

FEASIBILITY STUDY

On the Regulation of Personal Insolvency



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On the Regulation of Personal Insolvency

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Definitions

\$	US Dollar
Benef.	Benefits
Bill	Billion
CEIC	Census and Economic Information Center
DRO	Debt Relief Orders
EUR	Euro
GDP	Gross Domestic Product
GDP	Gross Domestic Product
GDP	Gross Domestic Product
GEL	Georgian Lari
Geostat	National Statistics Office of Georgia
GINI	Generalized Inequality Index
GNI	Gross National Income
HDI	Human Development Index
IMF	International Monetary Fund
IVA	Individual Voluntary Agreements
LILA	Low-Income Low-Asset
LTV	Loan to Value Ratio
Mill	Million
MPI	Multidimensional Poverty Index
NBG	National Bank of Georgia
NINA	No-Income No-Asset
NPV	Net Present Value
NPV	Net Present Value
OECD	Organization for Economic Cooperation and Development
Pg.	Page
pp.	Pages
PTI	Payment to Income Ratio
SDG	Sustainable Development Goal
SWOT	Strengths, Weaknesses, Opportunities, Threats
UNDP	United Nations Development Program
USA	United States of America
Vol.	Volume

Chapter 1. Introduction

1.1. Relevance and Objectives

The present Feasibility Study Report (hereinafter - the Report) is an overview of the multidisciplinary study results on the regulation of personal insolvency in Georgia (hereinafter - the Study).

Insolvency is an economic situation when a person is unable to cover matured liabilities.¹ Expected insolvency shall exist if there are reasonable grounds to presume that a debtor will become insolvent.²

For the past ten years or more, the number of debtors in Georgia who are unable to cover their matured financial liabilities has been growing and form a fairly large segment of the overindebted population. This has a negative implication on their normal social development and the country's economy in general. Therefore, in order to solve the abovementioned problems, in our opinion, it is necessary to establish legal framework for personal insolvency.

One of the desirable results of regulating the insolvency of individual entrepreneurs is to save the very economic activities that individual entrepreneurs engage in. Whereas, in case of insolvency of non-entrepreneurial individuals, taking into account the possibility of receiving income, rehabilitation (e.g. retaining the assets of an individual) and, at the same time, satisfaction of the claims of the creditors, is the basis of the "second chance" that is usually served by various personal insolvency systems.

Regulation of insolvency as a special regime of debtors due to economic situation in Georgia may be divided into three stages. In this regard, the first legislative act - Law of Georgia on Bankruptcy Proceedings was

¹ Law of Georgia on Rehabilitation and Collective Satisfaction of Creditors, Article 7.1.

² Law of Georgia on Rehabilitation and Collective Satisfaction of Creditors, Article 7.2.

adopted on June 25, 1996. According to the law, natural persons and legal entities of private law were authorized to use the regime.³ The 1996 law defined the application of either debtor or the creditor as the basis for initiating bankruptcy proceedings⁴ and envisaged liquidation of the legal entity after the full distribution of its property and discharge of the debtor natural person.⁵ The original version of the mentioned law, besides that it did not provide for the possibility of rehabilitation of legal entities or natural persons, established the possibility of forcible bringing and arresting of natural persons by the court, in the process of insolvency, which may not be considered as a modern system of insolvency regulation.⁶

Until 2007, several important amendments were made to the Law of Georgia on Bankruptcy Proceedings. One of such substantial amendments took place on April 10, 2001 when the possibility of rehabilitation of the legal entities was introduced.

On March 28, 2007, the Law of Georgia on Insolvency Proceedings was adopted (hereinafter – 2007 Law), which replaced the Law of Georgia on Bankruptcy Proceedings of September 25, 1996. By the virtue of 2007 Law, which is still in force, the right to initiate insolvency proceedings was granted only to legal entities and individual entrepreneurs i.e. natural persons who carry out entrepreneurial activities. However, this law does not specify the criteria and conditions which precluded the registration of natural persons as individual entrepreneurs, for the sole purpose of initiating insolvency proceedings. Accordingly, 2007 Law may not be considered as such regulation of the insolvency of entrepreneurial natural persons, which provides effective safeguards against the unfair use of this form of activity. This is also indicated by the interviews conducted within the framework of the present Study (see Chapter 3.2).

³ The Law of Georgia on Bankruptcy Proceedings, September 25, 1996, Article 2.1.

⁴ *Ibid.* Article 6.1.

⁵ *Ibid.* Article 29.1.

⁶ *Ibid.* Article 14.1(a).

The so-called first stage of the multi-year reform of the legislation on corporate insolvency in Georgia was finalized on September 18, 2020 with the adoption of the Law on Rehabilitation and Collective Satisfaction of Creditors (hereinafter – 2020 Law). The new law will replace 2007 Law from April 1, 2021.

The 2020 Law, unlike 2007 Law, does not apply to the insolvency of entrepreneurial natural persons. In Georgia, insolvency is the basis for the application of a special regime only for legal entities.⁷ Accordingly, after April 1, 2021, Georgian legislation will not cover notion of personal insolvency (including entrepreneurial natural persons) and there will be no legislative framework that would allow natural persons to enjoy a special regime, which is often the only opportunity for legal entities to save the business.

The present Study is conditioned by the need to analyze foreign experience and cost-benefit of the reform in order to define a new legal framework regulating the personal insolvency legislation in Georgia.

The aim of the study is to identify different approaches and basic legislative principles for regulating the personal insolvency, taking into account the legal, social and the economic environment of Georgia.

The purpose of the present Study is also preparation of the relevant justification for the legislative regulation of the issue of personal insolvency.

For achieving of the set goals, objectives of the Study are:

- Studying the foreign countries' experience in regulating the personal insolvency issues;
- Contextual analysis of regulation in the context of corporate insolvency and enforcement of claims;

⁷ Law of Georgia on Rehabilitation and Collective Satisfaction of Creditors, Article 4.

- Identification of the social and economic aspects to be considered during the reform and preparation of a package of relevant recommendations.

1.2. Methodology and structure

To ensure a comprehensive analysis of the issue, the Study was conducted by the multidisciplinary team of legal and economic experts.

Both quantitative and qualitative research methods were used in the process.

The following information was analyzed for during the Study as available for the research period: statistical data, surveys of various organizations, normative acts, relevant EU directives and regulations, also, studies and other documents prepared to assess the effectiveness of existing legislation in the EU.

In order to fully reflect the positions of stakeholders in the Study, the Study relied on interviews with different stakeholders. As a result of interviews, the positions of various representative groups and stakeholders representing the interests of businesses and consumers on the personal insolvency were identified.

While interviewing representatives of stakeholders, the focus groups of respondents consisted of representatives of the financial sector, the Revenue Service, the National Bureau of Enforcement and debt collection companies. Respondents were selected taking into consideration the greatest impact that new regulation would have on financial institutions and the activities of the Revenue Service, while the National Bureau of Enforcement and private debt collection companies have practical experience that can be taken into account while drafting legislation.

A significant part of the research was devoted to the cost-benefit analysis of the regulation of personal insolvency in Georgia. An important part of cost-benefit analysis is data collection, expert assumptions, and

summary-analysis. In data collection, the main sources used were data processed by the following organizations: National Statistics Office of Georgia (hereinafter - Geostat), National Bank of Georgia, National Bureau of Enforcement, Social Services Agency, World Bank, Galt & Taggart, Bloomberg and International Monetary Fund.

Different components influence the cost-benefit analysis of the regulation of personal insolvency. The influence of a number of factors will be positive, while the influence of other factors will be negative. A major challenge of this study is the monetization of the factors influencing cost-benefit analysis (Cost & Benefit) and the calculation of the results.

It should be noted that it is not possible to numerically analyze such components and include them in the economic model, as stress reduction for the individual and his/her family members, raising moral well-being, increase in average life expectancy, etc. The economic model will reflect: increase in incomes of individuals, business sector benefits, banking sector profits, budget savings, community benefits.

The report consists of 8 chapters:

- Chapter I - Introduction, where the goals, objectives, methodology, and structure of the study is discussed.
- Chapter II - Reviews the experience of different countries regarding the regulation of personal insolvency.
- Chapter III – Presents the results of interviews with stakeholders.
- Chapter IV – Overviews the relevant economic indicators in Georgia.
- Chapter V - Focuses on the relevant social aspects of insolvency and, in this regard, the situation in Georgia.
- Chapter VI - Analyzes the legal context in which the personal insolvency should be regulated.
- Chapter VII - Represents a cost-benefit analysis of the reform as a result of the regulation of personal insolvency.

- Chapter VIII - Includes findings and recommendations of study authors.

1.3. Assumptions and Limitations

The purpose of the present Study is not the creation of new data on the regulation of personal insolvency in Georgia. Accordingly, the cost-benefit analysis was based on the following assumptions:

- The cost-benefit analysis and duration of the economic model were defined as ten years. The positive impact of the regulation on the economy is not expected in the first year of the ten-year period;
- The regulation of personal insolvency will not have an instant effect on the economy, as individuals who have been unemployed for a long time and were not looking for a job because of the lack of an appropriate motivation are so-called "structurally unemployed". Such individuals will take probably at least one year to find a job, after that they will be able to start working and have a positive impact on the economy;
- Regulating the personal insolvency will not have an impact on the economy in the short run; the real impact of regulation can only be perceived in the long run. Accordingly, the cost-benefit model was developed over a 10-year period and, ultimately, the net present value was calculated according to the estimated effective date of the regulation. The discussion of the regulation is scheduled for 2021 and is expected to be adopted by the end of 2021; in reality, individuals will only be able to benefit from insolvency regulation from 2022 onwards. Accordingly, in the 10-year model of cost-benefit analysis, the first year is 2022, and the tenth year is 2031;
- The cost-benefit of the economic model will be calculated for three different scenarios: an optimistic scenario, when after

adopting the regulation 3% of natural persons with over 100 days overdue loans and being in the debtors' registry, from the very first year will submit an application for the use of the regulation; the level of involvement in the regulation is increasing from year to year and reaches 15% in the tenth year; medium activity scenario, when 1% will apply in the first year and the engagement rate in the tenth year will equal 5%, and a pessimistic scenario, when 0.5% will apply for the benefit of the regulation at the beginning, and 2.5% in the tenth year.

Chapter II. International experience on the regulation of personal insolvency

2.1. Basic regulatory approaches to personal insolvency

Regulating insolvency of natural persons and legal entities in different countries usually serve different objectives. Insolvency legislation for natural persons also includes aspects of social assistance to some extent, while the regulation of corporate insolvency is conditioned only by economic factors. Despite the differences, regulatory goals such as fair redistribution of payments between creditors and increasing overall public economic benefits are common in both cases of insolvency.

