Impact of collateral practice on lending to small and medium-sized enterprises

The EBRD, through its SME Strategy and Support Unit, has designed a survey to gather evidence of the perceived discrimination experienced by small and medium-sized enterprises (SMEs) in terms of collateral requirements when they are seeking finance. This article presents some of the survey findings. It explores the two main obstacles to assessing credit: excessive collateral requirements and exclusion of certain types of collateral. The results provide an indication of the attitude of banks, which seem to be influenced by their internal policy and experience in this area as well as by the legal and regulatory framework.

According to a large enterprise survey conducted in 1999 by the EBRD and the World Bank, access to finance is still one of the central problems for SMEs in transition economies. Within this problem area, smaller and, especially, younger companies felt that they were discriminated against more in terms of collateral requirements than in terms of interest rates or “red tape”. Following this study, the SME Strategy and Support Unit of the EBRD has designed its own questionnaire aimed at gathering more detailed evidence of this imbalance. The aim was to question the EBRD’s partner banks to identify the collateral-related obstacles that they perceive as influential in their lending activity to SMEs.

The questionnaire was sent to banks in 18 countries where the EBRD provides dedicated finance to SMEs through partner banks. Responses were received from a total of 51 banks in nine of the Bank’s countries of operations (Estonia, Former Yugoslav Republic of Macedonia, Georgia, Kazakhstan, Poland, Russia, Turkmenistan, Ukraine and Uzbekistan). On the basis of those responses, this article assesses the collateral practice of banks in these countries and the factors determining differences between countries and individual banks.

Background

In principle, secured lending – as opposed to unsecured lending – increases the opportunities for enterprises to access external finance. Unsecured lending requires an in-depth knowledge by the lender of the borrower in order to assess the likelihood that the borrower will pay back the loan. In the case of secured lending, the function of this knowledge in mitigating the risk of non-repayment is replaced by a charge over assets of the borrower. In the case of non-repayment, the lender takes possession of these assets and, usually through sale of the assets, recovers the loan.

Although knowledge of the borrower and pledged collateral are to some extent substitutable as risk-mitigating factors, unsecured loans are typically significantly smaller than secured loans. In addition, the different risk perceptions regarding loans based on knowledge of the borrower or on a collateral pledge might also lead the lender to offer a lower interest rate for a secured loan than for an unsecured loan. However, collateral practices of lenders can pose particular obstacles to accessing credit. Generally, two different forms of such obstacles exist: excessive collateral requirements in terms of the collateral/
loan value ratio, and restrictions in terms of the types of collateral that are acceptable to the lender. The survey assesses the role these two obstacles typically play in lending practice, especially vis-à-vis SMEs.

**Excessive collateral requirements**

The first type of obstacle is the requirement by lenders of a value of collateral that substantially exceeds the value of principal of the loan and the refinancing cost of the loan funds. Excessive collateral requirements tie up a large proportion of a borrower’s assets and therefore restrict access to further finance through secured lending. Lenders might have a variety of reasons for such excessively high collateral requirements. These reasons are largely related to the risk associated with the particular collateral offered.

One group of factors derives from the legal and regulatory framework governing the creation, perfection and the enforcement of security interests. Delays in the enforcement and realisation of collateral increase the cost of the enforcement and therefore will also induce lenders to raise the collateral/loan value ratio. If collateral in the case of bankruptcy is pooled into the estate, lenders might increase the nominal collateral requirements in order to ensure that they have effective priority at the liquidation stage. However, under certain regulations, banks might also have an incentive to require a higher collateral/loan value ratio since this might ease their statutory reserve requirements for secured loans.

On the other hand, risks can also be related to knowledge deficits of the lender. If lenders are unsure whether the market for a pledged asset is likely to become less liquid in the future, they might build in a ‘safety margin’ to account for this. A further possibility is that the lender is unsure about the valuation of certain types of collateral and therefore increases again the amount of collateral required. Western bankers active in the region have also reported that some lenders perceive the risk associated with a new borrower and the collateral on offer as so high that they will not only demand higher interest rates but will also try to discourage these borrowers through excessive collateral requirements. Whereas the legal and regulatory framework applies for all potential borrowers equally, knowledge deficits might discriminate against certain types of borrowers, thus creating an ‘uneven playing field’. In any case, small borrowers are typically less capital-intensive firms than larger firms and therefore have proportionally less collateral to offer. In other words, they will be more severely affected than larger borrowers by excessive collateral requirements.

**Survey results**

The survey results show a mixed picture on the question of collateral requirements. First, as shown in Table 1, the average collateral requirements for large, medium and small loans across the entire survey sample are very similar, with large loans requiring slightly less collateral than small or medium-sized loans. The overall level of collateral required (at almost 150 per cent of the loan value) certainly seems high compared with western lending markets, but it is still in line with common lending practice.

Second, an analysis of collateral requirements in individual countries shows that there are in fact marked differences between countries (see Table 1). The overall average of the collateral/loan value ratio is highest in the Former Yugoslav Republic of Macedonia, followed by Ukraine and Kazakhstan, all of which are clearly above the overall average. Also with respect to differences between small, medium and large borrowers, a country-by-country analysis reveals some degree of differentiation. It is interesting to note that it is only in Georgia that small borrowers face on average higher collateral requirements than both medium or large borrowers, while in Kazakhstan small and medium borrowers have to pledge proportionally more collateral than large borrowers. Against expectations, in two cases (FYR Macedonia and Russia) smaller

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5 However, compared with non-financial constraints, such as anti-competitive practices and taxes/regulations, restricted access to external finance appears less important (Business Environment and Enterprise Performance Survey, Transition Report 1999, EBRD, London, 1999, Chapter 8).

6 For more details on the Programme, see Finance for SMEs, EBRD, at www.ebrd.com/english/busi/index.htm

7 The EBRD’s operations with partner banks in these countries are at various stages of the project life cycle, which might explain the rather high number of non-responses from some countries. The small number of responses from some countries makes it difficult to draw country-wide conclusions.


10 Fleisig (supra note 4) assumes that central bank requirements for the collateral/loan value ratio reflect well the reality of these enforcement and realisation costs.

11 Ukraine is one example of such a regime among the EBRD’s countries of operations. The reserve requirements under this regime are calculated as follows: Provisions = Provision Rate x Outstanding Loan Amount – Provision Rate x Collateral Rate x Collateral Value. The Provision Rate is the level of reserves required for the loan type (standard, substandard, etc.) and the Collateral Rate is the percentage of the value of assets allowed for offsetting reserve requirements. The Collateral Rate for immovable assets is twice as high as for movable assets and both decline with the classification of the loan.

12 A commercial mortgage for small businesses in the UK requires typically a pledge on property of 125-145 per cent of the loan value.
borrowers on average face more favourable collateral requirements than both of the other two groups of borrowers. In Turkmenistan, small and medium loans on average require proportionally less collateral than large loans. This might suggest that banks do not necessarily identify smaller enterprises as riskier than larger ones or that the level of collateral requirements does not accurately reflect the risk associated with particular types of borrowers. In any case, SMEs are not systematically discriminated against across the region by banks with regards to collateral requirements.

Looking at the practice of banks within individual countries shows (see Chart 1) that the required collateral/loan value ratio for small and medium loans varied considerably between banks in three countries (Kazakhstan, Russia and Ukraine). In contrast, in Turkmenistan and Uzbekistan, all banks in each country (four in each case) reported the same average collateral requirements for small loans. The three responding banks in FYR Macedonia report collateral requirements within a fairly narrow range.

Impact of registration and enforcement on collateral requirements

Can the variation between the level of collateral requirements among the different countries be explained by differences in the registration or enforcement of security pledges? According to the survey, the time that it takes to register either movable or immovable assets as collateral does not seem to explain the different levels of collateral requirements since in both cases there seems to be a (weak) negative correlation between the collateral/loan value ratio and the time required for registering collateral. Also the existence of a central registry seems to have little impact on the level of the collateral/loan value ratio. The responding banks in FYR Macedonia reported uniformly high collateral requirements although a central registry exists (at least for movable assets). On the other hand, banks in Uzbekistan reported the second lowest average collateral/loan value ratio and, at the same time, gave inconsistent answers about the existence of a central collateral registry, reflecting an unclear legal situation.

Regarding the enforcement of collateral, the survey revealed partly substantial delays in the enforcement procedures, as shown in Table 2. The respondents were then asked whether they raised their collateral requirements because of expected delays in the realisation process or because of problems of collateral being incorporated in the estate in case of bankruptcy of the borrower (see Table 3). The expected delays in the realisation of pledged assets were more frequently cited as being likely to have an impact on the collateral/loan value ratio rather than problems related to bankruptcy procedures. Although the reported periods of delay are not strongly correlated to the rating that banks in individual countries gave to this problem (compare Table 2 and Table 3), in individual cases, the data suggest a link between the two (e.g., FYR Macedonia and Georgia).

