files/c_2014_1500_en.pdf

21 http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52016PC0723&from=EN

22 Provided by the European Commission Recommendation 'On a new approach to business failure and insolvency'.

Therefore, the continuation of the debtor's business, which is a key characteristic of out-of-court restructuring and reorganisation, is beneficial to the economy as a whole, as it leads to:

(i) no or limited employee redundancies;

(ii) continued contribution to public revenues (e.g. through taxes);

(iii) benefits for debtor's suppliers and customers; and

(iv) Reduced pressure on the judicial system, which is overburdened with bankruptcy proceedings.

These characteristics distinguish out-of-court restructuring and reorganisation from liquidation in bankruptcy, and underpin the importance of the former two.

5.2 Consensual financial restructuring in Serbia

Consensual financial restructuring in Serbia may be carried out under two statutes: the Obligations Act and the Consensual Financial Restructuring Act.

Voluntary restructuring is performed based on the fundamental principle of contracting freedom under the Obligations Act. Specifically, parties are free to choose their contractual counterparties; decide whether to enter into a contract; and include suitable provisions to regulate their contractual relations, provided such provisions are in line with mandatory rules of law (e.g. foreign exchange rules).

By the same token, the parties that have already entered into contracts are free to amend their terms and conditions without the intervention of any governmental or judicial authority.

It is important to note that, pursuant to the Obligations Act, agreements are only binding *inter partes* and will have no legal effect on any third party. As a result, a voluntary restructuring plan would not be binding on any creditor that has not agreed to, for example, a standstill agreement.

Consensual financial restructuring in Serbia could be described as a voluntary process in which the creditors and the debtor may renegotiate and redefine their relations based on the principle of good faith, provided that the debtor's business is viable.

The Consensual Financial Restructuring Act defines it as 'the redefining of debtor-creditor relations of a company or entrepreneurs in financial difficulty in their capacity as debtor and creditors, with the assistance of a mediator'. The designated institutional mediator for consensual financial restructuring is the Serbian Chamber of Commerce and Industry.

The Consensual Financial Restructuring Act could be characterised as a piece of legislation facilitating financial restructuring and providing consensual financial restructuring parties with a range of tools, including:

- the converting of lump-sum payment obligation into instalment payment obligation;
- postponement of maturity;
- change of interest rates and other terms and conditions of credit arrangements;

- collateral or other arrangements;
- sale or exchange of assets as compensation for liabilities;
- debt write-offs;
- realisation, release or substitution of collateral;
- provision of collateral by debtor or third parties;
- debt-to-equity swaps;
- cash injections; and
- the issuing of corporate securities.

In accordance with best international practice, the Consensual Financial Restructuring Act envisages standstills as crucial requirements for a successful financial restructuring[23].

A standstill agreement is an agreement signed by the debtor's creditors, whereby the signatories agree, amongst other things, to take no enforcement or similar action against the debtor for a specified period of time (including with respect to claims under bills of exchange).

The aim of standstill agreements is allowing the debtor sufficient time to repair its finances without fear of creditors bringing enforcement or collection actions.

While it could be argued that standstill agreements and their effects are in line with best international practice and successfully reduce the disruptive pressure of potential enforcement by creditors during negotiations, their conclusion is strictly voluntary, and they are only binding on the signatories.

Based in the Consensual Financial Restructuring Act, the standstill agreement cannot provide for retrospective termination (i.e., termination of enforcement actions already undertaken that have not been completed). Therefore, if a creditor has successfully submitted his bills of exchange and received repayment on that basis, it is entitled to the claimed amount.

According to the Consensual Financial Restructuring Act, consensual financial restructuring is underpinned by the following core principles:

- *Voluntariness* - Participation in financial restructuring is voluntary. The principle of voluntariness dictates that financial restructuring agreements be signed by all the parties involved in financial restructuring. They do not affect the rights and obligations of non-participating constituencies.
- *Viability of debtor's business and other conditions* - Financial restructuring can only take place if the debtor's business is viable; otherwise it only defers the debtor's inevitable liquidation in bankruptcy. The Financial Restructuring Act further provides that, where financial restructuring is used as an alternative option to reorganisation or bankruptcy, at least two foreign or domestic banks must partake.
- *Cooperation of creditors* - The Financial Restructuring Act provides that creditors have a duty to cooperate. However, it does not detail the form that any such

[23] Provided by the World Bank in its 'Principles for Effective Insolvency and Creditor/Debtor Regimes'.

cooperation should take (e.g. formation of coordinating bodies authorised to act on behalf of creditors having common interests).

- *Reference to general principles of contract law* - The Serbian Financial Restructuring Act regulates restructuring with reference to the Obligations Act. The latter contains the principles and general rules that parties must abide by in their contractual dealings, which are not exclusive to financial restructuring. Its underlying principles require the parties involved to act conscientiously, in good faith, to refrain from causing damage to one another and settle any disputes by agreement, mediation or other amicable manner.

5.3 Court reorganisation in Serbia

Under the Bankruptcy Act, one of the outcomes of bankruptcy proceedings is court reorganisation. Bankruptcy proceedings in Serbia are conducted in form of reorganisation or liquidation in bankruptcy. As defined in the Bankruptcy Act, liquidation in bankruptcy is the process of satisfying creditors' claims by means of realising the debtor's estate.

Reorganisation (*reorganizacija*) is the process of satisfying creditors' claims in accordance with an approved plan, by way of redefining debtor-creditor relations, status changes to the debtor or any other method determined in the reorganisation plan. The process is aimed at achieving a more favourable settlement of creditors' claims than liquidation in bankruptcy, where there are economically viable conditions for the continuation of the debtor's business.

The Bankruptcy Act provides for two forms of reorganisation (i.e., reorganisation carried out based on a reorganisation plan or a pre-packaged reorganisation plan).

The stage at which either form of reorganisation plan is prepared and negotiated represents the crucial difference between the two forms of reorganisation.

Reorganisation plans are typically negotiated, submitted and adopted as part of formal bankruptcy proceedings, by the following interested parties:

- bankruptcy debtor;
- bankruptcy receiver;
- secured creditors whose secured claims account for at least 30% of all claims;
- unsecured creditors whose claims account for at least 30% of all claims; and
- shareholders holding at least 30% of the debtor's share capital.

The preparation and negotiation of reorganisation plans is protected from unilateral enforcement or collection actions from creditors by means of a moratorium (i.e., automatic stay) applicable as of the opening of the bankruptcy proceedings. During preparation and negotiation debtors are also protected against creditor's actions on their accounts, including account blocking.

Reorganisation based on a pre-packaged reorganisation plan falls under the category of so-called 'hybrid work-out procedures'. Such reorganisation attempts to combine the advantages of both formal proceedings (i.e. reorganisation) and consensual out-of-court restructuring. The pre-packaged reorganisation plans are negotiated prior to the formal bankruptcy proceedings in which they are submitted and adopted.

Subject to some exceptions, pre-packaged reorganisation plans may only be submitted by the debtor provided the conditions for initiating bankruptcy proceedings have been satisfied. Negotiation of a pre-packaged reorganisation plan is only protected by a temporary stay on creditor action if granted by the bankruptcy judge upon debtor's request prior to submission of the pre-packaged reorganisation plan.