The regulation of personal insolvency is closely related to the insolvency legislation in force in a particular state and to the general system of social protection of the population. Accordingly, in this respect, the approaches of different states towards the issue differ.

As a result of the analysis of international experience in regulating the personal insolvency, we may outline two types of approaches: first, the Anglo-American so-called "fresh start" system, shared by U.S. and UK legislation; and second, the "deserved new beginning" system of continental Europe. The latter only provides for the commencement of insolvency proceedings when the responsible debtors find themselves in a hopeless situation due to someone else's mistakes.⁸

Despite the regulatory approach of the insolvency legislation, the main benefit that individuals receive from accessing an insolvency regime is

⁸ Arvydas, Paškevičius, Neringa, Jurgaitytė, *Bankruptcy of Natural Persons in Lithuania: Reasons and Problems*, *Procedia - Social and Behavioral Sciences*, Vol. 213, December 1, 2015, pp. 521-526, available at: <https://bit.ly/2MtF5aT>, last access on February 1, 2021.

the possibility of debt discharge. Discharge of debt in exchange for the transfer of part of the debtor's property and income is the main guarantee of starting a new financial life.⁹ Debt discharge is an essential mechanism of the fresh start policy, linking the function of collective satisfaction of insolvency regime creditors with the function of economic survival of the debtors.¹⁰

In order to develop conceptual recommendations for the regulation of personal insolvency in Georgia, in the framework of the Study, we reviewed the relevant EU regulatory framework, as well as the legislation of Lithuania, England and Wales and Poland. The following chapter provides a detailed overview of the regulation of personal insolvency in the comparison countries as a result of the analysis of relevant foreign experience in this regard.

2.2. EU experience

Over-indebtedness is a significant problem in the EU. In the 2016 report of the European Commission, *Macroeconomic Relevance of Insolvency Frameworks in a High-debt Context: An EU Perspective*, is noted that the high level of debts in Europe is a problem and the regulation of insolvent individuals can significantly reduce overdue loans from banks' balance sheets, and on the other hand, may have positive impact on the economies of countries as well. The study notes that the high share of overdue loans in banks is a barrier to lending and hinders the development of the economy. Regulating insolvent individuals is a way to solve the problem quickly and will have a positive effect on the economy, especially after the recession. According to the authors of the study, legislative regulation of the issue alone is not a panacea and its success will depend on additional concomitant actions as well. Also, it is important

⁹ Jackson, Thomas H., *The Logic and Limits of Bankruptcy Law*, Beard Books, October 1, 2001, pg. 225.

¹⁰ *Ibid.* pg. 226-227.

that there is no one specific optimal model that will work equally in all countries and will bring visible results.¹¹

Research has shown that, in general, loans are necessary to stimulate the economy, but the rapid increase in the share of the loans has a negative impact on investment opportunities. Analysis of the situation in different countries has confirmed that where there is effective regulation of personal insolvency, there are fewer overdue loans and more growing business dynamics. The research highlights the fact that the use of regulation should be easily accessible, which will enable an individual to have a “Fresh Start”.¹²

Study of the University of Leeds on New Approach of to Business Failure and Insolvency, Comparative Legal Analysis of Member States’ Relevant Provisions and Practices, commissioned by the European Commission was published.¹³ The study examined the approaches of Member States to debt settlement and bankruptcy procedures available to entrepreneurial individuals. It was established that from member states in Bulgaria, France, Luxembourg, Malta, Poland, and Romania, there was only the possibility of bankruptcy procedure for entrepreneurial individuals; Debt settlement was the possibility in Germany, Spain, Hungary, Lithuania, Latvia, and Slovakia, and in most Member States - Austria, Belgium, Cyprus, the Czech Republic, Denmark, Estonia, Ireland, Greece, Finland, Croatia, Italy, the Netherlands, Portugal, Sweden, Slovenia, the United Kingdom (as well as in the US and Norway) - for entrepreneurs both bankruptcy proceedings and debt settlement proceedings were available.¹⁴

¹¹ Bricongne, Jean-Charles, Demertzis, Maria, Pontuch, Peter and Turrini, Alessandro, *Macroeconomic Relevance of Insolvency Frameworks in a High-debt Context: An EU Perspective*, European Commission, Discussion Paper 032, June, 2016, pg. 3, available at: <https://bit.ly/3pMI0uP>, last access on February 1, 2021.

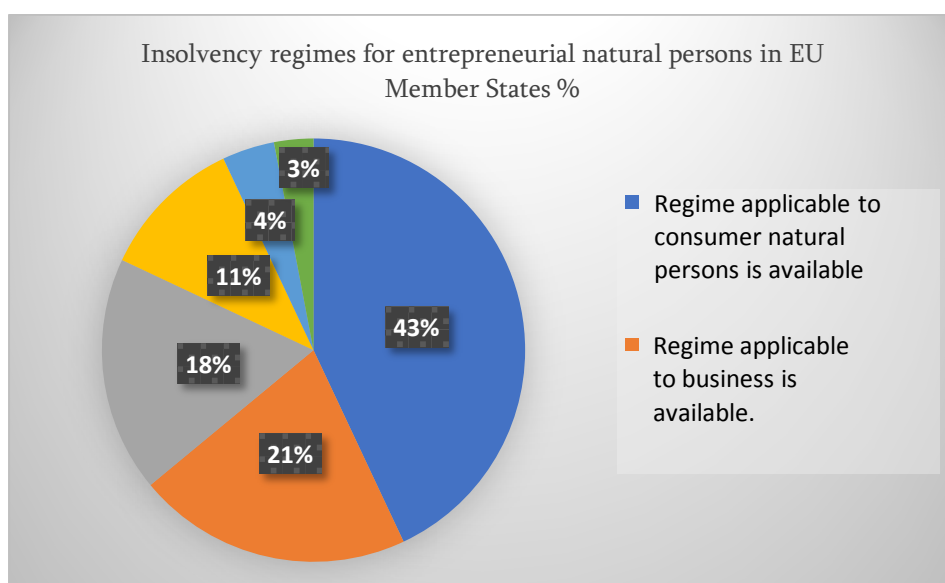
¹² *Ibid.* pg. 21

¹³ University of Leeds, *Study on New Approach of to Business Failure and Insolvency, Comparative Legal Analysis of Member States’ Relevant Provisions and Practices*, January 2016, available at: <https://bit.ly/2MJPFua>, last access on February 1, 2021.

¹⁴ *Ibid.* pg. 297

During the study by the University of Leeds, insolvency procedures of entrepreneurs in the Member States in the context of corporate and consumer insolvency regimes were also studied.

Chart 1. Insolvency regimes available to entrepreneurs in the 28 EU Member States



In most Member States (43%), the same insolvency regime is available to entrepreneurs as well as to non-entrepreneurial natural persons. In 21% of the countries, entrepreneurial natural persons use only business (corporate) insolvency proceedings. In 18%, for entrepreneurial natural persons is available certain part of the consumer insolvency system depending on the size of entrepreneur's activity, 11% have specially established procedures, in 4% there is no possibility of debt discharge and only 3% of Member States offer insolvency proceedings to entrepreneurs, where no consumer proceedings exist.¹⁵ In this respect, the minority countries include France, Latvia, Poland and Romania, and in Belgium, Denmark and Luxembourg, former entrepreneurs are eligible to

¹⁵ *Ibid.* pg. 298

benefit from a regulatory regime for consumers if they have not been in business for the last six months.¹⁶

The legislation of the most EU Member States lays down the insolvency proceedings for both entrepreneurs and non-entrepreneur natural persons. Insolvency is available to an individual with a business debt in Cyprus if he/she owns a small business and has used his own house as collateral for the business loan. A similar approach is shared by Finland and Sweden, where only an entrepreneur who has a personal and small business loan or whose business is easy to check is authorized to start insolvency proceedings. In Cyprus, Greece, and Portugal, only the self-employed or those engaged in professional activities have the right to initiate insolvency proceedings. And in Lithuania, the special regime for natural persons applies to farmers and self-employed individuals.¹⁷

In 2016, Impact Assessment Study on Policy Options for a New Initiative on Minimum Standards in Insolvency and Restructuring Law was published. The aim of the study was to assess the potential impact of different policy options and to make recommendations to the European Commission to develop minimum standards for the definition of insolvency and restructuring law.¹⁸

2016 Impact Assessment Report revealed the ineffectiveness of Member States' legislation in various respects. One of the main problems was the variability of discharge periods. While in Romania, Spain, Montenegro, Luxembourg, Hungary, Turkey, Belgium and Portugal took ten months for full discharge, in the Czech Republic, Germany, and Greece the discharge took more than seventy months.¹⁹

The report highlighted significant legislative differences in terms of so-called giving a second chance. For honest entrepreneurs to have an ad-

¹⁶ *Ibid.* pg. 299

¹⁷ *Ibid.* pg. 289

¹⁸ European Commission, *Impact assessment study on policy options for a new initiative on minimum standards in insolvency and restructuring law*, 2016, p. 15, available at: <https://bit.ly/3tgD6rb>, last access on February 1, 2021.

¹⁹ *Ibid.* pg. 58

equate opportunity to resume their activities, it is necessary to be fully discharged from liability after the completion of the procedure. The study has shown that in Cyprus, Ireland, Poland, and the UK, for example, the full discharge was available within 3 years of completing insolvency proceedings. Discharge in Belgium, Estonia, Luxembourg, Malta, Portugal, Romania, Slovakia, and Spain was possible only after three years. There were also member states - Austria, Denmark, Bulgaria, Finland, Hungary, Lithuania, Latvia, and Netherlands - where debt discharge did not take place even after the bankruptcy proceedings had been completed.²⁰

Regulation 2015/848 on Insolvency Proceedings (hereinafter - Regulation 2015/848) was adopted on 20 May 2015 to ensure uniformity of insolvency proceedings in the EU.²¹ 2015/848 Regulation shall apply to the public collective proceedings, including interim proceedings, which are based on laws relating to insolvency and in which, for the purpose of rescue, adjustment of debt, reorganization or liquidation of the debtor's assets are controlled by an appointed insolvency practitioner, under the supervision of a court and enforcement measures are suspended.²²

The document establishing the basic principles and standards of insolvency legislation in the EU is Directive 2019/1023 of 20 June 2019 on Preventive Restructuring Frameworks, on Discharge of Debt and Disqualifications, and on Measures to Increase the Efficiency of Procedures Concerning Restructuring, Insolvency and Discharge of Debt, and Amending Directive (EU) 2017/1132 (Directive on restructuring and insolvency) (hereinafter - Directive 2019/1023).²³

²⁰ *Ibid.* pg. 60

²¹ REGULATION (EU) 2015/848 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 20 May 2015 on insolvency proceedings, available at: <https://bit.ly/2MtFI4f>, last access on February 1, 2021.