Table 1: Average collateral requirements by loan size* and country (in percentage of loan value)

<table>
<thead>
<tr>
<th></th>
<th>Large loans</th>
<th>Medium loans</th>
<th>Small loans</th>
<th>Average</th>
</tr>
</thead>
<tbody>
<tr>
<td>FYR Macedonia</td>
<td>200</td>
<td>213</td>
<td>192</td>
<td>201</td>
</tr>
<tr>
<td>Ukraine</td>
<td>174</td>
<td>174</td>
<td>174</td>
<td>174</td>
</tr>
<tr>
<td>Kazakhstan</td>
<td>162</td>
<td>165</td>
<td>165</td>
<td>164</td>
</tr>
<tr>
<td>Estonia</td>
<td>150</td>
<td>150</td>
<td>150</td>
<td>150</td>
</tr>
<tr>
<td>Georgia</td>
<td>115</td>
<td>155</td>
<td>175</td>
<td>148</td>
</tr>
<tr>
<td>Russia</td>
<td>136</td>
<td>129</td>
<td>123</td>
<td>129</td>
</tr>
<tr>
<td>Turkmenistan</td>
<td>140</td>
<td>120</td>
<td>120</td>
<td>127</td>
</tr>
<tr>
<td>Uzbekistan</td>
<td>125</td>
<td>125</td>
<td>125</td>
<td>125</td>
</tr>
<tr>
<td>Poland</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>Average</td>
<td>145</td>
<td>148</td>
<td>147</td>
<td>146</td>
</tr>
</tbody>
</table>


Chart 1: Average collateral requirements of respondent banks by countries of operations

Marketability and valuation of the collateral

The survey provided some evidence on the knowledge deficits that might have an impact on the level of collateral requirements. As shown in Table 4, difficulties that banks expect in selling collateral are an important reason for them to raise the collateral/loan value ratio. This is much less evident with regards to potential valuation problems of pledged assets. Interestingly, the level of importance attributed to the problem of marketability of collateral does not – as one would expect – necessarily correspond to the state of the economy as a whole. Thus, this problem receives higher ratings in countries with comparatively healthy economies, such as Poland or Estonia, and lower ratings in less well-performing economies, such as Ukraine, Russia or Georgia.

Collateral requirements to deter customers

Finally, when asked whether they would sometimes use high collateral requirements to deter unwanted clients, the banks’ responses were mixed. Most banks rejected this technique. However, about 20 per cent of banks across almost all countries admitted that they sometimes resort to this method to signal to potential borrowers that the banks are not interested in lending to them. Overall, two banks reported that they are more likely to use this method with smaller clients than with larger clients. However, one bank reports to deter only large clients by means of high collateral/loan value ratios.

<table>
<thead>
<tr>
<th>Country</th>
<th>Immovable assets</th>
<th>Movable assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>FYR Macedonia</td>
<td>525</td>
<td>450</td>
</tr>
<tr>
<td>Estonia</td>
<td>135</td>
<td>30</td>
</tr>
<tr>
<td>Georgia</td>
<td>180</td>
<td>60</td>
</tr>
<tr>
<td>Kazakhstan</td>
<td>94</td>
<td>72</td>
</tr>
<tr>
<td>Poland</td>
<td>30</td>
<td>180</td>
</tr>
<tr>
<td>Russia</td>
<td>131</td>
<td>71</td>
</tr>
<tr>
<td>Turkmenistan</td>
<td>56</td>
<td>23</td>
</tr>
<tr>
<td>Ukraine</td>
<td>150</td>
<td>144</td>
</tr>
<tr>
<td>Uzbekistan</td>
<td>125</td>
<td>82</td>
</tr>
</tbody>
</table>


Types of collateral

The second form of restrictive collateral practice is that lenders might not accept certain types of assets as collateral. Again, the reasons for this can usually be found in the risk associated with security interests based on different kinds of assets. The factors influencing the level of risk are rooted in the legal/regulatory framework of a country and in the level of knowledge that lenders have acquired about the valuation and enforcement of secured transactions.

Table 2: Average period of days for collateral enforcement by country (from start of proceedings to sale)

<table>
<thead>
<tr>
<th>Country</th>
<th>Immovable assets</th>
<th>Movable assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>FYR Macedonia</td>
<td>525</td>
<td>450</td>
</tr>
<tr>
<td>Estonia</td>
<td>135</td>
<td>30</td>
</tr>
<tr>
<td>Georgia</td>
<td>180</td>
<td>60</td>
</tr>
<tr>
<td>Kazakhstan</td>
<td>94</td>
<td>72</td>
</tr>
<tr>
<td>Poland</td>
<td>30</td>
<td>180</td>
</tr>
<tr>
<td>Russia</td>
<td>131</td>
<td>71</td>
</tr>
<tr>
<td>Turkmenistan</td>
<td>56</td>
<td>23</td>
</tr>
<tr>
<td>Ukraine</td>
<td>150</td>
<td>144</td>
</tr>
<tr>
<td>Uzbekistan</td>
<td>125</td>
<td>82</td>
</tr>
</tbody>
</table>


Table 3: Average rating* of collateral enforcement problems with regards to their impact on collateral requirements

<table>
<thead>
<tr>
<th>Country</th>
<th>Problem of collateral being pooled into a bankrupt estate</th>
<th>Problem of delays in realisation of collateral</th>
</tr>
</thead>
<tbody>
<tr>
<td>FYR Macedonia</td>
<td>2.0</td>
<td>2.8</td>
</tr>
<tr>
<td>Estonia</td>
<td>1.0</td>
<td>2.0</td>
</tr>
<tr>
<td>Georgia</td>
<td>2.0</td>
<td>3.0</td>
</tr>
<tr>
<td>Kazakhstan</td>
<td>1.7</td>
<td>2.3</td>
</tr>
<tr>
<td>Poland</td>
<td>2.0</td>
<td>2.0</td>
</tr>
<tr>
<td>Russia</td>
<td>1.1</td>
<td>1.6</td>
</tr>
<tr>
<td>Turkmenistan</td>
<td>n/a</td>
<td>2.3</td>
</tr>
<tr>
<td>Ukraine</td>
<td>2.5</td>
<td>2.0</td>
</tr>
<tr>
<td>Uzbekistan</td>
<td>1.5</td>
<td>2.0</td>
</tr>
</tbody>
</table>

* 3 = very important; 1 = of little importance

ment of certain types of collateral. In situations where property rights over certain types of assets are unclear, lenders will be reluctant to accept these assets as security for a loan. Other related issues include problems concerning information about particular assets that were pledged.

Under regimes where no pledge register exists for certain types of assets, lenders will find it more difficult to establish whether they have a priority claim to a particular asset in case of repossession. But even if a register exists, differences in the complexity of registration processes might cause lenders to favour certain types of collateral over others. Closely linked to these institutional problems are issues of knowledge by lenders of how to deal with these difficulties. Some lenders might have acquired some experience in ensuring that assets that are pledged as security were not pledged simultaneously to other lenders. On the other hand, lenders without this kind of knowledge might refuse altogether to accept such assets as security for loans.

The valuation of a type of asset that is not familiar to the lender poses a further knowledge-related obstacle. Again, different lenders will deal differently with these ‘problematic’ assets, depending on the experience and knowledge that they have in valuing these assets. As a result, some lenders might discriminate against groups of borrowers if the available collateral of borrowers within these groups typically consists of a large extent of assets that are difficult to identify, to evaluate or to enforce.

Concerning the acceptance of different types of collateral, the survey shows that small loans are proportionally more likely to be covered by immovable assets than by movable assets, fluctuating pools of assets or receivables (see Chart 2). Financing based on receivables plays only a very limited role and in a number of countries is virtually unknown. Compared with loans for large enterprises, small loans are less likely to be secured by fluctuating pools of assets, but more likely to be based on pledges of movable and immovable assets. The difference between small and large loans is proportionally larger for immovable assets than for movable assets. Chart 2 shows the proportional shares normalised to 100 per cent of the sum of the four types of collateral. In a number of cases, banks reported the use of other forms of security interests, mainly personal guarantees.

### Existence of a central register for collateral

Banks in most countries surveyed are aware of the relevant register for immovable and movable collateral. Only a number of banks in Russia and in Uzbekistan reported that they cannot register movable collateral.