Debtors and creditors alike increasingly recognise the benefits of the hybrid nature of pre-packaged reorganisation plans. For them, these plans eliminate the pressure of negotiation failure due to creditors' actions (once the court has awarded stay on creditor action on debtor's request) and cram-down options afforded to hold-out creditors, while also providing the security of judicial approval for intended activities.

The response to pre-packaged reorganisation plans has been more enthusiastic than to consensual financial restructuring. From June 2010 to February 2015, more than 250 pre-packaged reorganisation plans were submitted and almost 75% of them approved by the court. The average resolution time from the case's initiation to the adoption of a plan has been approximately 5 months, with the shortest case being resolved in 31 days.

5.4 Implementation of internationally accepted standards for functional out-of-court restructuring and reorganisation in Serbian legislation

The fact that Serbian out-of-court and reorganisation legislation could be characterised as legislation enabling such work-out procedures further substantiates the claim that bills of exchange undermine successful implementation of work-outs.

The implementation in Serbian legislation of internationally accepted standards for functional out-of-court restructuring and reorganisation, provided by the World Bank's 'Principles for Effective Insolvency and Creditor/Debtor Regimes' and the European Commission's Recommendation 'On a new approach to business failure and insolvency' is detailed in Appendix 1.

6. Ramifications of bills of exchange on the various stages of reorganisation and out-of-court restructuring

The following sections describe the impact of the bill of exchange enforcement on the prospect of achieving a successful reorganisation and/or out-of-court restructuring by reference to the critical stages of these proceedings.

6.1 Assessing the feasibility of reorganisation and out-of-court restructuring

The preparation to commence a reorganisation or an out-of-court restructuring entails an assessment of the viability of the debtor's business, a statutory precondition for both proceedings under both the Consensual Financial Restructuring Act and the Bankruptcy Act[24].

Out-of-court restructuring and reorganisation proceedings are an option only if a debtor's business is viable. Otherwise, any attempt to maximise value for creditors

[24] This precondition is also envisaged in the European Commission Recommendation 'On a new approach to business failure and insolvency'; the World Bank's 'Principles for Effective Insolvency and Creditor/Debtor Regimes'; and the proposal for a Directive of the European Parliament and of the Council on Preventive Restructuring Frameworks, Second Chance and Measures to Increase the Efficiency of Restructuring, Insolvency and Discharge Procedure and Amending Directive 2012/30/EU.

through redefining debtor-creditor relations would only delay an inevitable liquidation in bankruptcy.

Cash sweeping and account blocking capabilities of bills of exchange diminish the prospect of a successful outcome for reorganisation and out-of-court restructuring, as they negatively affect the viability of a debtor's business in a number of ways.

6.1.1 Adverse effect on debtor's business

Cash sweeping and account blocking represent a major uncertainty for the business of a financially distressed debtor, which may at any time come to a halt if payments are discontinued as a result of the enforcement of bills of exchange.

6.1.2 Possible bankruptcy

As mentioned in Section 4.10.2 above, the viability of a debtor's business is also diminished by the high prospects of bankruptcy (and its effects), which could occur as a consequence of illiquidity caused by the enforcement of bills of exchange.

6.1.3 Run on the debtor

Given the priority ranking of bill of exchange holding creditors and the consequences of enforcement, as explained in Section 4.10.1 above, the publication of the enforcement of bills of exchange on the National Bank's website may alert other first mover creditors to enforce their own bills of exchange.

Further enforcements effectively lead to an increase in the blocked amounts, thereby diminishing the chances of the debtor's business continuing.

6.2 Negotiation of pre-packaged reorganisation plan/out-of-court restructuring plan

Amongst other elements, the stability of the debtor's business and the availability to creditors of complete and accurate information on the debtor and its business are essential for successful negotiation of pre-packaged reorganisation plans and out-of-court restructuring plans.

6.2.1 Stability of debtor's business

The existence of a standstill agreement in the context of an out-of-court restructuring, or a stay on creditors' actions as part of court reorganisation, is critical for stabilising a debtor's business.

Standstill agreements ensure that the viability of the debtor's business is not exposed to the risk of creditors' enforcement actions[25], and that assets required for successful reorganisation are not depleted by creditors' enforcement of bills of exchange.

With reference to Section 5.3 above, it should also be noted that, while reorganisation is shielded from all creditors by an automatic stay resulting from the opening of bankruptcy proceedings, due to the voluntary nature of out-of-court restructuring, in the latter proceedings debtors are only protected against actions of those creditors that signed a standstill agreement.

[25] Please see Section 5.2 above.

Bills of exchange could be an obstacle to out-of-court restructuring negotiations, as they prompt their holders to enforce them, thereby discouraging other creditors from participating.

The benefit of claim recovery from cash available in all the debtor's bank accounts through cash sweeping and the reservation of all future cash flows into the debtor's bank accounts through account blocking, afforded to the first enforcing creditor, incentivises the enforcement of bills of exchange, rather than the participation in the negotiations of out-of-court restructurings.

Creditors are also motivated to enforce their bills of exchange by the fear that another creditor may do so, and that they will reduce/forfeit their chance of recovery by choosing not to enforce. Such risk leads to runs on the debtor, triggering a further downward spiral for its business and financial position.

Such behaviour is particularly common among commercial banks, as evidenced by the questionnaires. They show that, while 60% of commercial banks would not typically enforce at the first sign of debtor's financial trouble, their inclination to enforce increases as a result of other creditors enforcing their bills of exchange. In such a case over 70% of commercial banks would attempt to increase their chance of recovery through enforcement, which could be jeopardised by other creditors' enforcing their bills of exchange in case of limited availability of funds in the debtor's accounts.

Commercial banks, being more sophisticated than other, non-institutional creditors, such as the members of the Chamber of Commerce and Industry might otherwise be inclined to participate in work-out solutions.

However, under the pressure of enforcement by other creditors and depending on the degree such enforcement threatens the bank's position the bank is likely to opt for enforcing its bills of exchange.

These incentives for the enforcement[26] of bills of exchange also discourage creditors that do not hold bills of exchange, and those who do but would normally opt for out-of-court restructuring, from actually doing so. Due to the stay not being compulsory for non-participating creditors, negotiations are exposed to the issue of hold-out creditors, which are capable of undoing the conclusion of an out-of-court restructuring plan.

The negotiations for out-of-court restructuring are not protected against non-participating creditors[27]; therefore, the viability of debtor's business is uncertain and the assets required for successful out-of-court restructuring are at a constant risk of enforcement.

Creditors wishing to participate in out-of-court restructuring are discouraged from doing so by the risk that non-participating creditors could enforce their bills of exchange, which could in turn:

- lead to the debtor being declared bankrupt;

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[26] Enforcing creditors "take" all current cash balances and "reserve" all future income of the debtor for their benefit.

[27] Standstill agreement is only binding upon creditors signatories of the agreement.

- cause the debtor's business to wind up; and
- deplete the debtor's asset base required for out-of-court restructuring.

The impact of bills of exchange on the prospect of a successful outcome is more prevalent in the case of out-of-court restructurings than in pre-packaged reorganisation plans, and is non-existent in reorganisation plans.

Namely, a debtor who has prepared a pre-packaged reorganisation plan may request an automatic stay from the bankruptcy judge. Such automatic stay, if granted, precludes all creditors from enforcing their bills of exchange (and prevents cash sweeping and account blocking), in contrast to out-of-court restructuring, where only signatories to the standstill agreement may be precluded from enforcing their bills of exchange.