²² Regulation 2015/848, Article 1.

²³ DIRECTIVE (EU) 2019/1023 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive

Directive 2019/1023 does not apply to natural persons who are not engaged in entrepreneurial activities.²⁴ However, Member States are empowered to extend it to non-entrepreneurial natural persons the same debt discharge procedures as are available to entrepreneurs under Directive 2019/1023.²⁵

According to Directive 2019/1023, entrepreneurial natural persons are individuals engaged in trade, business, craft or professional activities.²⁶ Debt discharge procedure envisions preclusion of enforcement against the entrepreneurs on their outstanding dischargeable debts or cancellation of those outstanding dischargeable debts after the approval of realization of assets and/or a repayment plan.²⁷

In the context of establishing more efficient and flexible procedures for the survival of businesses in the EU and for giving a second chance, one of the goals of adopting Directive 2019/1023 was also a unification of the heterogeneous practices in the Member States regarding the debt discharge of entrepreneurial natural persons. Debt discharge period from one to ten years and condition of partial payment was assessed as an inadequate protection mechanism for entrepreneurial natural persons. Accordingly, by Directive 2019/1023, the maximum debt relief period for honest entrepreneurial natural persons was set at 3 years and various mechanisms have been established to prevent abuse of power.²⁸

(EU) 2017/1132 (Directive on restructuring and insolvency), available at: <https://bit.ly/3pJu0Rw>, last access on February 1, 2021.

²⁴ Directive 2019/1023, Article 1.2(h).

²⁵ Directive 2019/1023, Article 1.4.

²⁶ Directive 2019/1023, Article 2.1(9).

²⁷ Directive 2019/1023, Article 2.1(10).

²⁸ Jourová, Věra, *Early restructuring and a second chance for entrepreneurs. A modern and streamlined approach to business insolvency. Factsheet*, June 2019, p. 4, available at: <https://bit.ly/3tb74fn>, last access on February 1, 2021.

To achieve the objectives of the present study, a detailed analysis of the regulatory framework of the three jurisdictions, Lithuania, England and Wales, and Poland was carried out.

2.3. The Lithuanian Experience

The main legal act regulating personal insolvency in Lithuania is the Law on Personal Bankruptcy of May 10, 2012 (hereinafter - Lithuanian Law on Personal Bankruptcy).²⁹

The Law on Personal Bankruptcy of Lithuania applies to natural persons, including farmers and natural persons pursuing individual activity.³⁰ Entrepreneurial natural persons registered as Individual Entrepreneurs as well as other commercial Legal Entities are subject to the Law on Enterprise Bankruptcy (hereinafter -Lithuanian Law on Enterprise Bankruptcy).³¹

Insolvency of entrepreneurial natural persons

Entrepreneurial natural persons in Lithuania are subject to the same insolvency regime as legal entities engaged in entrepreneurial activity. According to the Lithuanian Law on Enterprise Bankruptcy, the bankruptcy procedure involves appointment of an enterprise liquidator, the conclusion of a settlement between the creditors and the debtor, the reorganization or rehabilitation of the enterprise with the aim of avoiding bankruptcy, as well as the liquidation of insolvent enterprises.³²

²⁹ The law of the Republic of Lithuania on Personal Bankruptcy, of May 10 =, 2012, XI-2000, available at: <https://bit.ly/3pXCQf>, access was made on February 1, 2021.

³⁰ The Law on Personal Bankruptcy of Lithuania, Article 1.

³¹ Republic of Lithuania Law on Enterprise Bankruptcy, September 15, 1992, 1-2880, Article 1, available at: <https://bit.ly/3qr4Wyc>, last access on February 1, 2021.

³² *Ibid.* Article 2.

Prerequisites for initiating insolvency proceedings

Entrepreneurial natural persons have the authority to initiate insolvency proceedings:³³

- Creditors, if the debtor's liabilities exceed the debtor's assets, after the expiration of a specified period for the payment of the debt or, in the absence of such a period, after 3 months from the submission of the payment claim;
- Creditors, if the debtor improperly manages the assets (free transfer, sale at a low price) or other action is taken that poses a risk that the creditors' claims will not be satisfied by the debtor's assets;
- Debtor, if there is insolvency or an expected insolvency, or if the amount of assets is not sufficient to cover the liabilities.

Insolvency proceedings

Initiation of insolvency proceedings involves:³⁴

- Extending the moratorium on the debtor;
- Informing creditors;
- Appointment of a liquidator;
- Notification of the prohibition of termination of employment;
- Consultation of the debtor on the possibility of rehabilitation with the relevant responsible authority.

Consequences of insolvency proceedings

Insolvency proceedings may be completed:

- By reorganization of the debtor, which involves dividing and redistributing the business according to an approved reorganization plan;³⁵

³³ *Ibid.* Article 3.

³⁴ *Ibid.* Article 6.

- By rehabilitation of the debtor, which involves taking various administrative, economic and financial measures in accordance with an approved rehabilitation plan to avoid business bankruptcy and to satisfy creditors;³⁶
- By liquidation of the debtor, after the full or partial satisfaction of the creditors' claims as a result of the realization of the debtor's property.³⁷

Insolvency of non-entrepreneurial natural persons

Prerequisites for initiating insolvency proceedings

In Lithuania, insolvent good faith natural persons may benefit from the insolvency regime. According to the Lithuanian Law on Enterprise Bankruptcy, the purpose of the law is to restore the solvency of individuals who act in good faith to ensure a fair balance between the interests of the debtor and his creditors.³⁸ The good faith is an essential element that entitles natural person to enjoy a special insolvency regime. Accordingly, the Lithuanian Law on Personal Bankruptcy provides for various cases of termination of insolvency proceedings for a dishonest debtor, for example, the presence of alcoholism or drug addiction as a determinant of insolvency.³⁹

³⁵ *Ibid.* Article 20.

³⁶ *Ibid.* Article 22.

³⁷ *Ibid.* Article 27.

³⁸ The Law on Personal Bankruptcy of Lithuania, Article 1.

³⁹ Tamosiuniene, Egidija, Terebeiza Zilvinas, Bolzanas, Darius, *Bankruptcy of Natural Persons in Lithuania: Issues and Solutions*, *European Scientific Journal*, August 2013, Vol. 9, no. 22, pg. 78, available at: <https://bit.ly/3jbbaAb>, last access on February 1, 2021.

An individual may initiate insolvency proceedings if he/she is unable to fulfill his/her overdue obligations, amount of which 25 times exceeds the minimum monthly wage approved by the Lithuanian government.⁴⁰

The law defines a comprehensive list of cases when the court has the power to refuse the natural person to initiate bankruptcy proceedings. Such circumstances include cases where the cause of insolvency has become the debtor's alcoholism, drug addiction, gambling, the debtor has committed a certain crime under the criminal code, less than ten years have elapsed since the completion of the debtor's previous insolvency procedure, etc.⁴¹

Insolvency proceedings

According to the Lithuanian Law on Personal Bankruptcy, only the debtor has the authority to initiate insolvency proceedings, which includes the following stages:

- The debtor files an application in the court;
- The debtor notifies the creditors of the commencement of the proceedings;
- If necessary, the debtor nominates a bankruptcy trustee or the court appoints a trustee nominated by the relevant authority;
- The court publishes information on the public website no later than 1 day after receiving the application and sends a notification on the seizure of the debtor's assets to the relevant institutions;
- A court decision to refuse an application may be appealed to a higher court.

The law provides for a simplified insolvency procedure in case the debt repayment plan is agreed in advance and approved by all creditors

⁴⁰ The Law on Personal Bankruptcy of Lithuania, Article 2.2. According to 2020 data, the monthly minimum wage in Lithuania was set at 604 EUR, available at: <https://bit.ly/36txWoe>, last access on February 1, 2021.

⁴¹ The Law on Personal Bankruptcy of Lithuania, Article 5.

whose amount of claims exceeds more than half of the number of claims in creditor groups.⁴²

The law determines the procedure for the sale of the debtor's assets during insolvency proceedings. The realization of assets is carried out in accordance with the plan approved through the public auction. However, at the same time, at the request of the creditors and after the approval by the creditors' meeting, it is possible to transfer the unrealized assets to the creditors.⁴³

Exceptions to the general rule of an asset alienation is laid down for certain categories of assets. For example, if a natural person lives with his/her under age children or other persons under his/her care, the only dwelling may be sold only 6 months after the plan is approved. During this period of time, the debtor must secure the purchase or rental of alternative accommodation. Alienation of shares and other securities, if the buyer is not another shareholder of the relevant company, is allowed at a public auction. The alienation of precious metals and stones must be carried out in accordance with the rules established by the code of civil procedure. The Ministry of Culture of Lithuania shall be notified of the alienation of assets of historical, scientific, or artistic value. Alienation of radioactive substances, equipment containing radioactive substances, and generators with ion radiation are allowed in accordance with the rules established by the special law.⁴⁴

The secured creditor is entitled to request the alienation of the encumbered property and satisfaction the secured claim from the proceeds of the sale. In case of inability to sell the encumbered property, the secured creditor is entitled to request the transfer of the encumbered property to his ownership. As a result of the realization of the debtor's property, the claims of the secured creditors must firstly be satisfied.⁴⁵

⁴² *Ibid.* Article 9.

⁴³ *Ibid.* Article 27.

⁴⁴ *Ibid.* Article 28.

⁴⁵ *Ibid.* Article 29.

From unsecured creditors, claims arising from employment, income tax, state social security and health insurance contributions, physical or other injuries, deaths, occupational diseases, workplace accidents, and alimony must be met. Bankruptcy proceedings are terminated upon the submission of a certificate of satisfaction of all creditors to the court by the bankruptcy trustee.

The court shall decide to close the case if there is one of the following grounds prescribed by the law: all creditors are satisfied ahead of the schedule; the bankruptcy trustee submits to the court evidence that the debtor will be able to fulfill his/her obligations in the future; all creditors waive their claims.⁴⁶

Consequences of completion of insolvency proceedings

Upon completion of the insolvency procedure, all unsatisfactory claims under the solvency restoration plan (which should not exceed 3 years)⁴⁷ are subject to write-off and the creditors lose the right to satisfy the relevant claims.

Only the following categories of claims are not subject to write-off: compensation for damage caused by physical injury, alimony, state fines for administrative offenses or criminal offenses; compensation for damage caused by committing a criminal offense; reimbursement of the secured claim if the subject of the collateral was not alienated during the insolvency proceedings.⁴⁸

⁴⁶ *Ibid.* Article 30.

⁴⁷ *Ibid.* Article 7.5.

⁴⁸ European Union, *European Justice Network, Insolvency - Lithuania*, available at: <https://bit.ly/39EtGxX>, last access on February 1, 2021.