Concerning the existence of a central register for collateral, banks in Estonia, Russia, Turkmenistan and Uzbekistan reported that,

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**Table 4: Average rating* of problems concerning marketability and valuation of collateral with regards to their impact on collateral requirements**

<table>
<thead>
<tr>
<th>Country</th>
<th>Problems concerning marketability of collateral</th>
<th>Problems in valuation of collateral</th>
</tr>
</thead>
<tbody>
<tr>
<td>FYR Macedonia</td>
<td>2.5</td>
<td>1.0</td>
</tr>
<tr>
<td>Estonia</td>
<td>3.0</td>
<td>1.0</td>
</tr>
<tr>
<td>Georgia</td>
<td>2.0</td>
<td>2.0</td>
</tr>
<tr>
<td>Kazakhstan</td>
<td>2.6</td>
<td>1.0</td>
</tr>
<tr>
<td>Poland</td>
<td>3.0</td>
<td>1.0</td>
</tr>
<tr>
<td>Russia</td>
<td>2.0</td>
<td>1.5</td>
</tr>
<tr>
<td>Turkmenistan</td>
<td>2.8</td>
<td>1.7</td>
</tr>
<tr>
<td>Ukraine</td>
<td>1.8</td>
<td>1.5</td>
</tr>
<tr>
<td>Uzbekistan</td>
<td>2.8</td>
<td>1.0</td>
</tr>
</tbody>
</table>

* 3 = very important; 1 = of little importance


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**Chart 2: Share of banks’ loan portfolio secured by different types of collateral (in %)**

Table 5: Time required for registration process for immovable assets (X) or movable assets (O)*

<table>
<thead>
<tr>
<th>Country</th>
<th>1 day or less</th>
<th>2 or 3 days</th>
<th>Less than 1 week</th>
<th>Less than 1 month</th>
<th>More than 1 month</th>
</tr>
</thead>
<tbody>
<tr>
<td>FYR Macedonia</td>
<td>O</td>
<td>X</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Estonia</td>
<td>O</td>
<td>X</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Georgia</td>
<td>O</td>
<td>X</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Kazakhstan</td>
<td>O</td>
<td>X</td>
<td></td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>Poland</td>
<td>O</td>
<td>X</td>
<td></td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>Russia</td>
<td>O</td>
<td>X</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Turkmenistan</td>
<td>O</td>
<td>X</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ukraine</td>
<td>O</td>
<td>X</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Uzbekistan</td>
<td>O</td>
<td>X</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

* Based on the mode of responses per country. Two entries for the same kind of asset in one row reflect a bi-modal distribution.


Delays in registering a security interest

Overall, the lengthiness of registration procedures does not seem to be a powerful explanation for restrictions by banks on broad categories of collateral. In terms of the time that it takes to register immovable or movable assets, the responses to the survey show that overall it takes equally long to register immovable and movable assets. There is no clear pattern (see Table 5). In Estonia, Kazakhstan and Russia, it appears less time consuming to create a pledge over movable assets than it is to register immovable assets, while the reverse is true for Turkmenistan and Ukraine. In the latter two countries, however, the difference between the two types of assets is very small.

Given the differences in time that it takes to register the two different kinds of collateral in some countries, one would expect this to be reflected in the composition of pledges on which the loan portfolios of banks in these countries is secured. However, only in Russia is this the case. Of the part of the loan portfolio that is secured by movable or immovable assets, only 22 per cent are backed by immovable assets. This is a clear deviation from the overall trend, which favours immovable collateral over movable collateral. Estonia, Kazakhstan and Ukraine follow broadly this trend, while banks in Turkmenistan reported a collateral composition between the two asset types of 28 per cent for immovables and 72 per cent for movables. This is the exact opposite of what one would have expected looking at the variation of time required in registering pledges.

Relative importance of collateral-related obstacles to SME lending

The banks in the survey perceive collateral-related problems in lending to small business as equally important as problems related to the borrowers themselves. This could suggest that in the countries surveyed, collateral is only to a limited extent a suitable substitute to knowledge of the borrower as a risk-mitigating factor (see Table 6), thus limiting the basic function of collateral in bank lending (compare with the background section above). Although the most important obstacle overall appears to be the lack of reliable financial information about the borrower, this is closely followed by the lack of suitable collateral.

Within the area of collateral-related problems, lack of suitable collateral and poor market-ability of pledged assets are the most important issues, followed by delays in collecting collateral and the pooling of pledged assets into a bankrupt estate. Uncertainties in the valuation of assets are generally not perceived as a serious obstacle to SME lending. However, this might be due to the fact that problems in this area would be reported under the category of “unsuitable collateral” if lenders reject the pledge of assets that are difficult to evaluate.

Conclusions

Overall, the survey does not present strong evidence for discrimination against smaller borrowers in terms of the level of collateral requirements. Although there are wide variations between the requirements in individual countries, the spread between collateral/loan value ratios between large...
and small borrowers is usually small. While one would expect generally high collateral requirements in a country to be related to the legal/regulatory framework, the survey shows that there can also be significant differences between banks within one country. This points to the possibility that the level of collateral requirements depends considerably on a bank’s internal policy.

Major flaws in the legal/regulatory framework and its implementation have certainly some impact on the collateral policy of banks. This was particularly evident in countries where there are long delays in the enforcement of collateral. Generally, issues of enforcement play a more important role than issues related to the creation and registration of a pledge. However, the main impact on the level of the average collateral/loan value ratio comes from the perceived marketability of pledged assets. In a minority of cases, banks use high collateral requirements to deter potential borrowers.

Concerning restrictions on types of collateral, the legal/regulatory framework appears to have an impact through the existence or non-existence of a central registry. The lack of provisions in the pledge system on the publicity of a pledge leads to the lenders having to resort to informal checking methods or explicitly excluding certain types of collateral. On the other hand, delays in the registration of certain types of assets do not appear to significantly affect acceptance of these assets as collateral. One explanation for this might be that lenders in some cases simply do not register smaller collateral, as has been observed in a number of Central Asian countries.

An analysis of whether collateral-related obstacles to SME lending are rooted in the legal and regulatory framework or in knowledge/experience of the banks suggests that both causes are equally important. It has been shown that issues closely related to the legal and regulatory framework, such as the pooling of collateral into bankrupt estates and delays in collecting collateral, are as important as problems mainly related to the experience of banks, such as difficulties in the valuation of assets. By far the most important collateral-related problems, however, are lack of suitable collateral and poor marketability of collateral. Both of these might be due to lack of knowledge/experience of the banks but also to the legal and regulatory framework or the economic situation in particular sectors of the economy.

Overall, banks perceive obstacles to SME lending that relate to collateral to be as important as obstacles that relate to information about the borrower. In other words, in the present situation, reliance on collateral does not facilitate SME lending by taking the place of the need for knowledge of the borrower.

<table>
<thead>
<tr>
<th>Country</th>
<th>Availability of financial information</th>
<th>Borrower’s honesty</th>
<th>Quality of business plan</th>
<th>Risk profile of small borrowers**</th>
<th>No suitable collateral</th>
<th>Poor marketability</th>
<th>Collateral pooled into bankrupt estate</th>
<th>Delays in collecting collateral</th>
<th>Unsure about valuation of collateral</th>
</tr>
</thead>
<tbody>
<tr>
<td>Estonia</td>
<td>0.0</td>
<td>5.0</td>
<td>0.0</td>
<td>0.0</td>
<td>4.0</td>
<td>0.0</td>
<td>1.0</td>
<td>3.0</td>
<td>2.0</td>
</tr>
<tr>
<td>FYR Macedonia</td>
<td>1.0</td>
<td>2.0</td>
<td>0.3</td>
<td>1.8</td>
<td>0.0</td>
<td>4.3</td>
<td>0.0</td>
<td>2.3</td>
<td>1.8</td>
</tr>
<tr>
<td>Georgia</td>
<td>0.0</td>
<td>0.0</td>
<td>1.0</td>
<td>0.0</td>
<td>2.0</td>
<td>4.0</td>
<td>3.0</td>
<td>5.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Kazakhstan</td>
<td>2.9</td>
<td>1.6</td>
<td>1.0</td>
<td>0.9</td>
<td>1.2</td>
<td>1.2</td>
<td>1.3</td>
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* Weighted averages: 5 most severe impediment to 1 least severe impediment. Figures in bold show the highest problem score per country.

** Compared with large borrowers.

Taking security over offshore foreign currency accounts of a Russian borrower

The creation of a charge over an offshore currency account of a Russian borrower is considered to be the most effective way in banking practice to secure obligations of a Russian borrower. However, certain peculiarities connected with Russian currency regulations and insolvency laws should be taken into account.