However, the implementation of pre-packaged reorganisation plans may also, to some degree, be affected by bills of exchange. Mainly, creditors holding bills of exchange might be inclined to vote against the plan.

In addition, if the bankruptcy judge does not grant an automatic stay of enforcement, the negotiations for a pre-packaged reorganisation plan are, much like those for the out-of-court restructuring plan, exposed to unilateral enforcement of bills of exchange.

On the other hand, reorganisation plans are not affected by bills of exchange, as negotiations are always protected by an automatic stay, triggered by the initiation of bankruptcy proceedings (reorganisation plans being negotiated within bankruptcy proceedings).

Furthermore, unlike the pre-packaged reorganisation plan, failure to adopt a reorganisation plan does not lift the automatic stay. Thus creditors holding bills of exchange are not inclined to vote against the reorganisation plan, tempted by the prospect of enforcing their bills of exchange after the lifting of the automatic stay as a result of failure to adopt a reorganisation plan.

6.2.2 Information sharing

Both out-of-court restructuring plans and pre-packaged reorganisation plans must be based on complete and accurate information about the debtor and its business in order to be viable. Namely, a plan based on inaccurate or incomplete information is susceptible to fail, as the forecasts and measures envisaged therein would be inappropriate and incapable of achieving the intended outcome of the work-out.

Debtors whose bank accounts have been blocked typically devise and implement schemes consisting of the re-directing of cash receivables/liabilities, in order to minimise the negative effects of account blocking on their business.

The above-referenced schemes are in direct contravention to the provisions of the Payments by Legal Entities, Sole Proprietors and Non-Business Persons Act, which prohibits claim/debt assignment, and are classified as a criminal offence under the Criminal Code.

It cannot be reasonably expected that debtors who have engaged in such schemes and thereby violated statutory rules have fully and accurately disclosed all information to their creditors.

This issue is less relevant in the case of reorganisation plans, as such plans are prepared and negotiated as part of bankruptcy proceedings (i.e., at the time of their preparation and negotiation an independent bankruptcy receiver is appointed to manage the company and oversee the information provided).

6.3 Implementation of out-of-court restructuring measures

The World Bank and the European Commission, as well as Serbian legislation, all dictate that a functional work-out or restructuring and reorganisation in a bankruptcy environment requires an enabling framework.

A framework is considered to be enabling if, *inter alia*, it provides for a wide range of measures for re-defining debtor-creditor relationships. Such measures typically include debt/claim assignment and set-off.

Considering that claim/debt assignment is prohibited, as is the set-off of rights and liabilities of a debtor whose accounts are blocked[28], once account blocking is in place, out-of-court restructuring plans may envisage neither claim/debt assignment nor set-off as a measure for re-defining debtor-creditor relationships.

Therefore, unless supported by all creditors, some measures typically used for redefining debtor-creditor relationships will not be available as part of an out-of-court restructuring once account blocking has been put in place.

6.4 Adoption of the pre-packaged reorganisation plan/out-of-court restructuring plan

The adoption of the out-of-court restructuring or pre-packaged reorganisation plan is correlated to the participation of the key creditors in out-of-court restructuring/reorganisation negotiations.

The question of whether creditors holding bills of exchange will vote for the adoption of an out-of-court restructuring plan is redundant, since such plans are not binding on them without their consent, while incentives presented by bills of exchange encourage them to take unilateral action (i.e., enforcement), rather than participate in collective action (i.e., out-of-court restructuring).

Given that all the creditors must vote on a pre-packaged reorganisation plan, and that a stay on creditor actions[29] is automatically lifted in case of failure to adopt the plan, creditors holding bills of exchange may vote against the pre-packaged reorganisation plan in order to ensure the lifting of the stay enabling them to enforce their bills of exchange.

Conversely, creditors holding bills of exchange are not incentivised to vote against reorganisation plans, as non-adoption of a reorganisation plan does not lead to the lifting of the automatic stay, but to the debtor's liquidation in bankruptcy.

6.5 Facts and figures

As confirmed by the questionnaire results[30], market participants are generally willing to participate in pre-packaged reorganisation plans/out-of-court restructuring plans with their debtors.

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[28] In accordance with the Payments by Legal Entities, Sole Proprietors and Non-Business Persons Act.

[29] Where awarded by a bankruptcy judge as a preliminary measure.

[30] The statistics have been developed based on a questionnaire completed by 15 banks and 10 companies.

Furthermore, over 90% of market participants are willing to participate in both bilateral and out-of-court restructuring with other creditors, except in cases of uncooperative debtors (i.e., debtors that transfer their business to new companies and attempt to defer and even entirely avoid payment of their liabilities towards creditors, etc.).

They are also willing to participate in out-of-court restructuring or court reorganisation, even if bills of exchange have already been enforced by other creditors, as long as there is some chance of recovery.

However, most market participants have said that they will not participate in these schemes if the debtor's accounts are likely to remain blocked for an extended period of time and/or out-of-court restructuring is not likely to result in successful repayment of their claims.

7. Key recommendations for mitigating the impacts of bills of exchange on the various stages of reorganisation and out-of-court restructuring

Having in mind all of the foregoing obstacles posed by the bill of exchange enforcement in various stages of reorganisation and out-of-court restructuring proceedings in Serbia, we consider it advisable to rank the enforcement of bills of exchange at the same level as the enforcement of any other monetary claim.

However, given the long standing popularity of bills of exchange and their widespread use as collateral (evidenced by the market survey, which shows that over 90% of market participants require bills of exchange as collateral), replacing bills of exchange or reducing their direct cash sweeping and account blocking capabilities would likely be strongly opposed by market participants and potentially also the authorities, which might be unwilling to introduce changes to the current regime governing bills of exchange because of fears that this will reduce event further the existing low credit activity of market participants.

Therefore, the improvement of the out-of-court restructuring and reorganisation environment by eliminating obstacles arising from the unique features of bills of exchange must be carefully structured and gradually implemented.

At the same time, account pledges should be brought in line with their European counterparts[31], and other cash collateral used to secure trade finance receivables should be considered in order to "weaken" bills of exchange and generally promote more secured credit. In respect of the requirement and need to align Serbian legislation with EU legislation and to the importance of gradual transition, please note that the Serbian Financial Collateral Act (*Zakon o finansijskom obezbeđenju*)[32] currently excludes Serbian corporates from financial collateral arrangements, with the intention to include the same on further development of the market. The extension of the financial collateral regime to Serbian corporates could provide banks with an easily enforceable security interest over cash assets in commercial

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[31] With regard to legal issues stemming from the inoperability of the account pledge, please see Section 4.6 of this Study.

[32] Adopted by the Serbian Parliament on 8 June 2018 and published in the Official Gazette of the Republic of Serbia, no. 44/2018.

loan transactions, further reducing the dependency of the market on directly enforceable bills of exchange with account blocking and cash sweeping powers. The extension of the Serbian Financial Collateral Act would align Serbia with implementation of the EU Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements (the "**EU Directive**") by EU Member States. Among EU Member States only Austria exercised the full opt out to exclude legal persons referred to in Article 1(2)(e) of the EU Directive from their implementing legislation. Many EU countries instead modified this or only partially implemented this provision. This includes Germany which partially implemented Article 1(2)(e) of the EU Directive to cover a collateral provider which is an undertaking, provided the financial collateral is used to secure specifically defined financial obligations (excluding mainly long-term cash loans).