2.4. Experience of England and Wales

Insolvency legislation for individuals in England and Wales is based on approaches that are different from Lithuanian ones. The importance of the legislation of England and Wales in assessing the issue of regulation of personal insolvency in Georgia is determined by the fact that, the Law on Rehabilitation and Collective Satisfaction of Creditors, which is a new regulation of corporate insolvency is largely based on the experience of England and Wales, in particular, the encouragement of extrajudicial proceedings by legitimizing the notion of a regulated agreement.⁴⁹

In England and Wales, insolvency issues of individuals are regulated by the Insolvency Act 1986 (hereinafter - English Insolvency Act).⁵⁰ English Insolvency Act envisages three procedures for overcoming the personal insolvency: Individual Voluntary Agreement (hereinafter - IVA), Debt Relief Order (hereinafter - DRO) and bankruptcy.

DRO and bankruptcy proceedings imply procedures precisely defined by the law for a debt relief of individuals, as for IVA, it depends on the terms agreed upon as a result of negotiations between the debtor and the creditors. Individual entrepreneurs acting under the status of Sole Traders, are entitled to use the English Insolvency Act in accordance with the procedures established for individuals.

Any of these personal insolvency proceedings may be initiated by an insolvent individual or creditor if the debt owed to them is at least £5,000.⁵¹

⁴⁹ *Parliament of Georgia, Explanatory Card on the Draft Law of Georgia on Rehabilitation and Collective Satisfaction of Creditors*, March 20, 2020, pg. 7, available at: <https://bit.ly/3tcR6lr>, last access on February 1, 2021.

⁵⁰ Insolvency Act 1986, available at: <https://bit.ly/3j5pkmq>, last access on February 1, 2021.

⁵¹ European Union, *E-Justice Portal, England and Wales – Insolvency*, paragraph 2, available at: <https://bit.ly/3oHIVLW>, last access on February 1, 2021.

DRO

The DRO has been established as an alternative to traditional bankruptcy proceedings in England and Wales since 2006 and is intended for debtors with low income and small assets.

The process of bankruptcy, in turn, is a complex process that requires an appointment of a bankruptcy trustee and the realization of assets. The above is related to procedural costs, which can often be hard to afford by individuals.⁵²

The individual who is unable or will not be able to pay debts of the relevant categories is entitled to request DRO. DRO does not include secured debts.⁵³ The DRO is requested through specially authorized intermediaries, who hand over the case to the official administrator who makes the decision to issue the DRO.

Prerequisites for DRO Request

To apply for a DRO, an application must meet the following criteria:⁵⁴

- The amount of the debt should not exceed £20,000;
- Individuals should not be left with more than £ 50 per month after paying taxes, national insurance, and ordinary household expenses;
- The person must have experience working in England or Wales in the last 3 years;
- The value of the assets should not exceed £1,000;
- The person should not have not received a DRO in the last six years.

⁵² The Insolvency Service, *Insolvency Proceedings: Debt relief orders and the bankruptcy petition limit. Call for evidence*, Chapter 2, available at: <https://bit.ly/39yiAtX>, last access on February 1, 2021.

⁵³ English Insolvency Act, Section 215A.

⁵⁴ European Union, *E-Justice Portal, England and Wales – Insolvency*, paragraph 3, available at: <https://bit.ly/2MiVAGA>, last access on February 1, 2021.

The results of DRO issuance

Within 12 months of receiving the DRO, the debtor is discharged from the obligation to pay the debts. The exemption does not apply to the following obligations: alimony, student loan, social fund loans, secured loans, penalties imposed for drug offenses, obligation to pay damages or, a fine imposed by the court, unpaid television license fee, and debts incurred after receiving the DRO. After receiving the DRO, the debtor is subject to a number of business restrictions, both in terms of employment and relationship with the administrator. After the expiration of the DRO, the debts covered by it are subject to write-off.⁵⁵

Bankruptcy

Prerequisites for initiating bankruptcy proceedings

According to English Insolvency Act, both the debtor and the creditor are entitled to initiate bankruptcy proceedings.

The creditor is entitled to apply to the court and claim bankruptcy of the debtor if:⁵⁶

- His/her claim exceeds £5,000;
- The debt arises from a court decision on criminal bankruptcy and is not secured;
- The debtor has no opportunity or reasonable prospect to pay the debt;
- There is no claim for cancellation of the claim filed by the creditor with the debtor about a reasonable prospect of payment;

The individual debtor is entitled to apply to the insolvency adjudicator and request bankruptcy only if he/she is unable to pay the debts.⁵⁷ The

⁵⁵ The Insolvency Service, *Guidance on Getting a Debt Relief Order*, <https://bit.ly/3pwXy4C>, last access on February 1, 2021.

⁵⁶ English Insolvency Act, Section 267.

⁵⁷ *Ibid.* Section 263H.

debtor is entitled to appeal the decision of the insolvency adjudicator on refusal of bankruptcy in court.⁵⁸

Consequences of Completion of the Bankruptcy Procedure

A natural person who has been declared bankrupt is released from debts after 1 year from the date of the decision. The court is authorized to suspend the flow of the said 1-year period until a certain condition is met if it is established that the debtor has violated the requirements of the law. In case of criminal bankruptcy, debt discharge may be requested only after 5 years.⁵⁹

Debt discharge does not apply to:⁶⁰

- The obligations related to bankruptcy administration;
- The right of the secured creditor to satisfy its claim by the realization of the collateral;
- Claims arising out of fraud or fraudulent breach of trust;
- Administrative fines;
- Liability for damages for negligence, tort or violation of the law, contract, or other responsibility, or due to physical injury;
- The compensation imposed in family disputes and other exceptional cases.

Legislation allows an individual to maintain "exceptional assets" (daily living items, tools, a car if needed to go to work), a reasonable portion of their monthly income to live, and so on. For the initiation of bankruptcy proceeding, payment of an bankruptcy fee £ 680 is necessary.⁶¹

⁵⁸ *Ibid.* Section 263N.

⁵⁹ *Ibid.* Sections 279, 280.

⁶⁰ *Ibid.* Section 281.

⁶¹ The Insolvency Service, *Guidance on Getting a Debt Relief Order*, available at: <https://bit.ly/2Mkr6Eg>, last access on February 1, 2021.

IVA

One of the main hallmarks of the insolvency proceedings in England is the IVA system, which has been an important mechanism of consumer insolvency since 2000.

Prerequisites for obtaining IVA

IVA is an out-of-court settlement agreement, which the debtor concludes with the creditors on debt restructuring. Consequently, unlike the DRO and the initiation of an bankruptcy case, the execution of the IVA depends on:⁶²

- The debtor's ability to repay a certain portion of the debts over a specified period;
- The debtor's ability to substantiate the possibility of receiving a future regular income.

IVA Execution Procedure

A debtor who intends to submit an IVA proposal to a creditor is entitled, through the person nominated in the proposal, who must be an insolvency specialist, to request an interim measure from the court to declare a moratorium.⁶³

Within the time limit set by the interim measure, the person nominated in the proposal shall submit to the court a report in which the person expresses opinion as to whether there is a reasonable prospect of approval and execution of the proposal and how creditors should consider the offer. Based on the nominee's report, the court makes a decision to cancel the measure or to extend its validity.⁶⁴

⁶² Gov.uk, *Options for paying off your debts*, available at: <https://bit.ly/2Md81UF>, accessed on February 1, 2021.

⁶³ English Insolvency Act, Sections 252, 253.

⁶⁴ *Ibid.* Section 256.

If, according to the nominee, reviewing the IVA proposal by the creditors is advisable, the nominee shall notify all creditors of the IVA proposal at least 14 days prior to the date of the decision. Approval of the IVA requires the consent of creditors whose debt amounts to at least 75% of the total debt. The English Insolvency Act sets out the circumstances that prevent IVA approval, including the protection of secured creditors. The creditors are not authorized to approve IVA, if the priority of satisfaction of claims or other special rights of the secured creditor in relation to the secured claim is violated.⁶⁵

Consequences of Conclusion of IVA

Upon approval of the IVA by the creditors, on the basis of a notification, sent to the court by the nominee, the IVA becomes binding to all creditors, including those who disagreed with the IVA or did not participate in the IVA hearing. The English Insolvency Act provides for the right of interested parties, including uninformed creditors, to challenge the IVA if, for example, the notification rule has been violated.

The terms of the IVA are usually valid for 5-6 years when the debtor makes regular payments to the creditors.⁶⁶ The performance of the obligations by the debtor under IVA is overseen by the nominee. Deadline for the fulfillment of the obligations, rules, measures to be taken in case of violation and expiration consequences are determined by the IVA. However, as a rule, the terms of the IVA include the agreement of the parties, according to which the nominee is obliged to apply to the court to initiate bankruptcy proceedings in case of violation of the IVA. The rules for the realization of its claims by the secured creditors also depend on the terms of the IVA. As a rule, the secured creditors refuse to

⁶⁵ *Ibid.* Section 258.

⁶⁶ European Union, *E-Justice Portal, England and Wales – Insolvency*, available at: <https://bit.ly/3aovIRR>, last access on February 1, 2021. Spooner, Joseph, *Explaining Personal Insolvency and the Law*, 29 July, 2020, available at: <https://bit.ly/3cyMAIp>, last access on February 1, 2021.

initiate legal proceedings against the debtor in accordance with IVA, however, reserves the right to exercise its rights in accordance with the legislation in force on the subject of collateral.⁶⁷

2.5. Polish experience

Insolvency issues in Poland are regulated by two pieces of legislation: Bankruptcy Law of February 28, 2003 (hereinafter - Polish Bankruptcy Law) and Restructuring Law of May 15, 2015 (hereinafter - Polish Restructuring Law). Polish Bankruptcy Law regulates the liquidation process caused by insolvency and is available to both, entrepreneurs and non-entrepreneur natural persons, and Polish Restructuring Law regulates procedures initiated due to insolvency risk and applies only to entrepreneurs.⁶⁸

Restructuring

The restructuring proceeding may be initiated in case of insolvency or in case of such an economic situation, that indicates the emergence of insolvency in a short period of time.

Polish restructuring legislation, which applies to entrepreneurs, including natural persons carrying out economic activities define three types of proceedings:

- Approval of a Private Arrangement - If the amount of disputable liabilities (obligations) to be repaid by the debtor does not exceed 15% of the total sum of the liabilities (obligations), the debtor, with the involvement of the restructuring supervisor enters into an

⁶⁷ LexisNexis, *Individual Voluntary Arrangements – Overview*, available at: <https://bit.ly/2OBKIKr>, last access on February 1, 2021.