In the past few years the assignment or pledge of offshore accounts of Russian borrowers has become one of the most popular and effective ways to secure credit extended to Russian corporations. As the mechanisms for taking and enforcing security in Russia are still undeveloped and untested, the need for easily enforceable security offshore is vital. Following the rise of Russia’s country risk after the crisis of 1998, lenders have become keener to secure their rights by means of security situated outside Russia. With high oil prices and Russian exporters looking for money, the market has found the attachment offshore of cash proceeds from the export of Russian raw materials to be the safest and most effective solution.
Another reason for taking security over an offshore account of a Russian borrower is that a secured creditor will be entitled to preliminary injunctive relief to prevent the Russian debtor from asset stripping prior to judgement in the case of default. This may not be the case in relation to the unsecured creditors. The freezing injunction (previously known as a Mareva injunction in the English courts and mirrored by similar concepts in continental jurisdictions, such as Arrest in Germany and saisie in France) is one of the most important weapons in a claimant’s arsenal. Under this injunction, a defendant can be restrained from dealing with or dissipating its assets so that when a judgement is obtained, the claimant may actually recover the debt rather than be left with a worthless piece of paper.

However, in June 1999, the US Supreme Court decided in Grupo Mexicano de Desarrollo, S.A. v Alliance Bond Fund, Inc. that the US federal courts had no jurisdiction to grant a freezing injunction before a judgement had been obtained. Furthermore, on 30 March 2000 the New York State Court of Appeal handed down its judgement on Credit Agricole Indosuez v Rossiyiskiy Credit Bank lifting the injunction freezing the assets of Rossiyiskiy Credit Bank (Russia’s sixth-largest bank at that time), which was originally granted by the New York County Supreme Court to prevent the debtor from asset stripping. The ruling of the New York Court of Appeal is of major importance to the worldwide financial markets as it clearly established that New York courts cannot be used by unsecured creditors to freeze the debtor’s assets outside the jurisdiction of New York. However, properly created security interest should enable creditors to freeze the attached assets of the debtor in case of default by the latter.

The above development clearly shows that it is in the best interests of a creditor to secure its obligations with a charge over the accounts of a Russian debtor and not to rely on general means of protection available to unsecured creditors.

### Pledge and assignment of accounts governed by Russian law

Attempts to adopt the international practice of pledging bank accounts as a means of security have met certain obstacles in Russia. Russian courts have taken the view that funds deposited in a Russian bank account cannot be pledged. The main reason is that under Russian law, in order for a security right to be enforced, the pledged property or rights must be subject to sale by public auction. Russian courts have taken the position that money in the account cannot be sold. Given the uncertainty of the position of Russian law regarding the pledge and assignment of accounts, it is important that the parties’ obligations relating to the pledge or assignment of account be governed by a foreign law that will provide a more favourable regime for the transaction. However, this is not possible if the account of a Russian company is held with a Russian bank. In accordance with the Fundamentals of the Civil Legislation of the USSR and the Republics of 31 May 1991 (“Fundamentals of Civil Legislation”), only parties to an international business transaction may at their own discretion determine which law will govern such transactions. In order for a pledge agreement to qualify as an international business transaction and to be governed by foreign law, the bank account – the object of the pledge – must be held with a foreign bank. This chosen law will apply not only to the rights and obligations of the parties but also to the interpretation and validity of the transaction.

Accordingly, if the account of a Russian client is maintained with a foreign bank offshore and all agreements relating to the maintenance and assignment of the account are governed by foreign law (as a matter of practice, this is likely to be English or New York law), Russian law will be irrelevant and the creditor will receive the relevant benefits of enforcement by the courts of the relevant jurisdiction. The only possible exception to this arises when the insolvency of the Russian borrower, which is discussed in more detail below.
However, as is often the case when dealing with Russia, there are certain peculiarities to be kept in mind when taking security over an offshore account. The main issues to be considered are set out below.

**Pledge over an offshore account – transaction structure**

Under a typical financing agreement, a Russian company (the Russian borrower) borrows US dollars (or other hard currency, as the case may be) from a foreign incorporated and based bank (the lender) and enters into an export contract with a foreign offtaker who has an obligation to pay in dollars. The Russian borrower assigns all its rights under the export contract to the lender to secure its debt obligations to the lender. The Russian borrower then opens an offshore dollar-denominated collection/reserve account with an account bank that is usually the lender itself or a bank affiliated with the lender (not directly subject to Russian jurisdiction). In addition to the collection/reserve account, the Russian borrower may also open a number of accounts with specific functions to be used in the course of implementation of the transaction. The Russian borrower directs the off-taker to pay all amounts due under the export contract to the collection/reserve account and assigns or charges the collection/reserve account in favour of the lender to secure its debt obligations to that lender.

**Requirement of an offshore currency account licence from the Central Bank**

To open an offshore currency account, the Russian borrower will need to obtain a licence from the Central Bank of the Russian Federation (CBR). The CBR licence should cover any possible operations with, or by means of, the offshore accounts. A CBR licence is not required if the loan is to be paid back in 180 days or less.

As a matter of practice, the CBR sometimes agrees that the Russian borrower can submit a draft licence (i.e. the borrower drafts the CBR licence itself) together with the relevant transaction documentation. The process of drafting a licence for a complex transaction is effectively a negotiation process between the borrower and the CBR that aims to fully reflect the terms of the proposed transaction in the licence. The CBR has the discretion to make any amendments to the licence that it deems necessary; hence it is vital for the borrower to explain accurately to the CBR the terms of the transaction so that the licence will match the structure of the deal.

The licence can be drafted in a “free” form, meaning that there is no strict format for the licence. However, to be approved by the CBR, the licence should follow the style that the CBR normally adopts for licences (sometimes also called “permissions”) of that type. Needless to say, the style and wording of CBR licences is often ambiguous. Nevertheless, to enable the borrower to assign its offshore account, the CBR licence should be specific with regards to all operations envisaged in relation to the offshore account. In particular, the CBR licence should permit the borrower to open an offshore account with a foreign bank, to credit the proceeds from export sales to the account and to use money on the account to repay the loan together with the accrued interest and any other related costs (default interest, breakage costs, bank commissions, etc.).

Taking into account the general principle of the Russian currency legislation that anything not directly permitted is prohibited, it is advisable for the CBR licence to permit the creation and enforcement of security over offshore currency accounts. In practice, the CBR will most probably be reluctant to permit this. Sometimes it is possible to obtain an “indirect” authorisation whereby the licence points out that a charge is created over the account. It is unclear whether such “indirect” reference to the security over an offshore account can be treated as an authorisation.

The CBR licence will contain a requirement for the borrower to report regularly to the CBR all operations involving the offshore account. All CBR licences of that type have a requirement that the licence will be revoked by the CBR in the event of a breach by the borrower of the terms of the licence, of currency regulations or of Russian legislation in general. The CBR licence will also have an expiry date and it is necessary to make sure that the licence does not expire prior to the completion of the transaction and the discharge of the obligations of the parties.

**Mandatory repatriation and sale of currency proceeds of Russian exporters**

One of the main problems associated with offshore accounts is that 75 per cent of all export proceeds of Russian exporters paid in foreign currency is subject to mandatory sale on the Russian internal currency market. Moreover, Russian-resident exporters are required to repatriate to their accounts in Russia 100 per cent of all foreign currency proceeds earned from the export of goods and
Focus on secured transactions

Balance requirement for an offshore account

ers, 25 per cent of currency export proceeds the most financially sound Russian borrow-
ted by the CBR licence). Even in the case of offshore account at all times (and only if permit-
of all export proceeds may stay in the off-
of the proceeds. Accordingly, only one quarter
be transferred to the borrower's authorised
within seven days of receipt by the borrower
means that 75 per cent of all currency pro-
ceeds credited to the offshore account should
Russian borrowers would face serious obstacles.

As mentioned above, the current percentage
Brazilian law perspective, the

Enforcement of security over offshore accounts in the event of bankruptcy of the Russian borrower

Although generally a security interest over an offshore account of a Russian borrower is
easily enforceable, certain issues arise when
insolvency proceedings in Russia.

Basically, the Federal Law of the Russian Federation “on Insolvency (Bankruptcy)” No. 6-FZ of 8 January 1998 (the “Insolvency Law”) provides that, in the event of insol-

The Insolvency Law governs all insolvency
proceedings initiated against Russian
entities. Article 1 of the Insolvency Law
provides that insolvency proceedings involv-
ing foreign creditors should be governed
by the Insolvency Law unless otherwise
provided by an international treaty of the
Russian Federation. No distinction is drawn
in the Insolvency Law between assets of
a debtor in Russia and its assets outside
Russia. Although there is no definitive
answer as to whether the Insolvency Law
has extraterritorial effect, it is likely that
from a Russian law perspective, the
Insolvency Law will apply to all assets of
the Russian debtor, including those situated
outside Russia, such as an offshore account.
A stay on execution or a stay on the attachment or enforcement of rights ordered under the Insolvency Law will not be effective automatically on assets and/or creditors based outside Russia simply as a result of the insolvency of the Russian borrower. The foreign courts do have discretion, upon application of the Russian arbitration manager, to assist him by issuing an order extending such stay to the account (or other assets) of the Russian borrower in that country. The foreign courts might be willing to provide their assistance if, for example, the enforcement of the security would generally affect the other creditors of the insolvent Russian borrower in a manner that would be unfair and prejudicial.