The following three phases are suggested to achieve the goal of eliminating the reliance of the market on directly enforceable bills of exchange.

7.1 Initial Phase

7.1.1 Phase 1 – Removal of the direct account blocking capability of bills of exchange

Considering that the direct account blocking capability of bills of exchange, more than their cash sweeping capability, represents a significant obstacle to the prospect of achieving a successful outcome in reorganisation/out-of-court restructuring, it is recommended that the direct account blocking feature be eliminated leaving bills of exchange as a tool that only has cash sweeping capabilities, as a first step towards mitigating the issues raised by bills of exchange.

7.1.2 Potential benefits

- Removal of the direct account blocking capability from the bill of exchange enforcement mechanics would reduce the ramifications of account blocking on the viability of the debtor's business[33]. Namely, although in such a scenario bills of exchange would still be able to sweep cash across all debtor's bank accounts, they would not have the ability to "reserve" future inbound proceeds to such accounts for the benefit of a single creditor. Instead, future proceeds could be freely disposed of to meet the debtor's day-to-day business obligations and thus bills of exchange would not bring a debtor's business to a halt.

- The chances of stabilising a debtor's business during the preparation and negotiation of a pre-packaged reorganisation plan/out-of-court restructuring plan would be significantly improved if creditors were not incentivised to take unilateral action by "reserving" the debtor's future cash receivables for their benefit.

  In other words, the elimination of the account blocking capability would make creditors holding bills of exchange less incentivised to enforce them, as they would have to carefully balance whether a work-out would

[33] Please see Section 6.1 above.

yield a higher repayment rate versus cash currently in the debtor's account (available to them through the cash sweeping measure).

- Considering that the prohibition of claim/debt assignment is triggered by account blocking, the removal of the account blocking capability of bills of exchange would eliminate the ramifications of the prohibition on out-of-court restructuring (i.e., debt/claim assignment would remain available to creditors as a measure for re-defining debtor-creditor relations)[34]. Furthermore, information sharing would not be an issue since debtors would no longer be violating the statutory prohibition on debt/claim assignment[35].

7.1.3 Method

The direct account blocking capability of bills of exchange could be abolished by way of amendments to Article 47 of the Payment Transactions Act, whereby any cash sweeping instrument would trigger cash sweeping, but where only a tax or customs authority decision or a court decision on enforcement would trigger account blocking.

Such amendments would effectively render account blocking contingent on a prior court ruling to that effect by removing the direct account blocking capability of bills of exchange.

7.1.4 Result

Under this solution, bills of exchange should remain a tool capable of direct and accelerated one-off cash sweeping across all debtor's accounts on creditors' request. At the same time, the solution limits the negative ramifications of bills of exchange on the prospect of achieving a successful outcome to reorganisation/out-of-court restructuring. This would bring the Serbian legal regime governing bills of exchange closer to that of Austria, Germany and Slovenia.

7.1.5 Parallel actions

In parallel to any limitation of the enforcement powers of bills of exchange, including removal of their account blocking capability, appropriate amendments to the account pledge legislation should be introduced in order to render account pledges operable.

Such amendments should, *inter alia*, allow for the account pledges to also cover future proceeds on the debtor's accounts, and not just the amount on the debtor's accounts at the time of the creation of the pledge. Any cash subject to an account pledge should be carved out from cash sweeping and account blocking triggered by bills of exchange and court decisions on enforcement.

The current inoperability of account pledges has led to 60% of the market participants being reluctant to replace bills of exchange with account pledges. However, the security ensured by reserving future proceeds on of

[34] Please see Section 4.10.4 above.

[35] Please see 6.2.2 above.

a debtor's account upon amendment of account pledge legislation may considerably ease the transition away from the bills of exchange as significant enforcement instruments.

7.2 Further Phases

7.2.1 Phase 2 – Removal of the capability of bills of exchange to directly sweep cash across all debtor's accounts

At a later stage, further consideration should be given to aligning Serbian legislation with that of Slovenia by preventing cash sweeping across all of the debtor's accounts.

The mechanism of direct cash sweeping across all accounts of a debtor should be limited to cash sweeping from a specific debtor account (i.e., the account to which the bills of exchange are linked).

The reason to consider this solution is that, under the present arrangements, cash sweeping deprives the debtor of all current working capital, which also has ramifications on the prospect of achieving a successful outcome of out-of-court restructuring/reorganisation.

The proposed timeline for the implementation of changes in Serbian legislation is currently estimated at 12 to 18 months from the introduction of functional account pledges.

This is mainly due to the difficulties expected to arise as a result of reduction of the powers of bills of exchange, as described by market participants in their response to our questionnaire, detailed in Section 4.11 of this study.

The Legal Consultant expects that the amendment to legislation/enactment of new Bills of Exchange Act may require numerous discussions with all the stakeholders, followed by a lengthy statutory procedure for the amendment/enactment of laws.

It should also be noted that the current Bills of Exchange Act has not been amended in over 17 years; therefore, albeit change is necessary, it is likely to be strongly opposed by market participants.

The Legal Consultant further considers the introduction of a functional account pledge a necessary pre-condition, which must be met prior to initiating any amendments of the current legislation governing bills of exchange.

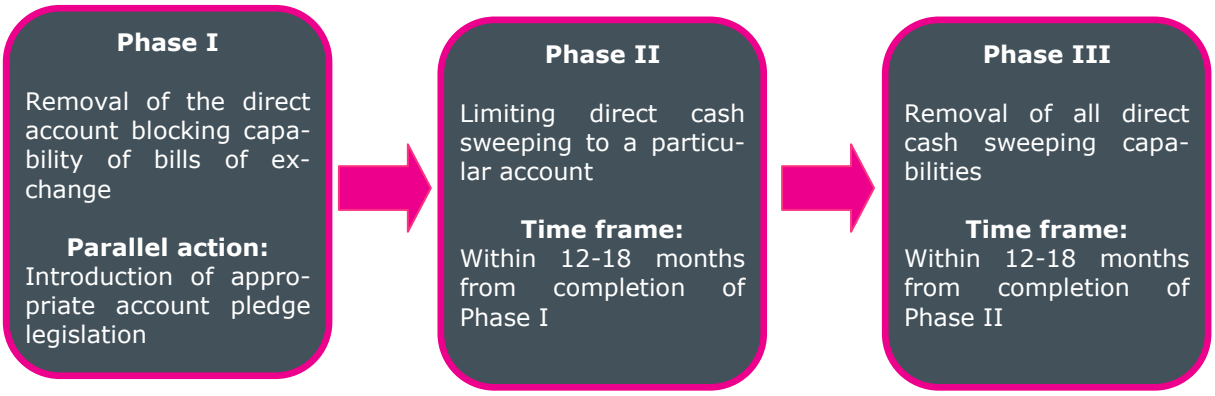
7.2.2 Phase 3 – Removal of the capability of bills of exchange to directly sweep cash from any account of a debtor

The final phase in mitigating the effects of bills of exchange would involve the removal of all their direct cash sweeping capabilities, by way of introduction of a requirement that bills of exchange may only be enforced through/based on a court ruling, rather than directly. The vast popularity of bills of exchange as enforcement instruments, afforded by quick and effective enforcement, would thus be significantly reduced, however, if timed correctly with extending the Financial Collateral Act to corporates,

since this would provide banks with an easily enforceable alternative security interest over financial (cash) collateral.