⁶⁸ European Union, *E-Justice Portal, Poland*, available at: <https://bit.ly/3aiKODq>, last access on February 1, 2021.

agreement with the creditors and submits it to the court for approval;

- Summary Arrangement Proceedings - If the sum of disputable liabilities (obligations) does not exceed 15% of the total sum of the liabilities (obligations). After the list of liabilities has been made, the arrangement is approved by the court;
- Regular Arrangement Proceedings – If the sum of the disputable liabilities (obligations) exceeds 15% of the total sum of the liabilities (obligations) more complex restructuring proceedings are conducted, in which individual liabilities may be disputed by the debtor.⁶⁹

Bankruptcy

Unlike restructuring, no arrangement can be reached in the event of bankruptcy. The purpose of bankruptcy is the satisfaction of creditors by realizing the debtor's property.⁷⁰

Prerequisites for bankruptcy

Bankruptcy is possible only in case of insolvency. It should be noted that in the event of bankruptcy and insolvency claims against the same debtor, the court will primarily consider an application for restructuring, except for special cases provided by the law.⁷¹

Bankruptcy proceedings

As a result of the reform of bankruptcy legislation, an arranged liquidation procedure was introduced in Poland when the debtor is looking for

⁶⁹ Polish Investment & Trade Agency, *Bankruptcy law and restructuring proceedings*, pp. 2-3, available at: <https://bit.ly/3jfKXkd>, last access on February 1, 2021.

⁷⁰ *Ibid.* pg. 3.

⁷¹ *Ibid.* pg. 5-6.

an entity interested in acquiring the entire or essentially entire business, and requests the court for approval. The court is obliged to approve the arrangement if the proposed price exceeds the amount that would normally be available in the event of liquidation of the debtor.⁷²

In Poland, there is a special bankruptcy regime for consumers, that may be initiated by the natural persons who are not carrying out commercial activities and also, by the natural persons operating an agricultural farm.⁷³ Bankruptcy may be initiated by natural persons who are insolvent i.e. unable to meet overdue financial obligations and if they have more than one creditor. The grounds for rejecting the application for bankruptcy are cases where the insolvency was not caused by special events beyond the control of the debtor. Such cases include liabilities incurred after insolvency or if the termination of employment was caused by the debtor's cause or by the mutual agreement. A ground for refusing a bankruptcy claim is if, within ten years prior to the filing of an application, bankruptcy, or other procedure has already been instituted against the debtor by writing off the obligations or reaching an agreement; in case of non-fulfillment of the obligation by the debtor after the completion of the procedure with the satisfaction of all creditors; bankruptcy proceeding was terminated except for the case when termination was done at the request of all creditors; action against the interests of creditor was taken.⁷⁴

Only the debtor may initiate the consumer bankruptcy and unlike an entrepreneur, non-entrepreneur debtor has no obligation to initiate bankruptcy in the event of insolvency. The court refuses to accept the bankruptcy application if the debtor's property is not sufficient to cover the costs of the proceedings. After receiving the application, the court

⁷² *Ibid.* pg. 8.

⁷³ Adamus, Rafal, *Consumer Bankruptcy in Poland*, International and Comparative Law Review, 2011, Vol. 11, no. 2, pg. 95, available at: <https://bit.ly/36ukRoi>, last access on February 1, 2021.

⁷⁴ *Ibid.* pg. 97.

applies various measures to protect the debtor's property, which may be manifested by an appointment of an administrator or other action.⁷⁵

Consequences of admitting the application of bankruptcy

Admission of a bankruptcy application has the following legal results as defined by the law:

- The monetary obligations, which are not yet due shall become due;
- Non-monetary obligations shall be converted into monetary obligations;
- Accrual of interest shall be stopped;
- Enforcement and other procedures are suspended;
- The court receives information from the tax authorities about the tax activities declared by the debtor during the last five years.⁷⁶

Consequences of bankruptcy procedure

After approving the asset distribution plan, the court approves the creditors' repayment plan to cover the debtor's liabilities that are not covered under the asset distribution plan. The timeframe of this plan should not exceed a period of 3 years. A bankrupt person is not entitled to take any obligations during the term of the payment plan, except the bankrupt may incur obligations necessary to support oneself and the persons with regard to whom the bankrupt is under a statutory obligation to support. Amending the plan is possible by taking into account changes in the debtor's economic situation. After performing all the obligations

⁷⁵ *Ibid.* pg. 99.

⁷⁶ *Ibid.* pg. 100-102.

under the repayment plan the court shall issue a ruling on the discharge of the unsatisfied obligations to ensure “a fresh start”.⁷⁷

⁷⁷ *Ibid.* pg. 104-106

Chapter III. Overview of the interviews conducted with the representatives of stakeholders on the need for regulatory intervention and expectations on the issue of personal insolvency in Georgia

3.1. Selection of the respondents and format of the interviews

As part of the feasibility study, the attitudes and expectations of various stakeholders in Georgia regarding the introduction of a new legal regime for personal insolvency was studied.

Representatives of the various financial institutions (banks and micro-finance organizations), the Ministry of Finance, the Revenue Service, the National Bureau of Enforcement and private debt collection companies were selected as respondents; 3 respondents were representatives of the Ministry of Finance and the Revenue Service (heads of departments and services); 1 respondent - a debt-collecting private company (company owner), 1 - representative of a microfinance organization (head of the organization), 7 - banks (managers of problem loans and legal departments), and 3 – the representatives of the National Bureau of Enforcement (insolvency case managers).

The focus group of the respondents was selected considering the fact that the new regulation will affect mostly financial institutions and the Revenue Service, while the National Bureau of Enforcement and private debt collection companies have practical experience that may be taken into account while drafting the legislation.

The average duration of the interviews was 1 hour.

The questionnaire consisted of three parts. The first part examined the information that the respondent had about the personal insolvency and the policy of the state in the direction of debt write-off and solving the problem of high-debt. The second part of the questionnaire was regarding the respondent's experience with regard to problem debts, and in the third part, we discussed the respondents' views on various issues of the personal insolvency proceedings. This set of issues in the questionnaire helped us to explore attitudes and expectations, as well as helped to identify problems that would allow us to think about the ways to address them. Ultimately, the results obtained should help us to elaborate appropriate legislation for Georgia's economic and social environment.

3.2. Summary of the results

Summarizing positions of the respondents revealed that:

- In general, the problem of personal insolvency is well known. It has been revealed that in practice there are frequent cases when natural persons fail to pay their overdue debts, which in turn has a negative impact on both the economy in general and their daily lives. Accordingly, the need to return such persons to civil turnover is on the agenda. For a debtor who is honest, but fails to fulfill his obligations, there must be safeguard mechanisms. However, while regulating the issue of personal insolvency, the risks and threats that may arise from the introduction of this system must be taken into consideration. It is important that the legislation not have a negative impact on consumer's behavior and not allow him/her to abuse the law. According to the respondents, it is also important that the new law is predictable and the deadlines are precisely spelled out.
- A visible example of changing the behavior of natural persons became a one-time measure of debt write-off by the state in 2018,

the aim of which was a reduction of high-debt. Such a step on the part of the state led to a misperception of the debtors and as a result, had a negative impact not only on dishonest but also on honest individuals. There was an expectation in the society that such events on the part of the state would be systematic. As a result, it may be said that one-time measures usually do not have a long-term effect and put large financial institutions in a worse position. In general, in this regard, according to all respondents, there is very low awareness and a lack of information among the population.

- As a result of various regulatory measures taken by the government to date, too many people have been left without a loan product, which again benefited private lenders. It is right that commercial banks are increasingly rarely using the method of realization of immovable property to cover overdue debts, however, this method is still relevant for private lenders. Therefore, the interests of commercial banks should be taken into account when introducing the personal insolvency system. There is no doubt about the need for a personal insolvency system, but it is important that this system is formed with the right segmentation and the right policies.
- The responsible crediting system of individuals has led to the freezing of issuing credits, because a very large number of citizens in the country do not have officially confirmed income.
- Developing a personal insolvency system is a very complicated and complex process.
- There is a little information about the insolvency systems of individuals in other countries, in-depth research is therefore needed to examine existing systems and identify the best approaches.

3.3. The need for the regulation

The survey on the experience of the respondents showed that:

- All financial institutions have internal debt collection policies and mechanisms. These mechanisms are used before going to the court, starting with relatively light methods and gradually becoming more complicated, as in terms of attitude towards the debt, also in terms of resource utilization.⁷⁸ The stages and approaches of negotiating and debt restructuring with natural persons vary slightly across different financial institutions:
 - a. Priority is given to the negotiations after the first notice of payment of the debt is sent;
 - b. The restructuring plan is made in the form of debt distribution. Accrued fines are generally forgiven;
 - c. The term of a new payment schedule, on average, is 5-7 years; Experience has shown that the real collection period is 3-5 years. If the debtor fails or does not repay the overdue debt within this period, it is considered that there is an inappropriate spending of resources.
 - d. Proper mechanisms for finding property are not available for various institutions, which, in turn, pose many practical problems. Monitoring the change in the financial condition of the debtor is possible only on the registered property and on the income accrued on the bank accounts (in most cases, income is hidden, property is re-registered, and money remittances are not controlled at all);
 - e. Practice shows natural persons are frequently kept debtors' registry. Creditors pay the annual fee for registering the debtor in the debtors' registry hoping that the income will appear;

⁷⁸ So called soft collections and hard collections: various actions taken by the creditor to repay the debt, which in the first stage (soft collections) include sending short text messages, phone calls, e-mail reminders, providing with the debt acknowledgment letter draft, etc. As for the next stage (hard collections), it includes the court stage and enforcement procedures.

- f. An extreme mechanism for repaying overdue debt is putting a dwelling up for an auction. This is especially problematic in the regions and villages due to the close connection of the local population with each other. Having immovable property acquired at auction or directly from the debtor on balance sheet is an additional burden for the financial institutions themselves. In practice, there are frequent cases of the return of property purchased on the basis of a repurchase agreement with the owner, for which in many cases an additional low-interest loan is issued.
- g. Although respondents do not produce annual debt collection statistics, according to the oral assessment, on average, about 20-25% of the total amount is collected at periods of 5-7, 7-10 years.
- h. Honest debtors always try to negotiate and pay off debt with the help of various mechanisms. As for dishonest debtors, they may even have financial resources, but in various ways are avoiding fulfillment of their obligations.
- j. A large portion of restructured loans, over time, becomes a problem loan.
 - A similar mechanism of the personal insolvency system exists both in the Ministry of Finance and in the Revenue Service. The policies of these agencies are relatively soft and familiar with the so-called tools of debt write-off and individual schedules. Tax amnesty is also announced periodically. From the interviews with the Revenue Service we can highlight the following issues:
- a. There are several mechanisms in the Tax Code for managing accumulated liabilities: 1) Distribution of overdue debt according to the schedule. According to the Code, this term is three years. However, in practice, a one-year term is usually used, while maintaining the possibility of applying coercive measures. 2) Tax agreement - in practice, most of the filed applications, regarding tax agreements are satisfied. The agreement usually deals with part of the taxes and its payment schedule is one year (so-called base amount) (fines and sanctions are removed). There is an exception

to this rule when the agreement relates not to the entire debt but only to a reasonable amount. 3) Debt write-off - this tool is used when the debtor does not own any property. The use of this tool is rare in practice, since it is related with a thorough examination of the debtor's property. Information about the debtor's property may not be available to the tax authority, which naturally makes it difficult to use the debt write-off tool against such a debtor. 4) Tax amnesty - the purpose of this tool is to write off overdue debts from the inactive payers. Amnesty mainly covers cases where debt relief in fact is without prospect and when the debtor is not carrying out an economic activity for the last two or three years.