Even if the Russian arbitration manager may not persuade a foreign court to extend a stay on enforcement proceedings of the security over an offshore account, there may be indirect methods of enforcing Russian law against creditors who fall within the Russian jurisdiction. These would include equalisation, i.e. obliging a creditor who obtains more abroad than he would have done in Russia to return the excess to the insolvent Russian borrower. Although there is no developed practice in this area, equalisation would be one (and the most likely) of the possible scenarios. This is most likely to arise when the creditor also declares a claim in the Russian bankruptcy.

Enforcement of the charge over the offshore account will depend largely on the application of the relevant governing law, the lex situs of the offshore account and any conflict of laws rules. It should be noted that the conflict of laws position in insolvency proceedings in key jurisdictions is in a state of flux, and is therefore uncertain. Furthermore, as far as we are aware, there have been no precedents where a foreign court has assisted a Russian arbitration manager in preventing the enforcement of security governed by foreign law. It is doubtful that a foreign court would do so, not least because it would cause immense concern in the international financial community. As mentioned above, the main purpose of banks choosing offshore collection/reserve accounts to be located in the major financial centres around the world is that they can be certain of enforcing their security over such accounts.

On the other hand, assuming that the Insolvency Law is recognised as having an extraterritorial effect, the discharge of obligations of the Russian debtor by enforcement of security over an offshore account on the insolvency of the Russian borrower:
- would be preferential from a Russian law perspective;
- would breach, as of the moment of introduction of the external management and the nomination of the arbitration manager, the moratorium imposed in accordance with Article 69 of the Insolvency Law regarding all creditors’ claims that had matured prior to the introduction of the external management; and
- would breach at any time during the liquidation stage of bankruptcy proceedings the legal provision that all assets of the bankrupt be pooled together upon liquidation.

The violation of Russian law, as argued above, may give interested parties grounds to challenge in the Russian courts the legality of the charge created over the offshore account. Although, as mentioned above, under Russian conflict of laws rules, an international business transaction involving a Russian counterparty can legally be governed by foreign law if the choice of that law does not prevent application of mandatory provisions of Russian law relevant to the particular transaction irrespective of its governing law. While the Fundamentals of Civil Legislation do not explicitly mention the above principle, its application is confirmed by an express provision in the draft Part III of the Civil Code of the Russian Federation (which is not yet in force). Furthermore, Russian courts usually follow this principle in practice.

Most of the provisions of the Insolvency Law are mandatory, including the rule that prohibits the satisfaction of creditors’ claims during the moratorium and liquidation stages of insolvency proceedings. The breach of the Insolvency Law would enable a creditor or the arbitration manager to request a Russian court to invalidate a transaction under which the bank is able to enforce its security over an offshore account ahead of other creditors. From a practical point of view, in such a situation the lender must consider whether and to what extent it is subject to the jurisdiction of the Russian courts. Effectively, it would be subject to Russian law only to the extent that it has assets in Russia that fall within the jurisdiction of the Russian courts. Such assets include both physical assets and intangible assets, such as choses in action or debts owed to the lender by other Russian borrowers. Such assets could be attached or ordered to be seized by the Russian courts to give effect to their orders.

**Conclusion**

Regardless of certain complications with the granting of security over offshore accounts of Russian borrowers in relation to currency controls and uncertainties in enforcing the security in the event of the debtor’s insolvency, the assignment of offshore accounts represents one of the most secure and commercially effective ways to secure lending to Russian borrowers. The further development of practice in this area and possible liberalisation of currency control rules would undoubtedly make the assignment and pledge of offshore accounts of Russian borrowers even more attractive for international lenders.
Secured transactions in the Czech Republic – a case of pre-reform

The Czech Republic is struggling with the implementation of a modern collateral law that would allow the taking of security over movable assets without dispossession. This article explores the current situation, highlighting its shortcomings, and looks towards future developments. It also reports on the newly adopted Act on Public Auctions, which allows the enforcement of creditors’ rights over property without court involvement.
The execution of secured transactions in jurisdictions that are not rated among the “safe havens for creditors” is a very tough business – if it is a business at all. Experience shows that banks and potential investors have learned their lessons from the beginning of the 1990s and have become very careful when choosing their investments in areas where the enforcement of creditors’ rights is not always easy. The Czech Republic has been at the forefront of central European countries that enjoyed a tremendous boom in the early 90s. Foreign investment has flooded into the country and in particular its most precious and beautiful gem, the Czech capital Prague. The second half of the 90s, however, showed a trend towards scepticism among investors and, interestingly enough, also among rating agencies.1

The Czech commercial community and Czech legislators have recognised the need for reform. Investments will flourish only in a jurisdiction where investors can be sure that, in the worst of all cases, they still have the legal means to enforce their rights in a reasonable timeframe and at reasonable cost. In order to improve the structural deficiencies of Czech law relating to secured transactions, two important issues are currently of interest. On the one hand, a debate has evolved regarding the introduction of a registered pledge for movables under the Czech legal system. The reasons for this are discussed below. Some issues relating to the involvement of third parties are also discussed in this article. The other target for reform is the enforcement of secured rights by way of public auction outside of the usual court procedure. After approximately five years of preparation, the new Act on Public Auctions came into force on 1 May 2000, and its implications on the position of secured creditors are discussed in more detail below.

Creation of charges

The creation of charges over immovable property under the Czech system is, in contrast to their enforcement (see below), easily brought about. Debtor and creditor have to sign a mortgage agreement, usually certified by a public notary. On the basis of such a mortgage agreement, a mortgage is registered in favour of the creditor with the real estate cadastre. Although there are various open legal questions regarding minor issues, such as the possibility of securing interest payments, and if so at what rate etc., on the whole the creation of such mortgages is very similar to the manner opted for by several other European countries.

The case is a little different with regard to charges over movables.2 The law provides that a charge can be created by pledging a movable to a creditor. However, the law requires that the movable must be handed over to the creditor or to a third person appointed by the parties to act as caretaker. This sort of possessory charge or pledge is not unknown in other jurisdictions, for example in Germany, but the same problems always arise in this context: a possessory charge is simply not suitable for use in commercial life. The debtor who needs the item – for example, a car, a machine, raw materials etc. – to carry out its business has to hand it over to a creditor, who in turn has no interest at all in having to safeguard it and incurring further costs, which make the financing more expensive. In practice, business people in the Czech Republic have found a way around this problem for a number of years now. By invoking a section of the Czech Civil Code, they claim that, in order to perfect a pledge, it is sufficient to mark the pledged item in a way that enables third parties to recognise that it has been pledged. This is done by fixing signs or other markings to the chattels. However, this application of the law is clearly wrong.3 The handing over to a creditor of the chattel can not be substituted validly by marking the chattel as pledged. It may be presumed that there are quite a number of business people and most certainly also banks who believe that their claims have been validly secured by pledges – they are mistaken.

Another concept to solve this problem has been imported from Germany. German law allows for a transfer of title by way of security or, in other words, a fiduciary transfer of title. The debtor grants to a creditor the title to a chattel by way of security, which enables the debtor to remain in possession of the chattel. No publication is required to make effective what is in fact a security interest, and it is generally accepted in Germany. There have, however, always been (academic) voices pointing out that this mechanism circumvents the statutory requirements for the possessory pledge and should be abolished.4

The legislators in the Czech Republic have indicated through an amendment to the Czech Civil Code that the instrument of transfer of title by way of security will be accepted. In addition, certain tax rules expressly deal with the tax consequences of such transfer of title by way of security. Thus, it is generally accepted that this instrument exists under Czech law. However, in practice it has not managed to overcome some serious problems. Often, the parties of secured lending transactions are not familiar with this instrument and are reluctant to make use of it. Furthermore, and perhaps even more importantly, pursuant to a recent amendment to tax provisions, the transfer of title by way of security is subject to value-added tax (VAT) if the creditor is not a bank. Hence, the high costs involved in using this instrument make it rather unattractive. With regard to secured transactions that were completed before the described amendment of the VAT rules came into force, a tax issue arises as

1 See also Petr Dusek, “The Act on Public Auctions – Finally a Return to the Original Meaning of a ‘Pledge’” (Czech language) in Karlovarske pravnice dny 2000, p.90.
2 Or “chattels”.
3 For details, see Schorling, Das Recht der Kreditsicherheiten in der Tschechischen Republik, (Secured Transactions in the Czech Republic) (Springer-Verlag Berlin, Heidelberg, 2000), pp.72-73.
4 In Austria, for example, this transfer of title by way of security is regarded as a circumvention of the statutory rules, thus making such a transfer invalid.
to the retroactive effect of the above rules. The parties will have to consider whether the security interests created before the amendment now require payment of VAT.