The Legal Consultant expects that the amending the legislation/enactment of the new Bills of Exchange Act may require up to further 12 to 18 months following the limitation of cash sweeping powers of bills of exchange, especially considering the estimated time required for extending the cash collateral to corporates. It is expected that the second amendment of the legislation will be more readily accepted, and therefore this Phase 3 is more likely to be implemented more swiftly than Phase 2.

Phases diagram:



In addition to the above recommendations, which aim to minimise the adverse impact of bills of exchange and their enforcement mechanism on the prospect of achieving successful out-of-court restructuring and/or reorganisation, it is also strongly recommended that the EBRD and the Legal Consultant discuss the availability of further statistical data with the regulators (in particular the National Bank); the discussion may serve as empirical confirmation of the legal analysis made and conclusions reached in this study.

Such data could include historical data concerning companies with blocked bank accounts, such as the number of companies currently blocked; the number of companies where the block was lifted; the total number of companies that were blocked in the past; and, in regard to the type of bankruptcy proceedings initiated, the number of companies that were blocked and subsequently went through out-of-court restructuring and/or reorganisation.

Appendix 1 – Implementation of internationally accepted standards for functional out-of-court restructuring and reorganisation in Serbian legislation

Prior to assessing the implementation of internationally accepted standards for functional out-of-court restructuring and reorganisation in Serbian legislation, it is important to first explain the elements that are, according to such standards, considered to characterise the functional framework that enables work-out procedures.

A. Elements characterising functional framework that enables work-out procedures

1. Enabling framework

A functional framework should facilitate out-of-court restructuring and reorganisation by providing various measures available to creditors and debtors, and enable achievement of out-of-court restructuring and reorganisation through their application. Such measures should include debt-to-equity swaps, debt write-off, set-off, amendment of debt obligations and priority for new financing providers.

In addition to introducing these measures, a functional framework should also incentivise both debtors and creditors to accept them. Such incentives should range from the relaxing of bad debt provisioning for banks to tax benefits.

Finally, regardless of the functionality of out-of-court restructuring and reorganisation legislation, other legislation should also incentivise out-of-court restructuring and reorganisation rather than hinder these work-out procedures.

2. Neutral forum

A functional out-of-court restructuring and reorganisation legal environment should facilitate these work-out procedures by providing for a neutral forum where both creditors and debtors can negotiate, explore arrangements and overcome their opposing interests with a view to implementing out-of-court restructuring and reorganisation.

3. Participants

Out-of-court restructuring and reorganisation both have in common the indebtedness of the debtor towards numerous creditors of varying financial and risk profiles. It is therefore paramount that the key creditors, whose collateral could lead to the debtor's liquidation in bankruptcy, or affect restructuring measures, be involved in negotiations and included in the out-of-court restructuring plan or reorganisation plan. The feasibility of such plans is contingent on the creditors' not jeopardising work-out by exercising the rights arising out of their arrangements with the debtor.

4. Coordination

Typically, a debtor has numerous creditors, whose actions tend to be disorganised and contradictory; this can frustrate the out-of-court restructuring and reorganisation process. Thus, for a functional work-out, it is essential that the actions of creditors be coordinated and uniform. Such coordination could be achieved through the creation of coordinating bodies with delegated authority from groups of creditors having a common denominator.

5. Stabilisation

In order to prevent unilateral action by creditors intending to realise their individual interests, triggered by the debtor's financial difficulties, a functional out-of-court restructuring and reorganisation environment must provide for a contractual or statutory stay of action against the debtor. This step should have a stabilising effect on the debtor and his creditors, as it ensures that the debtor's assets will not be subject to enforcement during negotiation of the work-out plan, and will be included in the process once the plan is adopted.

6. Access to new money

Most unsuccessful out-of-court restructurings and reorganisations fail due to a lack of liquidity, which is crucial for implementing the necessary measures. The parties to the process are unwilling to inject further cash into a financially distressed debtor, and so are new investors. A functional legal framework should provide incentives for injecting new money into financially distressed companies.

Such incentives could be in the form of priority payment, collateral ranking or deferral of outstanding liabilities. In particular, the debtor may offer his creditors to repay, in the long term, more than they were originally entitled to, in return for their agreement to extend the maturity of their claims and maintain their business relationship with the debtor.

7. Information

The out-of-court restructuring and reorganisation process can only be effective if all key participants have access to key information regarding the debtor's affairs. Otherwise, the plan would be based on unconfirmed or false presumptions, making it susceptible to failure.

8. Legal effects

Ideally, the out-of-court restructuring plan and reorganisation plan should be binding on all constituencies whose actions could result in liquidation in bankruptcy of a financially distressed debtor. Where there are creditors not bound by the plan, out-of-court restructuring and reorganisation envisaged thereunder may be at a risk of the debtor's liquidation in bankruptcy resulting from unilateral action by such creditors.

B. Implementation of the elements characterising functional framework that enables work-out procedures into Serbian legislation

Elements of a functional environment	Voluntary Restructuring	Consensual Financial Restructuring	Reorganisation	Comments
Enabling Framework	√	√	√	**Voluntary Restructuring** While voluntary restructuring is not institutionalised in a separate piece of legislation (i.e., voluntary restructuring is not codified), general provisions of civil and corporate law may be used as the legal basis for the implementation of work-out measures. For example, debt/claim assignment may be agreed pursuant to the Obligations Act, while debt-to-equity swap may be stipulated in line with the Companies Act. **Consensual Financial Restructuring** The Consensual Financial Restructuring Act provides a wide range of restructuring measures for redefining debtor-creditor relations. Please see Section 5.2 of this Study for consensual financial restructuring measures. **Reorganisation** The Bankruptcy Act contains a wide range of measures available to creditors and debtors to agree upon and redefine their relations accordingly. Such measures include: • repayment in instalments; change of maturity dates; interest rates; and other terms of a loan, a credit, or other claim or security instrument;

Elements of a functional environment	Voluntary Restructuring	Consensual Financial Restructuring	Reorganisation	Comments
				• closure of plants or change of business activities; • pledge of encumbered or unencumbered assets; • transfer of part or all of the property to one or more existing or newly established entities; • conversion of debt to equity; and • debt/claim assignment.
Neutral Forum	√	√	x	**Voluntary Restructuring** Given that voluntary restructuring is not codified, there are no explicit provisions governing the forum for such work-outs. However, there are no obstacles for parties to agree on a forum in which work-out will be performed based on general rules of civil law. **Consensual Financial Restructuring** The Serbian Chamber of Commerce and Industry and the appointed mediator are the neutral forums appointed to facilitate negotiations and mediate between opposing interests of the parties. **Reorganisation** The role of the bankruptcy court is opposite to that of the mediator appointed in consensual financial restructuring, as it is not involved in the preparation of the reorganisation plan. Its role is limited to verifying the legality of the reorganisation plan; and supervising/facilitating voting.