- b. For debts over 300 GEL, encashment is placed on the bank accounts. In practice, the only house is not being sold, and consequently, considering current enforcement practices, the person maintains the minimum living conditions.
- c. Tax agreement - this is the most flexible instrument since it does not require additional conditions and is entirely at the discretion of the parties. Despite the fact that the tax agreement instrument works best in the practice, it is also often misused in the form of debt accumulation or diversion of the property. This is the case when the debtor owns the property, has income, but tries to evade the payment of obligations with dishonest intent, by concluding a tax agreement. In practice, it is also common to apply for a tax agreement several times, which, in turn, negatively affects the effectiveness of this tool itself. It turns out that a certain category of debtors by the tax agreement constantly enjoys benefits, while taxpayers who are constantly paying taxes on times, who may, to some extent, even be their competitors, remain on an unequal condition on the part of the state.
- d. In case of personal insolvency, if debts are written off based on the court decision, and then the tax authority will see that this person

has become economically active and has generated income, this will lead to some sense of injustice;

- Both, financial institutions and the Revenue Service generally feel comfortable within the procedures established for their activities and do not see the need for other mechanisms of debt distribution or forgiveness;
- According to the existing practice of banks, individual entrepreneurs use the insolvency process to stop the accrual of interest and to delay the court cases. They note that none of the court cases started so far have been completed and no separation of responsibilities are taking place in the process.
- According to the representatives of the National Bureau of Enforcement, individuals, if they do not experience any discomfort, mainly remain in the enforcement process and do not apply for insolvency. Discomfort can be a threat of selling a house. In this case, in recent practice, individuals are registered as individual entrepreneurs and even though, their obligations do not arise as individual entrepreneurs, they still, try to use insolvency proceedings of the individual entrepreneur in order to stop the enforcement process.
- Financial institutions have an obligation to reserve the relevant amounts of non-performing loans in the National Bank of Georgia. Different percentages of the loan amount are reserved at different stages of the loan problems, and if the case goes to court, the reservation is subject to 100% of the problem loan. Consequently, financial institutions initially prefer to use their own mechanisms and go to court only in extreme cases. Initiating insolvency proceedings is equivalent to filing a lawsuit, which necessitates reserving funds from the outset. Added to this is the risk that both the debtor and the other creditor may initiate insolvency proceedings, therefore, financial institutions will find it difficult to control the policy of reserving funds.

- However, creating a legal framework for personal insolvency is very important to promote business and the free market. Leaving debtors in the process of long-term enforcement has no positive effect. A well-functioning insolvency system will establish better relations, more trust between the parties. It will be a more sustainable arrangement of this relationship and financial institutions will also be better able to defend themselves. Therefore, it is important to establish a uniform and fair policy towards bad debts, which will increase public confidence in financial institutions, but at the same time, the risks of abusing the system must be taken into account.
- The Association of Microfinance Organizations follows the ethical practice of loans and has a self-regulatory mechanism - the code of ethics. Their policy is mainly directed at reducing litigation, whereas, in cases of litigation, the issue of enforcement of court decisions is frequent in practice. Microfinance organizations operate mostly in the regions, where the realization of immovable property is associated with additional difficulties, creditors therefore prefer to withdraw even part of the claim from the debtor and then close the case.

3.4. Considerations on the regulatory framework

As we mentioned at the beginning, the main question of the respondents interviewed as part of the study is related to the question of where the line will be drawn between the abuse of the right and the effective use of this mechanism. Threats and doubts about the operation of the new system were revealed with all respondents; however, the following tendencies were shown to the questions we asked:

- It is better to deal with insolvency through rehabilitation and bankruptcy should be an extreme solution to a problem.⁷⁹ In practice, individual entrepreneurs were registered with the tax authority and initiated insolvency proceeding because they were looking for rehabilitation/distribution and the creditors were refusing.
- It will be good, if the procedure will not be oriented to just finalizing the case, by the realization of the debtor's assets. The Civil Code institute - sequestration, which implies the forced management of the property, may be used. Also, the debtor may be required to submit an initial plan with the application. It is desirable to avoid such an approach when the debtor refuses to pay the debt and does not actively participate in finding the solution out of the situation. In this regard, the promise of a bonus may yield good results. For example, promise to write off 20% of the debt in case of presenting a good plan (motivation, to maximize involvement in the process).
- The debtor should have the right to initiate the process, and the minimum amount of debt should be defined for the creditor to commence an insolvency proceeding.
- Repeated application of insolvency proceedings should be subject to specific restrictions, such as time limits. In the case of the individual entrepreneur, additionally, restriction of re-registration for a certain period.
- The most effective mechanism should be set up to identify honest but unlucky debtors. It is possible to create a registry with the history of insolvency, similar to the debtors' registry, where the reasons for insolvency will be described to give creditors the opportunity to assess the debtor's insolvency history based on human factors.
- As a result of the launch of the new system the behavior of debtors will be changed, as they will be given an opportunity to be re-

⁷⁹ Bankruptcy means selling property and writing off debts, while rehabilitation means defining a schedule.

leased from the debt and they will maximize efforts to pay the debt.

- Even after the plan is approved, the debtor's property and income should be periodically monitored in order to reveal the fact of increase in income or property and to adjust the plan accordingly.
- Distribution dates can be linked to the amount requested. In the event of a short term, the debtor may not disclose the property and achieve early release from debt by abusing the system. For example, similar to the enforcement proceedings - if the disputed subject is up to 2000 GEL, the case should be completed within two years and so on. The term can be extended up to four years if the interested creditors will pay an extra 2%. Those who pay will continue to benefit, those who do not - will lose the right to make a claim. This mechanism still works and after the expiration of the first term the creditor himself determines whether it is worth continuing the process.
- For a plan approved by the court acceptable will be 5 years on average.
- Public structures that administer the processes are not fully effective, so the involvement of private specialists would be more appropriate. For example, it has been revealed that a private enforcement officer is more motivated and efficient and in the period, when there were no restrictions on private enforcement officers, cases were mostly presented to them.
- The insolvency procedure of natural persons should be cheaper than enforcement, and, in this respect, the debtor may be exempted from the fee in the first instance on the condition of the payment from the property afterward.
- In the event of an insolvency proceeding being used by natural persons, it is likely that financial institutions will require additional guarantees when taking out new loans before they can still be trusted. It is the definition of this credibility that needs to be regulated and ensured by the legislative framework.

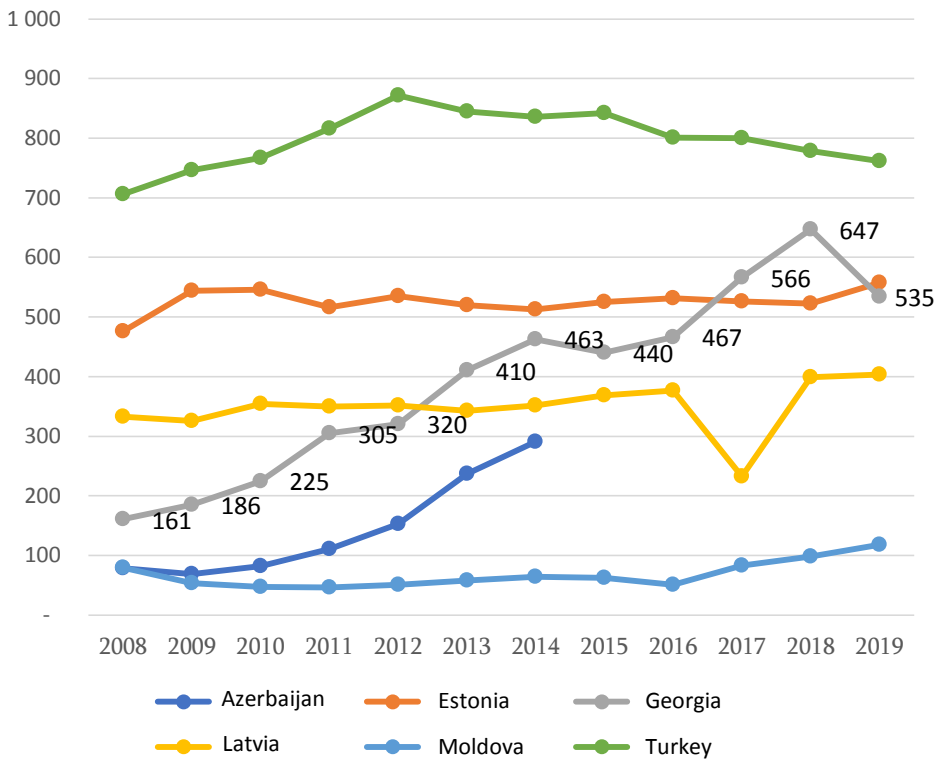
- The following types of debts may be restricted from writing off:
 - a. The claim arising out of a tort;
 - b. Alimony;
 - c. Dishonestly obtained loan;
 - d. Liabilities taken while being insolvent.

Chapter IV. Overview of economic indicators relevant to the elaboration of the legal regulation of personal insolvency

4.1. Financial analysis of households

Financial stability is one of the fundamental factors of the country's development, which, in its turn, does not only imply the financial stability of the banking sector. It is also important to assess and analyze the financial risks of households.

Chart 2. Number of debtors on average per 1,000 individuals



International Monetary Fund Data ⁸⁰ shows that the number of borrowers per 1,000 adults in Georgia in 2019 decreased compared to the previous year and amounted to 535 (in 2018 it was 647). It should be noted that including 2018, a growing trend of this indicator was observed. The indicator of Georgia on the graph is compared with the indicators of neighboring countries (unfortunately, the IMF database does not contain data on Armenia and Russia, Azerbaijan data has not been updated since 2014) and Baltic countries (EU member states with a Soviet past similar to Georgia).