On the whole, it is evident from the analysis above that the situation relating to the creation of security interests over movables is highly unsatisfactory. For this reason, the introduction of the concept of a registered pledge over movables is currently being contemplated within the legal profession – although as yet, no draft proposals have been put forward. This system has been successfully established in other jurisdictions, such as in Poland and Hungary. It combines two advantages: on the one hand, the debtor retains possession of the movable, while on the other hand, third parties, such as suppliers and banks, can identify the existence of such a pledge.

In Germany too, this argument has been raised against the transfer of title by way of security because the fact that no act of publication is required does not allow a third party to assess the capital and financial situation of the debtor. Thus, it may well be possible that Germany will follow the central European trend, in particular in light of the development of information technology and the possibilities thereby created, of implementing a system for the registration of charges. Should this concept be adopted in the Czech Republic, it would appear that many of the difficulties described above would be resolved.

**Involvement of third parties**

One of the problems that frequently arises in secured transactions, in particular those involving the syndication of loans, is the transferability of security interests from the lead lender to syndicate members. In a typical transaction it is the lead lender or a security trustee who administers the security on behalf of the syndicate members. This requires the existence of a legal right that would allow the creditor of a loan not to hold the security interest itself, but have a third party, e.g., a security trustee, hold and administer the security. However, this is not possible with respect to some key security instruments, namely the real estate mortgage and the personal guarantee. Both of these instruments are governed by the “accessory concept”. This means that these security interests are accessory to the claim that they secure.

As a consequence, if a loan or part thereof is syndicated to a syndicate member, the security interest mandatorily follows the specific loan thus secured. The security trustee would not be able to administer a real estate mortgage on behalf of the syndicate member. Moreover, the syndicate banks participating in a syndicated loan transaction would have to take the necessary measures to ensure that they themselves, and not the security trustee, are registered in the real estate register as creditor of the secured claim. This leads to increased legal costs, fees and waste of time. Thus, a further objective of reform could be the introduction of security instruments that can be handled more flexibly and that would be of more use to sophisticated secured transactions.

**Enforcement and termination**

The most important reform project of recent years is the Act on Public Auctions, which was passed by the Czech parliament on 18 January 2000 and which came into force on 1 May 2000. The general perception of the need for this reform is easily explained. Litigation in Czech courts is cumbersome and risky and, even if a favourable judgement is obtained, the enforcement thereof may take a number of frustrating years. This situation is caused by, among other things, the workload of Czech judges, their poor training and low levels of remuneration. This led to the idea of introducing a method of enforcement that involves as little participation of the state courts as possible. Apart from the intention to increase the attractiveness of investment in the Czech Republic for potential investors, it has also been made clear that it is intended to improve the ratings of existing loan portfolios of Czech banks. These banks are still, to a large extent, owned by the Czech State, and one of the hurdles to overcome in their privatisation is to solve the problem of huge amounts of bad debt in their books.

In a nutshell, the Act provides for the following: Part I contains general provisions; Part II deals with public auctions on a voluntary basis. Part III deals with the compulsory enforcement of creditors’ rights into the property of the debtor. A creditor whose rights are secured by a real estate mortgage or a pledge over movables may start a public auction on the basis of an enforceable judgement or arbitration award or notarial deed. The latter instrument is of particular
importance since it enables the parties to a secured transaction, if the deed is signed at the outset of the transaction, to start enforcement proceedings without having to obtain a prior court judgement. The auction itself is carried out by a private auctioneer licensed by the competent authority.

The Act contains very detailed and, to a certain extent, complicated provisions on the way that the auction is to be held. While this is not the forum to discuss such details, it may be noted that a shadow of doubt must be cast on the ability of a private auctioneer to abide by all these detailed rules. This is of particular importance, as the Act specifically provides that the auction may be annulled if a participant claims with the competent court within six months from the date of the auction that its rights have been violated. This would lead precisely to the result that the Czech legislator tried to avoid by passing the Act. Ultimately, it will again be the Czech courts that will decide on the legality and validity of the enforcement of creditors' rights by way of public auction.

Thus, serious doubts must be raised as to whether the Act will actually fulfil the hopes placed in it. From the author’s perspective, in the long run it may have been more effective to dedicate more time and money to improvements in the court system, the training and remuneration of judges and to allocate sufficient staff to operate the court system.

Conclusion

It is evident that significant efforts have been made to improve the legal position of secured creditors, in particular with regard to the possibilities of the enforcement of rights. It seems uncertain, however, whether these efforts have been targeted in the right direction. Notwithstanding these efforts, all parties interested in the effectiveness of secured transactions will no doubt agree that the road to a world where the creditor feels comfortable is still a very long one.

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7 It seems that Spain is another jurisdiction that provides for such private enforcement of rights. See Petr Miksovsky, “The Act on Public Auctions” (Czech language), in Karlovarske pravnícke dny 2000.
8 This aspect is particularly stressed by other legal authors. See Miksovsky supra note 7, p.148 and Dusek, supra note 1.

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ALBANIA

LEGAL DEVELOPMENTS

Telecommunications

In June 2000 a new telecommunications law was adopted by the Albanian Parliament. The law was drafted with the assistance of the EBRD, creating the foundation for a modern regulatory framework favouring competition and private investment. This law provides for all telecommunications services and networks, with the exception of public voice telephony and the underlying infrastructure, to be liberalised immediately. Public voice telephony will be liberalised in 2003. The law provides for the establishment of an independent regulator, the Telecommunications Regulatory Entity, which has authority with regard to sector regulation matters, such as interconnection rules and charges, tariff regulation, access issues and dispute resolution among operators. Policy functions remain with the ministry responsible for telecommunications.

CZECH REPUBLIC

LEGAL DEVELOPMENTS

Financial markets

A new law entered into force in May 2000, which ended the practice of the Czech Government of negotiating incentive packages for foreign investment on a case-by-case basis. The new law codifies and standardises tax and other investment incentives available to foreign investors, thereby making the assessment of the country’s investment incentive programme much simpler and clearer to potential investors.

Legal and regulatory reform regarding the securities market

At the request of the State Committee for Securities of Azerbaijan, the EBRD has approved a project to assist Azerbaijan in improving its laws and legal institutions governing the securities market. This aims to bring the Azeri laws into line with international practice and to facilitate the establishment and functioning of the Baku Stock Exchange. This project is expected to get under way in the fourth quarter of 2000.

LEGAL REFORM PROJECTS

Telecommunications

In 1999 the Armenian Government requested assistance from the EBRD in establishing an effective independent regulator with the power and the means to control the incumbent operator and ensure its compliance with the conditions attached to its licence. Following a number of political delays, a comparative analysis of the regulatory authorities in four other countries as well as a presentation of the telecommunications policies and overall telecoms legal frameworks in these countries has been completed and presented to the Government.

AZERBAIJAN

LEGAL DEVELOPMENTS

Financial markets

In June 2000 the Parliament of Azerbaijan approved a new law “On the Protection of Rights and Interests of Investors in the Securities Market”. The law provides for penalties for traders who violate stock market laws, and the establishment of a compensatory fund for shareholders whose interests are harmed, with contributions generated from stock market operators. The law also allows investors to form organisations to protect their interests.

LEGAL REFORM PROJECTS

Draft amendments to Commercial Code

Recently the Lower Chamber of the Czech Parliament approved amendments to the Czech Commercial Code, which aim to strengthen shareholders’ rights. Under these amendments, extraordinary meetings may be convened upon request of shareholders holding 5 per cent of shares as opposed to 10 per cent as previously required. Holders of 40 per cent of shares may offer to buy out other shareholders, compared with 50 per cent in the old provisions. The amendments also contain provisions on pricing designed to protect minority shareholders during a buyout, on prohibiting company directors from holding new directorships three years
after a company bankruptcy, and on increasing the role of public notaries in the setting up and changing of the legal status of a company. The amendments will pass for discussion and approval to the Upper Chamber of Parliament, the Senate.

**ESTONIA**

**LEGAL DEVELOPMENTS**

**Financial markets**

Estonia adopted a new Insurance Law in June 2000, which outlaws the sale by insurance brokers of products of foreign insurance companies. Under the new law, brokers can only sell products of insurers who hold a permit for insurance activity in Estonia. The new law, however, grants an exception to Lloyds of London through a specific article that governs Lloyds’ activities.