Elements of a functional environment	Voluntary Restructuring	Consensual Financial Restructuring	Reorganisation	Comments
Ensured Participation of Key Constituencies	x	x	√	**Voluntary Restructuring** As voluntary restructuring is binding only on its participants and there is no legislation prescribing other mechanisms to ensure the participation of all creditors (e.g., the Bankruptcy Act), voluntary restructuring is undertaken and effective only between parties willing to engage in it. **Consensual Financial Restructuring** Participation is voluntary and the effects of the adopted financial restructuring plan are limited to its signatories. The availability of financial restructuring as a solution to financial distress is contingent on the participation of at least two banks. The Financial Restructuring Act does not require obligatory participation by key constituencies (i.e., creditors whose unilateral actions could lead to the distressed debtor being declared bankrupt). **Reorganisation** All parties wishing to realise their claims must participate in the bankruptcy proceedings; the reorganisation plan must include all claims; and its terms are imposed on each creditor, regardless of whether the creditor is for or against such plan (i.e., cram-down).
				Voluntary Restructuring No explicit provisions regulate creditors'

Elements of a functional environment	Voluntary Restructuring	Consensual Financial Restructuring	Reorganisation	Comments
Coordination /organisation of creditors	x	x	√	coordination/organisation. However, the parties may agree on the manner of coordination and delegate authority by power of attorney under general civil law. **Consensual Financial Restructuring** While proclaiming the principle of creditor cooperation and envisaging their duty to cooperate, the Financial Restructuring Act fails to provide for any specific coordination bodies or duties. **Reorganisation** The Bankruptcy Act does not explicitly regulate the coordination of creditors in respect of preparation and negotiation of the reorganisation plan. However, it provides that only groups of creditors exceeding specific thresholds can submit a reorganisation plan, thus assuming some level of coordination within these groups.
Stabilisation	x	√	√	**Voluntary Restructuring** Given the inter-party legal effect of contractual obligations, standstill agreements reached in voluntary restructuring are binding only on their signatories. **Consensual Financial Restructuring** The Financial Restructuring Act envisages standstill agreements with legal consequences in accordance with best international practice. **Reorganisation**

Elements of a functional environment	Voluntary Restructuring	Consensual Financial Restructuring	Reorganisation	Comments
				Reorganisation based on a reorganisation plan is protected from hold-out creditors' unilateral actions by way of an automatic stay on such actions, triggered on initiation of bankruptcy proceedings. The same protection is also available for reorganisation based on pre-packaged reorganisation plans, if the bankruptcy judge approves it upon a debtor's request.
Information	√	√	x	**Voluntary Restructuring** Based on the Obligations Act, contracting parties must act in good faith and with due care during negotiations. The Obligations Act also prescribes the prohibition to cause damage and obligation to compensate for damage occurring as a result of breach of good faith negotiations. **Consensual Financial Restructuring** The Financial Restructuring Act obliges a debtor to share information with his creditors. **Reorganisation** There is an obligation to share information during implementation of the reorganisation plan. There is no obligation to share information in the course of preparation of the pre-packaged reorganisation plan.
Legally Binding on all Creditors	x	x	√	**Voluntary Restructuring** Agreements concluded in voluntary restructuring are binding only on their signatories.

Elements of a functional environment	Voluntary Restructuring	Consensual Financial Restructuring	Reorganisation	Comments
				Consensual Financial Restructuring Due to the voluntary nature of financial restructuring, the financial restructuring plan is legally binding only on its signatories. **Reorganisation** The Bankruptcy Act obliges all creditors to participate in bankruptcy proceedings, thus ensuring the participation of all creditors in reorganisation as a method of conducting bankruptcy proceedings. The Bankruptcy Act provides for a cram-down of dissenting creditors by stipulating that reorganisation is binding on all creditors if adopted with the specified majority of votes.

Appendix 2 – Questionnaires completed by market participants

Background

This questionnaire is provided to you within the context of a study conducted by the European Bank for Reconstruction and Development together with its consultants Moravčević Vojnović i partneri AOD in cooperation with Schönherr on account blocking and its impact on debtor-creditor relations in the Western Balkans (i.e. Republic of Serbia, Montenegro, Federation of Bosnia and Herzegovina, the Republic of Srpska as well as in FYR Macedonia).

The ability to restructure or reorganise financial obligations is immensely important for debtors and creditors and for the wider economy, particularly in financially challenging times. Both out-of-court restructuring and court-led reorganisation can maximise value to creditors by ensuring that viable debtors in financial difficulty continue operations rather than enter into unplanned liquidation in bankruptcy (*bankrotstvo*). They can also preserve employment of the debtor's staff and ensure continuation of the business of the debtor's business partners and suppliers, as well as the debtor's ability to pay taxes and contribute to the public revenue.

Cash sweeping and account blocking on the basis of bills of exchange have existed as an effective means of quasi-security for creditors in Serbia for a long time and are perceived to be important in the absence of effective account pledge security instruments. Nevertheless preliminary evidence suggests that this practice can reduce the incentives for creditors (and their debtors) to cooperate on out-of-court restructuring and court-led reorganisation in bankruptcy (*reorganizacija*), since it gives rise to a 'first to act' advantage[36].

The purpose of this questionnaire is to gather stakeholder feedback on the effects of account blocking on out-of-court restructuring (*vansudsko restrukturiranje*) and court-led reorganisation in bankruptcy (*reorganizacija*) and to obtain stakeholder views on whether any changes are needed to the existing legal framework for account blocking to support out-of-court restructuring and/or court-led reorganisation.

Please note that this questionnaire is voluntary and you are not obliged to answer every question. If you do not know the answer to a particular question or do not wish to answer, please leave this blank.

[36] First movers benefit from (i) any available cash balance on the debtor's accounts at the moment of enforcement, through the ability of bills of exchange to sweep cash from all of the debtor's accounts in the jurisdiction and (ii) "reserving" all future cash receivables of the debtor by the account blocking mechanism.

Questionnaire – Association of Banks

1. Questions - Bills of Exchange

1.1 Does your financial institution typically require bills of exchange from borrowers as a form of collateral for providing financing? Please tick one box as applicable.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

1.2 Do you consider bills of exchange to be essential collateral, without which your financial institution is not willing to provide financing? Please tick one box as applicable.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

1.3 If your answer to the above question 1.2 is positive, please briefly explain why you consider bills of exchange to be essential collateral for providing financing.

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1.4 The account pledge is not popular in Serbia due to difficulties in creating effective security over a debtor's bank account(s). If the account pledge were fully effective, would you be willing to rely on the account pledge rather than bills of exchange as collateral? Please tick one box as applicable and provide any additional comments below.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

_____

1.5 In your experience, does the enforcement of bills of exchange by your financial institution secure a good rate of recovery i.e. 60% or above of the original debt? Please tick one box as applicable and provide any additional comments below.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

_____

1.6 Do you agree with the following statement "The cash sweep and the payment of existing proceeds from the debtor's accounts are important for the overall recoveries of my financial institution"? Please tick one box as applicable and provide any additional comments below.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

_____

1.7 Do you agree with the following statement "Account blocking and the payment of future proceeds from the debtor's accounts are important for the overall recoveries of my financial institution"? Please tick one box as applicable and provide any additional comments below.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

_____

1.8 Does your financial institution typically enforce bills of exchange at the first sign of financial distress of the debtor? Please tick one box as applicable and provide any additional comments below.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

_____

1.9 Does your financial institution typically enforce bills of exchange as a result of other creditors enforcing or threatening to enforce their bills of exchange? Please tick one box as applicable and provide any additional comments below.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

_____

1.10 Does your financial institution initiate insolvency proceedings in respect of a debtor on the grounds of the debtor's accounts being blocked? Please tick one box as applicable and provide any additional comments below.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

_____

2. Questions - Out-of-Court Restructuring / Reorganisation

2.1 Does your financial institution ever participate in bilateral out-of-court restructuring of a debtor? Please tick one box as applicable and provide any additional comments below.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

_____

2.2 Does your financial institution ever participate in out-of-court restructuring of a debtor with other creditors (including under the Consensual Financial Restructuring Act (*Zakonom o sporazumnom finansijskom restrukturiranju*))? Please tick one box as applicable and provide any additional comments below.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

_____

2.3 When your financial institution participates in an out-of-court restructuring and hold bills of exchange, does it typically:

☐ enforce any bill(s) of exchange first and then engage in out-of-court restructuring (including negotiation of a standstill agreement);

☐ engage in negotiation of a standstill agreement first but hold onto bills of exchange as a leverage tool for the negotiations; or

☐ other/ none of the above.