The graph clearly shows that the average data in Turkey is much higher, but it is important that the Turkish data is stable and the growth rate in 2019 compared to 2008 was only 8%, whereas the same figure for Georgia is equal to 233%. Dynamics is also an important factor. The graph shows that the figure in Estonia in the period from 2008 to 2017 was higher than the data in Georgia, but the stability of the tendency must be taken into account. No sharp declines or ascents are observed in the Estonian curve trajectory. The International Monetary Fund data shows that the dynamics of borrowing by natural persons in Georgia is growing against the background of international data and requires in-depth analysis and study.

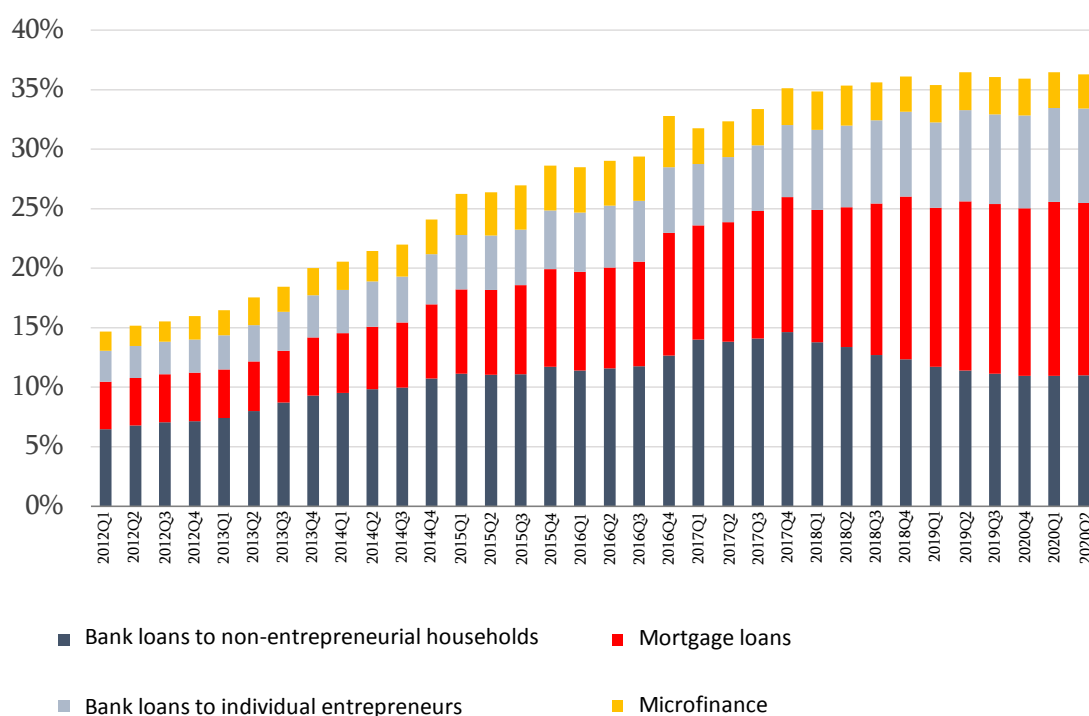
Since 2003, the Georgian economy became more active and the private sector has become more motivated to increase the scale of operations of existing businesses and also, to create new businesses. Consequently, the growing dynamics of the total balances of loans taken by natural persons since 2004 was noticeable, which amounted to GEL 3.2 billion at the beginning of 2012 ⁸¹ (14% of total GDP), and 17.2 billion at the end

⁸⁰ International Monetary Fund, *IMF Data, Access to Macroeconomic & Financial Data, Financial Access Survey (FAS) by Country*, available at: <https://bit.ly/2MkfMbf>, last access on February 1, 2021.

⁸¹ National Bank of Georgia, *Loans as per their Purpose*, available at: <https://bit.ly/3mc2Fq7>, last access on February 1, 2021.

of the second quarter of 2020 (37% of total GDP⁸²). NBG data also shows that household borrowing growth slowed down in 2020 due to the economic crisis caused by the pandemic. In general, it seems that the growth rate was the fastest in the direction of mortgages. In the first quarter of 2012, the share of mortgage loans in total loans was 4%, and in the second quarter of 2020 - 15%.⁸³

Chart 3. Debt ratio of households to GDP



National Bank of Georgia is considering the restriction of excess lending to the economy as one of the most powerful tools for maintaining finan-

⁸² Geostat, *Gross Domestic Product*, available at: <https://bit.ly/3cFOQx3>, last access on February 1, 2021.,

⁸³ National Bank of Georgia, *2020 Financial Stability Report*, pg. 29, available at: <https://bit.ly/3sIPwan>, last access on February 1, 2021.

cial stability as excess lending leads to an increase in systemic risks. It is also important that the restrictions not be drastic and not have a shock effect on the economy. The 2019 Financial Stability Report states that the responsible lending framework for natural persons, which was launched at the beginning of the year, reduces financial stability risks, is important but insufficient for the sustainability of the financial sector.⁸⁴

According to the data for the third quarter of 2020, 48% of loans to households are secured by residential real estate or commercial real estate. On average, every second insolvent natural person is at risk of losing the property. This figure indicates that stress is high for natural persons.

According to the Financial Stability Report of the National Bank of Georgia (Financial Stability Report 2019), as of December 31, 2018, more than 700,000 people had overdue loans, which restricts consumers' access to financial services and negatively affects the employment motivation of natural persons whose potential wages can only be used to pay off debt.⁸⁵

According to Geostat, the economically active population of Georgia, based on the data for the second quarter of 2020, is 1,526,900 people.⁸⁶ The financial stress of natural persons and, consequently, economic passivity has a negative impact on economic growth, which is a problem for the entire population.

4.2. Employment/unemployment and income/expense analysis

An important component of household risk assessment and analysis is the level of employment of individuals and the amount of income, as it

⁸⁴ The National Bank of Georgia, *Financial Stability Report 2020*, pg. 30, available at: <https://bit.ly/3aoYjX0>, last access on February 1, 2021.

⁸⁵ The National Bank of Georgia, *Financial Stability Report 2019*, pg. 28, available at: <https://bit.ly/2Mkv93q>, last access on February 1, 2021.

⁸⁶ Geostat, *Employment and Unemployment*, available at: <https://bit.ly/3ctMXUf>, last access on February 1, 2021.

all determines their solvency. According to the data for the second quarter of 2020, the unemployment rate in Georgia was 18.3%. These data were obviously affected by the economic constraints imposed due to the pandemic. According to the latest data for 2019, unemployment was 0.7% lower and was 17.6%.⁸⁷

According to the data of the second quarter of 2020, the average salary of an individual is 1,150 GEL⁸⁸ and the average household income is 1,175 GEL. Consequently, we may assume that there is an average of one person working in one family and the cost of maintaining the family is entirely on him/her. Consumer cash expenditures for one household amounts to 781 GEL⁸⁹ (consumer expenses include food, clothing, medical services, education, utility bills, etc.), which in turn, is 66% of the average income. Based on these data, we may assume that a natural person can pay only 34% of his income for loan servicing.

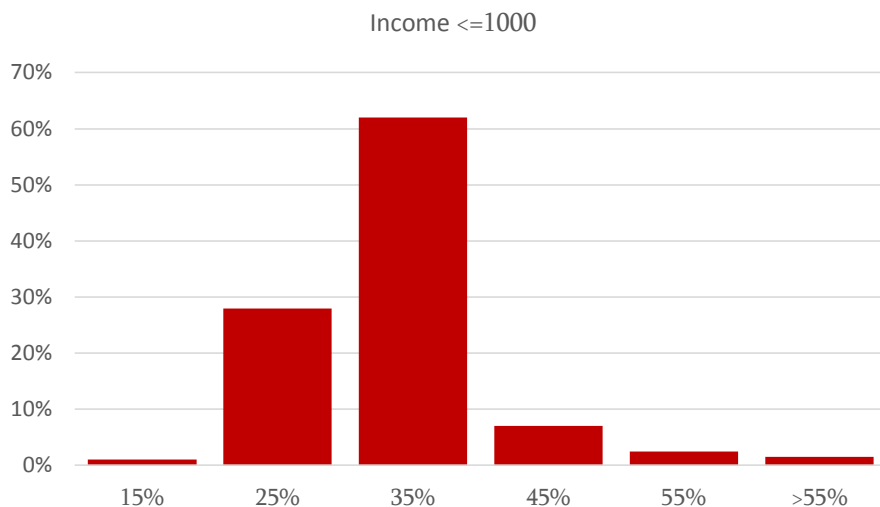
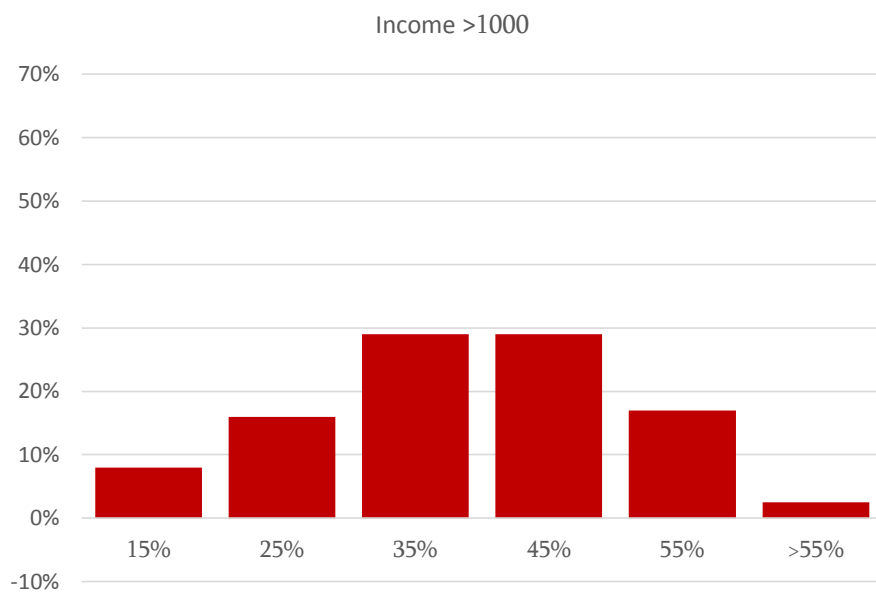
The Financial Stability Report (2020) of the National Bank of Georgia states, that as a result of the pandemic, the debt burden on households against the background of income has been increased. The three-month grace period only had an impact in the short term and eased the financial condition of natural persons for several months. PTI (Payment to Income Ratio) is an index that shows the ratio of payment for loan services to income. This index is calculated separately for high (income over 1,000 GEL) and low income (less than or equal to 1.000 GEL) natural persons separately.⁹⁰

⁸⁷ *Ibid.*

⁸⁸ Geostat, *Wages*, available at: <https://bit.ly/3r9uwZf>, last access on February 1, 2021.