**GEORGIA**

**LEGAL REFORM PROJECTS**

**Assistance to the development of telecommunications regulatory framework**

Through the use of consultants, the EBRD is assisting the authorities of Georgia in adopting a modern regulatory framework in telecommunications. Assistance will be provided in adopting a modern licensing law and policy and preparing a sound interconnection and tariff policy. Legislation that will vest the Independent Telecommunications Regulatory Commission with the power and means to implement and enforce a telecommunications policy based on the principles of objectivity, transparency and impartiality is being discussed. Also, efforts are being made to raise general awareness on telecommunications law and policy. Assistance will also be provided to the authorities in drafting the legislative and regulatory instruments necessary to implement any new policies.

**LITHUANIA**

**LEGAL DEVELOPMENTS**

**Approval of new Civil Code**

On 18 July 2000 the Parliament of Lithuania passed a new Civil Code. The new code aims to integrate Lithuanian private law principles with the changed economic and social environment of the country, and harmonise it with EC legislation. The new Civil Code, which will take effect from 1 July 2001, will replace the Soviet-era code of 1964, which lagged behind changing economic and political conditions.

The new Civil Code consists of six chapters dealing with basic private law principles, rules concerning persons and their legal capacity, property law, contract law, family law, heritage and other aspects of private law. The chapter on property law offers a more detailed and broader regulation of property relations than provided for presently. This part of the code includes amended special fundamentals of acquisition of property right providing, for instance, that in special cases individuals shall be entitled to acquire treasures or findings. The chapter on contract law determines new measures of protection of rights and interests of creditors.

**KAZAKHSTAN**

**LEGAL REFORM PROJECTS**

**Assistance to develop the telecommunications regulatory framework**

At the request of the Kazakh Minister of Telecommunications, the EBRD has undertaken a project aiming to provide assistance in developing an adequate regulatory framework in telecommunications that is likely to foster private investment and lead to the development of the telecommunications sector. The project was launched in September 2000.

**POLAND**

**LEGAL DEVELOPMENTS**

**New Commercial Code**

The Polish Parliament has passed a new Commercial Code, which will enter into force on 1 January 2001, replacing the current Commercial Code which dates back to 1934. The new code provides for the establishment of four types of companies, including joint-stock partnership, which is a novelty under the Polish system. Meanwhile, new partnerships, modelled on the US system, can be formed by independent professionals, such as lawyers, auditors and tax advisors. Partners in such partnerships would bear legal responsibility only for cases that they oversee personally. The new code also outlaw preference shares in public joint-stock companies. From now on, one share will always equal one vote at shareholders’ meetings. The two previously existing company types – joint-stock and limited liability companies – are largely unaffected by the new code, although the initial share capital requirement for establishing a company is higher. The new code aims to adapt Polish corporate law to EU standards and to facilitate the development of a modern market economy.

**REGIONAL**

**LEGAL REFORM PROJECTS**

**CIS model securities law**

The EBRD is sponsoring a technical assistance project to develop model CIS securities legislation. In this context, the first draft Law “On Securities Circulation” has been drafted and was approved by the Working Group in May 2000. The drafting group has started working on the second Law “On Capital Markets”.
**RUSSIA**

**LEGAL DEVELOPMENTS**

**Financial markets**

In March 2000 the Federal Commission for the Securities Market issued a letter “On the Requirement for the Transfer of Share and Bond Holders’ Registers to a Specialised Registrar”. The letter clarifies an inconsistency between the Law “On the Securities Market” and the Law “On Joint Stock Companies” regarding the maintenance of the share register of a company by a specialised registrar. It states that the former law should take priority with respect to issues concerning securities and the securities registrar.

In March 2000 the Government of Russia adopted a new resolution to impose anti-trust control on the financial services market and on methods of evaluating the turnover and limits of the financial services market. This resolution was adopted in compliance with the Law “On the Protection of Competition on the Market of Financial Services”, which was promulgated in 1999.

**LEGAL REFORM PROJECTS**

**Legal and regulatory reform related to the issuance of debt securities in Russia by foreign issuers**

At the request of the Federal Commission for the Securities Market of the Russian Federation, the EBRD has approved a project to assist Russia in improving the Russian legal and regulatory framework governing the debt capital markets by bringing it into line with the sound practice of international bond markets. The project aims to establish a clear regulatory regime in Russia, under which foreign issuers with good credit ratings would be able to raise capital in roubles by issuing rouble-denominated-and-paying debt securities in a cost-efficient way.

**Federal Commission for the Securities Market (FCSM) project to develop Russian company/securities laws**

The EBRD has completed a technical assistance project to help the FCSM develop Russia’s companies/securities laws. Draft amendments to the “Company Law”, prepared with the assistance and under the supervision of the EBRD, have been passed by the State Duma. However, the draft law was rejected by the upper chamber of the Federation Council. The conciliatory committee is expected to consider the draft law in Autumn 2000. The draft Law on Investment Funds, also prepared with the assistance and under the supervision of the EBRD, has been approved at its first reading by the State Duma and has been put forward for second reading at the end of September 2000. Two concept documents – for the draft Law on Electronic Documents and for the draft Law on Transactions over Securities – have also been elaborated within the project’s framework.

The EBRD has a number of other legal reform projects in its pipeline aiming, in particular, at improving the corporate governance standards in Russian companies.

**Telecommunications**

In March 2000 the Slovak Parliament approved a new telecommunications law, which created conditions for effective liberalisation and competition and allowed for the sale of Slovak Telecom, the national carrier. The new legislation provides for the creation of a regulator to oversee prices and competition among providers of fixed-line telephony, mobile telephony and Internet services.

**SLOVAK REPUBLIC**

**LEGAL DEVELOPMENTS**

**Bankruptcy law**

In June 2000 the Slovak Parliament approved amendments to the Bankruptcy Act, which will enter into effect in August 2000. The main contribution of the amendments is substantial acceleration of bankruptcy proceedings and significant strengthening of the position of creditors. It is expected that the new provisions will contribute significantly to the improvement of the investment climate in the Slovak Republic and will encourage foreign investments.

**TAJIKISTAN**

**LEGAL REFORM PROJECTS**

**Assistance in development of the telecommunications regulatory framework**

The EBRD is preparing a project to assist the Tajik authorities in drafting a modern telecommunications law and in establishing a clear, predictable and pro-competitive regulatory framework. This involves further elaboration of a telecommunications sector policy, elaboration of a licensing policy, facilitating the establishment of an independent regulatory authority with the powers and means to enforce the telecommunications regulatory framework and facilitating the creation of sound interconnection and tariff policies.
UKRAINE

LEGAL DEVELOPMENTS

Financial markets

In February 2000 the Ukrainian State Commission on Securities and Stock Markets adopted a new regulation “On Special Information of the Public Joint-Stock Companies and the Bond Issuers”, stipulating the kind of information that must be disclosed by public joint-stock companies and issuers of bonds.

Amendments to Central Bank Law

The Ukrainian President signed a decree on amendments to the Central Bank Law of May 1999, which called for the Central Bank to be governed by a 14-member Council, which would be able to intervene in Central Bank activities and monitor decisions by the Central Bank’s board. At the time, experts and the Central Bank itself criticised the Central Bank Law, claiming that it contained loopholes permitting political pressure to be applied to the Central Bank. The Ukrainian President submitted amendments to the Law immediately after its adoption.

The amendments provide the Central Bank board and the Council with equal rights. The Central Bank Council will now consist of 15 members, with seven members appointed by the President and seven by Parliament from within its ranks, plus the Central Bank governor. The Central Bank Council is elected for seven years. The President has not yet appointed his seven members to the Council. The Council, therefore, has not been established.

LEGAL REFORM PROJECTS

Assistance in developing a telecommunications regulatory framework

The EBRD, at the request of the Ukrainian Government, is undertaking a project that aims to assist the Ukrainian authorities in establishing a clear and predictable regulatory framework likely to attract private investment, to bring about the overall development of the sector and to facilitate the forthcoming privatisation of Ukreetelecom. The consultant selection process is currently under way, and the project will be launched in the first week of September 2000.

UZBEKISTAN

LEGAL DEVELOPMENTS

Banking

In March 2000 the Uzbek President signed a decree on measures to liberalise and reorganise the banking system. The objective of the decree is to enhance the independence of commercial banks and to increase their role in investment activities.
“Trading in derivatives in Hungary” Conference, Budapest

On 17-18 May 2000, Allen & Overy, serving as European Counsel for the International Swaps and Derivatives Association, Inc. (ISDA), held a derivatives conference in Budapest. The conference focused on trading in derivatives in Hungary, with special emphasis on netting and the ISDA documentation. This conference was organised in connection with the close-out netting legal reform project in Hungary currently undertaken by the Legal Transition Team of the EBRD in cooperation with ISDA. Hsianmin Chen, Counsel and the operation leader of the project, made a short presentation at the conference, introducing the EBRD and close-out netting projects in the region.