Please tick one box above as applicable and provide any additional comments below.

_____

2.4 In your opinion, does the possession of bills of exchange by creditors undermine negotiations on a standstill and/or out-of-court restructuring? Please tick one box above as applicable and provide any additional comments below.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

2.5 Does your financial institution typically participate in out-of-court restructuring even if bills of exchange by creditors (including your financial institution) have been enforced[37]? Please tick one box above as applicable and provide any additional comments below.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

2.6 Do bills of exchange in any other way effect your decision whether to participate in out-of-court restructuring / court-led reorganisation process and why? Please tick one box above as applicable and provide any additional comments below.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

2.7 Does existence of bills of exchange in any way affect negotiations or voting of creditors on pre-packaged reorganisation plans (*unapred pripremljeni planove reorganizacije*)? Please tick one box above as applicable and provide any additional comments below.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

2.8 If the answer to the above question 3.7 is positive, could you please elaborate on how bills of exchange affect negotiations or voting of pre-packaged reorganisation plan?

2.9 If you see bills of exchange and the effects of their enforcement (i.e. account blocking) as an obstacle for achieving successful out-of-court restructuring / court-led reorganisation, could you please suggest any potential solutions to overcoming this obstacle?

2.10 Would you generally support a reform of the legal regime for bills of exchange which would strengthen out-of-court restructuring and court-led reorganisation? Please tick one box as applicable and provide any additional comments below.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

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[37] Cash standing on account of debtor, at the time of enforcement, has been transferred to the enforcing creditor and account receivables of the debtor are automatically being transferred to the benefit of enforcing creditor.

Questionnaire – Chamber of Commerce and Industry

1. Questions - Bills of Exchange

When in capacity of the creditor

1.1 Do you typically require bills of exchange from your business partners as a form of collateral for your monetary claims against your business partners? Please tick one box as applicable.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

When in capacity of the debtor

1.2 Do your business partners typically require bills of exchange from you as a form of collateral for their monetary claims against you? Please tick one box as applicable.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

When in capacity of the creditor

1.3 Do you consider bills of exchange to be essential collateral, without which you are not willing to provide your business partners with a loan/trade credit? Please tick one box as applicable.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

When in capacity of the creditor

1.4 If your answer to the above question 0 is positive, please briefly explain why you consider bills of exchange to be essential collateral for providing loan/trade credit.

_____

When in capacity of the debtor

1.5 Do your business partners/creditors consider bills of exchange to be essential collateral, without which they are not willing to provide you with a loan/trade credit? Please tick one box as applicable.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

When in capacity of the debtor

1.6 If your answer to the above question 0 is positive, please briefly explain why you consider bills of exchange to be essential collateral for providing loan/trade credit.

_____

General question (i.e. regardless of whether you are in capacity of the creditor or the debtor)

1.7 The account pledge is not popular in Serbia due to difficulties in creating effective security over a debtor's bank account(s). If the account pledge were fully effective, would you be willing to rely on the account pledge rather than bills of exchange as collateral? Please tick one box as applicable and provide any additional comments below.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

_____

General question (i.e. regardless of whether you are in capacity of the creditor or the debtor)

1.8 In your experience, does the enforcement of bills of exchange secure a good rate of recovery i.e. 60% or above of the original debt? Please tick one box as applicable and provide any additional comments below.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

General question (i.e. regardless of whether you are in capacity of the creditor or the debtor)

1.9 Do you agree with the following statement "The cash sweep and the payment of existing proceeds from the debtor's accounts are important for overall recoveries"? Please tick one box as applicable and provide any additional comments below.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

General question (i.e. regardless of whether you are in capacity of the creditor or the debtor)

1.10 Do you agree with the following statement "Account blocking and the payment of future proceeds from the debtor's accounts are important for overall recoveries"? Please tick one box as applicable and provide any additional comments below.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

When in capacity of the creditor

1.11 Do you typically enforce bills of exchange at the first sign of financial distress of the debtor? Please tick one box as applicable and provide any additional comments below.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

When in capacity of the debtor

1.12 Do your creditors typically enforce bills of exchange at the first sign of your financial distress? Please tick one box as applicable and provide any additional comments below.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

When in capacity of the creditor

1.13 Do you typically enforce bills of exchange as a result of other creditors enforcing or threatening to enforce their respective bills of exchange? Please tick one box as applicable and provide any additional comments below.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

When in capacity of the debtor

1.14 Do your creditors enforce bills of exchange as a result of other creditors enforcing or threatening to enforce their respective bills of exchange? Please tick one box as applicable and provide any additional comments below.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

When in capacity of the creditor

1.15 Do you initiate insolvency proceedings in respect of a debtor on the grounds of the debtor's accounts being blocked? Please tick one box as applicable and provide any additional comments below.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

When in capacity of the debtor

1.16 In case your account were ever blocked, have any of your creditors initiated insolvency proceedings on the grounds of your accounts being blocked? Please tick one box as applicable and provide any additional comments below.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

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2. Questions - Out-of-Court Restructuring / Reorganisation

When in capacity of the creditor

2.1 Do you ever participate in bilateral out-of-court restructuring of a debtor? Please tick one box as applicable and provide any additional comments below.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

When in capacity of the debtor

2.2 If you were in situation of financial distress, have you ever engaged in bilateral out-of-court restructuring with your creditors? Please tick one box as applicable and provide any additional comments below.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

When in capacity of the creditor

2.3 Do you ever participate in out-of-court restructuring of a debtor with other creditors (including under the Consensual Financial Restructuring Act (*Zakonom o finansijskom restrukturiranju*))? Please tick one box as applicable and provide any additional comments below.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

When in capacity of the debtor

2.4 If you were in situation of financial distress, would you invite your creditors to join out-of-court restructuring (including under the Consensual Financial Restructuring Act (*Zakonom o sporazumnom restrukturiranju*))? Please tick one box as applicable and provide any additional comments below.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

When in capacity of the creditor

2.5 When you participate in an out-of-court restructuring and hold bills of exchange, do you typically:

☐ enforce any bill(s) of exchange first and then engage in out-of-court restructuring (including negotiation of a standstill agreement);

☐ engage in negotiation of a standstill agreement first but hold onto bills of exchange as a leverage tool for the negotiations; or

☐ other/ none of the above.

Please tick one box above as applicable and provide any additional comments below.