Developing insolvency laws in central and eastern Europe — Roundtable presentation at the EBRD Annual Meeting, Riga

On 20 May 2000 the Office of the General Counsel of the EBRD held its legal roundtable discussion on developing the law and institutions to facilitate the restructuring of enterprises in central and eastern Europe. The legal roundtable provided a provocative discussion of insolvency reform issues in the EBRD’s 26 countries of operations.

Emmanuel Maurice, General Counsel of the EBRD, chaired an impressive panel of four speakers and three discussants. Mr Maurice emphasised the commitment by the EBRD to insolvency law reform in central and eastern Europe. Kamen Zahariev, Senior Counsel and Team Leader of the Corporate Recovery and Litigation Team at the EBRD discussed the Bank’s practical experience as an important investor in the region with the bankruptcy and restructuring situation. He also described the EBRD’s results of a recent survey of the state of bankruptcy laws and practice in the region. The other speakers were Prof. Dr. Stefan Smid from Martin-Luther Universität, Germany; Georgy Konstantinovich Tal, Director of the Russian Federal Service on Financial Rehabilitation and Bankruptcy; and Lajos Bokros, Hungary’s former Minister of Finance and now director for financial advisory services in central and eastern Europe for the World Bank.

Other roundtable participants were Mario Thurner, Managing Director, Center of Legal Competence (CLC), Vienna, Austria, who conducted a comprehensive review of the insolvency law of the region; Raino Paron, Raidla & Partners Law Firm, Tallin, Estonia; and Oliver Greene, Co-head of the Corporate Recovery and Litigation Team, EBRD. They all shared their experiences with insolvency and bankruptcy situations. They pointed out that some of the major problems facing the countries of the region are the lack of proper implementation of insolvency laws and the lack of willingness of creditors and debtors to help companies in financial difficulties.

IBA Conference on the Legal Framework for Secured Credit, Lisbon

In May 2000 the International Financial Law Reform Sub-Committee of the International Bar Association (IBA) held a conference on the legal framework for secured credit at which IBA members from 11 countries (Argentina, Australia, Canada, Finland, France, Hungary, Italy, Netherlands, Poland, South Africa and Switzerland) presented papers. These papers examined the extent to which the laws of these countries correspond to the EBRD’s Core Principles on Secured Transactions.

Conferences/workshops on the telecommunications regulatory framework of Bosnia and Herzegovina (BiH), Sarajevo

In Spring 2000, EBRD Counsel Meni Styliadou participated in a conference organised by the Independent Media Commission of BiH on “The Telecommunications Regulatory Framework of BiH: Opportunities of Investment”.

At the conference the State Telecommunications Law, adopted with EBRD assistance in 1998, was discussed extensively with all interested parties. This law created the Telecommunications Regulatory Agency at the state level with authority to issue international telecommunication licences, to prepare and adopt the country’s frequency plan, to adopt the numbering plan and to regulate and decide on all interconnection matters. The Law also allocated powers and responsibilities between the state of BiH and the two entities, Federation of Bosnia and Herzegovina and Republika Srpska. While the Telecommunications Regulatory Agency is responsible for licensing all international services as well as inter-entity services, the entities remain responsible for local networks.

In July 2000 a workshop on licensing regulation and GSM licences was held in cooperation with the Telecommunications Regulatory Agency. Technical discussions took place redefining some notions to clarify the terms.
The EBRD continues to collaborate with the international community in Sarajevo, including the Office of the High Representative, to identify areas of the telecommunications sector where further development is needed.

**World Bank Conference on Comprehensive Legal and Judicial Development: Towards an Agenda for a Just and Equitable Society in the 21st Century, Washington, D.C.**

From 5 to 7 June 2000 the World Bank hosted an international conference in Washington, D.C. to explore innovative ideas to promote legal and judicial reform. In front of an audience of over 600 participants, World Bank President James Wolfensohn and Nobel Laureate Armatya Sen opened the conference by highlighting the critical role that a sound legal order and functioning justice system play in the development process. The conference included a variety of panel discussions on topics ranging from alternatives for holding governments accountable and curbing judicial corruption to informal mechanisms for enforcing contracts and resolving disputes, and developing effective strategies for legal reform programmes. EBRD General Counsel, Emmanuel Maurice, participated in the closing panel on the role of multilaterals in legal and judicial reform and emphasised the need for countries of central and eastern Europe and the CIS to place legal reform higher on the political agenda and to dedicate further resources to legal institutions building.

**Seminar on International Insolvency and Secured Transaction Lending Law Reforms, Dallas**

On 12 June 2000 the Southwest Legal Foundation’s International and Comparative Law Center hosted a seminar on the reform of international insolvency and secured transaction laws to facilitate credit to small and medium-sized businesses in developing countries.

Craig Averch, EBRD Counsel, provided a description of the EBRD’s efforts to assist countries in the development of more extensive and effective insolvency laws and described the Bank’s actual experience with insolvency law and practice in the EBRD’s countries of operations. Mr Averch also presented the results of the EBRD’s annual surveys assessing the adequacy of insolvency laws in the region. Gordon Johnson, Senior Counsel at The World Bank, made a presentation on the initiative of The World Bank (co-sponsored with other international financial institutions) to develop principles and guidelines for effective insolvency systems. A consistent theme among the presentations at the conference was the need for emerging market countries to have effective and transparent secured transaction and insolvency systems to encourage foreign lending to small and medium-sized businesses.

**International Council for Central and East European Studies (ICCEES) World Congress of Central and Eastern European Studies, Tampere**

The 6th ICCEES World Congress took place from 29 July to 3 August 2000 in Tampere, Finland. The general theme was “Divergencies, convergencies, uncertainties”. The programme was composed of a selection of panel, roundtable and individual papers on a variety of subjects, such as history, religion and philosophy; language, politics and international relations; economics; and law and legal culture. Law Professor Ferdinand J.M. Feldbrugge from the University of Leiden serves as President of the ICCEES Executive Committee.

**International Symposium on Legal Assistance Projects in Asia and International Cooperation, Nagoya**

On 13 and 14 September the Graduate School of Law of Nagoya University, Japan, hosted an international symposium to exchange views on the state of legal assistance work in Asia and to enhance international co-ordination. The symposium opened with a series of presentations from the international community, bilateral legal assistance providers and non-governmental organisations (NGOs) on their efforts to implement legal reform projects in Asia. These presentations focused on the policy behind each organisation’s legal reform assistance, the method of implementing these legal reform projects as well as the evaluation of project results. EBRD Assistant General Counsel, Gerard Sanders, participated in the conference and spoke on the EBRD’s experiences in Central Asia and its efforts to assess the state of legal transition in this region. He emphasised that further efforts need to be made by these countries in ensuring greater public participation in law making, improved funding of legal institutions, and the provision of other forms of political support that underpin legal reform. The second part of the symposium focused on the intersection of law and politics. Speakers focused on the role of legal reform in the processes of political and economic development.
For the latest information on secured transactions laws and the work undertaken by the EBRD’s Office of the General Counsel in this area, visit the EBRD’s Web site (www.ebrd.com/english/st.htm).

Here you will find:

- the Model Law on Secured Transactions, in English, German and Russian;
- the EBRD’s Core Principles for a Secured Transactions Law;
- the Regional Survey, which provides a short analysis of existing secured transactions law in the Bank’s 26 countries of operations;
- reports and working papers on a number of country projects, such as Moldova’s Registration of pledges under the Law on Pledge of 23 May 1996, June 1998; and
- other publications, such as the Glossary of secured transactions terms (English-Russian and Russian-English).

All this information may be accessed and downloaded free of charge.

The Secured Transactions Project welcomes all comments and suggestions – please send to SecuredTransactions@ebrd.com.
The European Bank for Reconstruction and Development (EBRD) is an international institution whose members comprise 58 countries, the European Community and the European Investment Bank. The EBRD operates in the countries of central and eastern Europe and the Commonwealth of Independent States committed to multiparty democracy, pluralism, and market economies.

The EBRD’s countries of operations are Albania, Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Bulgaria, Croatia, Czech Republic, Estonia, FYR Macedonia, Georgia, Hungary, Kazakhstan, Kyrgyzstan, Latvia, Lithuania, Moldova, Poland, Romania, Russian Federation, Slovak Republic, Slovenia, Tajikistan, Turkmenistan, Ukraine and Uzbekistan.

The EBRD works through the Legal Transition Programme, which is administered by the Office of the General Counsel, to improve the legal environment of the countries in which the EBRD operates. The purpose of the Legal Transition Programme is to foster interest in, and help to define, legal reform throughout the region. The EBRD supports this goal by providing or mobilising technical assistance for specific legal assistance projects which are requested or supported by governments of the region. Legal reform activities focus on the development of the legal rules, institutions and culture on which a vibrant market-oriented economy depends.

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