When in capacity of the debtor

2.6 In case you have ever been subject of out-of-court restructuring, did your creditors holding bills of exchange:

☐ enforce bill(s) of exchange first and then engage in out-of-court restructuring (including negotiation of a standstill agreement);

☐ engage in negotiation of a standstill agreement first but held onto bills of exchange as a leverage tool for the negotiations; or

☐ other/ none of the above.

Please tick one box above as applicable and provide any additional comments below.

General question (i.e. regardless of whether you are in capacity of the creditor or the debtor)

2.7 In your opinion, does the possession of bills of exchange by creditors undermine negotiations on a standstill and/or out-of-court restructuring? Please tick one box above as applicable and provide any additional comments below.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

When in capacity of the creditor

2.8 Do you typically participate in out-of-court restructuring even if bills of exchange by creditors (including yourself) have been enforced[38]? Please tick one box above as applicable and provide any additional comments below.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

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When in capacity of the debtor

2.9 In case you have ever been subject of out-of-court restructuring, did your creditors participate in out-of-court restructuring even if bills of exchange by other creditors have been enforced[39]? Please tick one box above as applicable and provide any additional comments below.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

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When in capacity of the creditor / debtor

2.10 Do bills of exchange in any other way effect your decision whether to participate in out-of-court restructuring / court-led reorganisation process and why? Please tick one box above as applicable and provide any additional comments below.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

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General question (i.e. regardless of whether you are in capacity of the creditor or the debtor)

2.11 Does existence of bills of exchange in any way affect negotiations or voting of creditors on pre-packaged reorganisation plans (*unapred pripremljeni planove reorganizacije*)? Please tick one box above as applicable and provide any additional comments below.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

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General question (i.e. regardless of whether you are in capacity of the creditor or the debtor)

2.12 If the answer to the above question 0 is positive, could you please elaborate on how bills of exchange affect negotiations or voting of pre-packaged reorganisation plan?

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General question (i.e. regardless of whether you are in capacity of the creditor or the debtor)

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[38] Cash standing on account of debtor, at the time of enforcement, has been transferred to the enforcing creditor and account receivables of the debtor are automatically being transferred to the benefit of enforcing creditor.

[39] Cash standing on account of your account, at the time of enforcement, has been transferred to the enforcing creditor and your account receivables of have been automatically transferred to the benefit of enforcing creditor.

2.13 If you see bills of exchange and the effects of their enforcement (i.e. cash sweeping/account blocking) as an obstacle for achieving successful out-of-court restructuring/court-led reorganisation, could you please suggest any potential solutions to overcoming this obstacle?

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General question (i.e. regardless of whether you are in capacity of the creditor or the debtor)

2.14 Would you generally support a reform of the legal regime for bills of exchange which would strengthen out-of-court restructuring and court-led reorganisation? Please tick one box as applicable and provide any additional comments below.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

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Appendix 3 – Definitions and Abbreviations

Account Blocking	Measure prescribed under the Payment Transactions Act and implemented by the National Bank consisting in prohibiting the debtor from disposing of any future proceeds paid into his bank account and automatically transferring such proceeds to the creditor enforcing his account blocking instrument, if the amount of available proceeds at the time of enforcement of the claim is insufficient to repay the creditor's claim in full;
Bankruptcy	Bankruptcy (*bankrotstvo*) is a term defined in the Bankruptcy Act as the process which achieves satisfaction of creditors' claims through the sale of a debtor's assets, or that of the debtor itself as a legal person;
Bankruptcy Act	Bankruptcy Act (*Zakon o stečaju*) (Official Gazette of the Republic of Serbia Nos. 104/2009, 99/2011, 71/2012 (Constitutional Court Decision), 83/2014);
Bills of Exchange Act	Bills of Exchange Act (*Zakon o menici*) (Official Gazette of the Federal People's Republic of Yugoslavia No. 104/46; Official Gazette of the Socialist Federal Republic of Yugoslavia Nos. 16/1965, 54/1970 and 57/1989; Official Gazette of the Federal Republic of Yugoslavia No. 46/1996);
Cash Sweeping	Measure prescribed under the Payment Transactions Act and implemented by the National Bank, which entails the transfer of all funds held in all debtor's bank accounts at the moment of commencement of the enforced collection of a cash sweeping instrument to the benefit of the enforcing creditor;
Chamber of Commerce and Industry	Chamber of Commerce and Industry of Serbia (*Privredna komora Srbije*)
Consensual Financial Restructuring	Out-of-court financial restructuring carried out under the Consensual Financial Restructuring Act with the assistance of the Serbian Chamber of Commerce and Industry, appointed mediator;
Consensual Financial Restructuring Act	Consensual Financial Restructuring Act (*Zakon o sporazumnom finansijskom restrukturiranju*) (Official Gazette of the Republic of Serbia No. 89/2015);
Decision on the Manner of Enforcement of Claims by Debiting the Client's Account	Decision on the Manner of Enforcement of Claims by Debiting the Client's Account (*Odluka o načinu vršenja prinudne naplate s računa klijenta*) (Official Gazette of the Republic of Serbia Nos. 14/2014 and 76/2016), adopted by the National Bank;

EBRD	European Bank for Reconstruction and Development;
Enforcement and Securing of Civil Claims Act	Enforcement and Securing of Civil Claims Act (*Zakon o izvršenju i obezbeđenju*) (Official Gazette of the Republic of Serbia Nos. 106/2015 and 106/2016);
Legal Consultant	Moravčević Vojnović i partneri AOD in cooperation with Schönherr;
Market Participants	15 banks and 10 members of the Chamber of Commerce and Industry in their capacity as creditors, comprising the representatives of market participants;
Obligations Act	Obligations Act (*Zakon o obligacionim odnosima*) (Official Gazette of the Socialist Federal Republic of Yugoslavia Nos. 29/1978, 39/1985, 45/1989, 57/1989; Official Gazette of the Federal Republic of Yugoslavia Nos. 31/1993, 22/1999, 23/1999, 35/1999, 44/1999);
Out-of-Court Restructuring	Voluntary restructuring and/or (depending on the context) consensual financial restructuring;
Payment Transactions Act	Payment Transactions Act (*Zakon o platnom prometu*) (Official Gazette of the Republic of Serbia Nos. 43/2004, 62/2006 and 111/2009);
Payments by Legal Entities, Sole Proprietors and Non-Business Persons Act	Payments by Legal Entities, Sole Proprietors and Non-Business Persons Act (*Zakon o obavljanju plaćanja pravnih lica, preduzetnika i fizičkih lica koja ne obavljaju delatnost*) (Official Gazette of the Republic of Serbia No. 68/2015);
Reorganisation	Court reorganisation (*reorganizacija*) is defined in the Bankruptcy Act as the process of satisfying creditors' claims in accordance with an approved reorganisation plan/pre-packaged reorganisation plan through a redefinition of debtor-creditor relations, changes in the organisation of the debtor or any other method determined in the reorganisation plan/pre-packaged reorganisation plan;
Pledge Act	Pledge Act (*Zakon o založnom pravu na pokretnim stvarima upisanim u registar*) (Official Gazette of the Republic of Serbia Nos. 57/2003, 61/2005, 64/2006 and 99/2011); and
Voluntary Restructuring	Out-of-court financial restructuring between parties on a voluntary basis, which takes place outside of a formal statutory framework, subject to general rules and conditions established by the Obligations Act.