⁸⁹ Geostat, *Household Expenses*, available at: <https://bit.ly/2MEJCaB>, last access on February 1, 2021.

⁹⁰ National Bank of Georgia, *Financial Stability Report 2020*, pg 32, available at: <https://bit.ly/39xPbAa>, last access on February 1, 2021.

Chart 4. PTI in case of income of GEL 1,000 or less*Chart 5. PTI in case of income over 1,000 GEL*

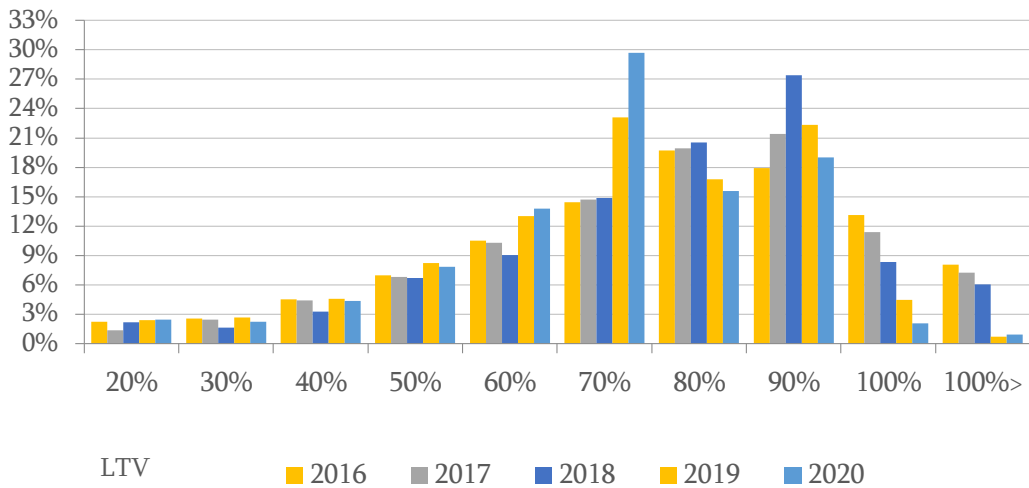
The graph above shows that 62% of low-income borrowers pay 35% of their income on loan servicing and are about at break-even point (66% consumer expenses, 35% loan service), which is considerable data, as these individuals will not be able to cover unforeseen expenses. 10% of low-income families are in an even worse situation, which pay more than 35% of their income on loan services. 20% of high-income households pay 60% or more of their income on loan services. This obligation also puts borrowers in this category in a difficult position, even though their income exceeds 1,000 GEL.

Another indicator that may be used to determine the stability of the financial market and also to show in dynamics how the vulnerability of households in terms of mortgage loans is changing, is the so-called LTV (Loan to Value Ratio) indicator, which shows the ratio of the amount of the mortgage loan to the value of the collateral. Following the enactment of the responsible lending regulation by the National Bank of Georgia, the burden of excess lending on households has been reduced, which made the market more resilient to the current crisis (pandemic).⁹¹ The data shows the dynamics of reducing pressure on households, which is largely due to the policy of the National Bank of Georgia. It can be seen that in the type of mortgage loans issued in 2020, where the value of the collateral is 80% of the loan, there is a decrease compared to the previous years.⁹² It is important to note that the dynamics are declining even in loans where the collateral value is 90% or 100% of the loan. The general trend is that the number of high-risk loans in the banking portfolio is decreasing, which reduces the financial stress on households.

⁹¹ The National Bank of Georgia, *the National Bank of Georgia has approved the rules for issuing loans to Individuals*, available at: <https://bit.ly/2Yxa8Fm>, last access on February 1, 2021.

⁹² The National Bank of Georgia, *Financial Stability Report 2020*, pg. 32, available at: <https://bit.ly/39xPbAa>, last access on February 1, 2021.

Chart 6. Distribution of mortgage collateral share



As stated by the Young Lawyers' survey, according to 2019 data, 158,422 individuals are registered in the debtors' registry.⁹³ After the 2018 loan write off program, when the loans of 615,164 debtors were written off, according to the survey, there was an increase in the number of individuals registered in the debtors' registry and just in the first quarter of 2019, 23,254 persons were added to the debtors' registry.

Despite debt write off act,⁹⁴ the dynamics of the number of subjects added to the debtors' registry annually is growing. 73,719 persons were registered in 2016, 85,470 persons were registered in 2017, and 96,464 persons in 2018. The loan write off program also applied to individuals who had overdue loans of up to 2,000 GEL for at least one year. 11 private banks and 43 microfinance organizations participated in this pro-

⁹³ Young Lawyers, 158,422 natural persons and 7,172 legal entities are registered in the debtors' registry, May 8, 2019, available at: <https://bit.ly/36w1TO1>, accessed on February 1, 2021.

⁹⁴ Forbes.ge, How much did it cost to the Cartu Foundation to write off debts before election, February 7, 2020, available at: <https://bit.ly/3pFKiuA>, accessed on February 1, 2021.

gram, but it should be noted that a significant portion of bad debts remained behind the program.

The analysis of the data discussed above reveals the need to regulate the issue of personal insolvency, in particular:

- The number of borrowers is more than 1,000 on average in Georgia and compared with the experience of other countries has a sharp upward tendency;
- The share of household loans in GDP is growing and this increase is associated with risks, whereas the income of individuals is not sufficient to service the loans painlessly;
- Households are under stress and some of them are at risk of losing their mortgaged immovable property.

Accordingly, the regulation on personal insolvency should give the so-called second chance to many tens of thousands of debtors, and return them to economic activity. A large proportion of debtors, due to high-debt, have no motivation for economic activity, as they know that a large part of their income will be spent on meeting overdue financial obligations and not on the socio-economic improvement of their lives. Applying special regime to the personal insolvency will give the debtors such motivation, will enable them to return to economic life and contribute to the growth of the country's gross domestic product.

Chapter V. Overview of important social indicators for defining the regulatory framework of personal insolvency

In case of adoption of the insolvency regulation in Georgia, it is important to analyze the effect that the new regulation will have on potential beneficiaries of the system. In this regard, the number of natural persons registered in the debtors' registry in Georgia is important.

Within the framework of the study, the social vulnerability of the Georgian population was analyzed based on several data: number of state pension beneficiaries, the number of poor people receiving subsistence benefits under the targeted social assistance program.

As of October 2020, 782,923 people received state pensions in Georgia (while in 2019 762,621 people), which is 20.5% of the total population of Georgia - 3,716,900 by January 1, 2020. As of October 2020, the number of registered population for socially vulnerable status was 993,935 (26.7% of the total population) out of which 510,343 people were receiving benefits (13.7% of the total population).⁹⁵

The main purpose of regulating the personal insolvency is to promote economic benefits by encouraging them to reduce losses and increase productivity. Also, creating the possibility of an insolvency mechanism for natural persons to improve the social component should be taken into consideration, due to the combination of the function of social insurance, which is related to the protection of natural persons from financial tragedy.⁹⁶

⁹⁵ Georgian Social Service Agency, *Statistical data 2020*, available at: <https://bit.ly/2MMOjyV>, accessed on February 1, 2020.

⁹⁶ World Bank, *Report on the Treatment of the Insolvency of Natural Persons* (2013), pg. 11, available at: <https://bit.ly/2YBp9Wy>, last access on February 1, 2021.

While insolvency beneficiaries may have benefited from temporary social assistance packages, unemployment benefits, and medical insurance, the effectiveness of the insolvency regime is mainly reflected in those natural persons, who have the opportunity to earn an income and do not need long-term social support. Therefore, the purpose of the regulation is not to acquire financial or other resources for natural persons, but to stop the process of repaying non-productive debts.⁹⁷

While insolvency is not usually intended to improve the living conditions of the socially vulnerable people, insolvency beneficiaries are often the so-called Low-Income-Low Asset (LILA) debtors or No-Income-No Asset (NINA) debtors, which according to the 2013 World Bank report, is considered as one of the challenges of physical persons' insolvency system.⁹⁸ As a rule, for NINA debtors traditional insolvency proceedings are not available as they do not have even the minimum amount of assets or income necessary to cover procedural costs. For the protection of those type of debtors, in England and Wales DRO system was established, which provides relief from the debts of the most distressed debtors at a minimum cost.⁹⁹

Therefore, it is important that while determining the mechanisms available for the protection of natural persons in case of insolvency in Georgia, the regulation should take into account the social status of potential beneficiaries of the system.

One of the important criteria for measuring the social vulnerability of the country's population is the UN Sustainable Development Goal N1 (SDG 1), which envisions the end of all forms of poverty. Since 2010, the Global Multidimensional Poverty Index (MPI) has measured the vulnerability of each person to ten indicators in three directions in more than

⁹⁷ *Ibid*, pg. 12.

⁹⁸ Ramsay, Iain, *The new poor person's bankruptcy: Comparative perspectives*, pg. 2, available at: <https://bit.ly/3rr1vZp>, last access on February 1, 2021.

⁹⁹ *Ibid*, pg. 3.

100 countries around the world - health, education and standard of living. In MPI, the population is considered poor if they do not have access to 1/3 out of 10 indicators.¹⁰⁰ According to 2020 data, out of 107 countries participating in the study (28 low-income, 76 middle-income, and 3 high-income) Georgia is on the third place with MPI index (0.001 index) and lags behind only Armenia and Ukraine. According to the research, only 0.34% of the Georgian population is a multifaceted poor, whereas 2.08% is vulnerable to poverty according to the MPI methodology.¹⁰¹

One of the criteria for assessing the social status of the population of Georgia may be the Human Development Index of Georgia (HDI). HDI examines three areas of human development: a long and healthy life, an education, and a proper standard of living.¹⁰² According to the 2020 report, Georgia rank 61st according to the HDI and with an index of 0.812 is included in the list of countries with very high human development. It should be noted that among the countries surveyed, Georgia lags behind Lithuania by 27 positions (0.882), Poland by 26 positions (0.880) and the United Kingdom by 48 positions (0.932). Among the EU countries closest to Georgia in terms of HDI are Bulgaria (0.816), Romania (0.828), and Croatia (0.851).¹⁰³

One of the indicators for calculating HDI is GNI and GNI Per Capita. According to the World Bank data, as of 2019, Georgia's GNI is \$ 4,780, which is at least three times lower than the comparable countries: Poland - \$ 15,350, Lithuania - \$ 19,080, United Kingdom - \$ 40,220.

¹⁰⁰ UNDP, *Charting pathways out of multidimensional poverty: achieving the SDGs*, 2020 Report, pg. 4, available at: <https://bit.ly/3ap7eb3>, last access on February 1, 2021.

¹⁰¹ *Ibid*, 41.

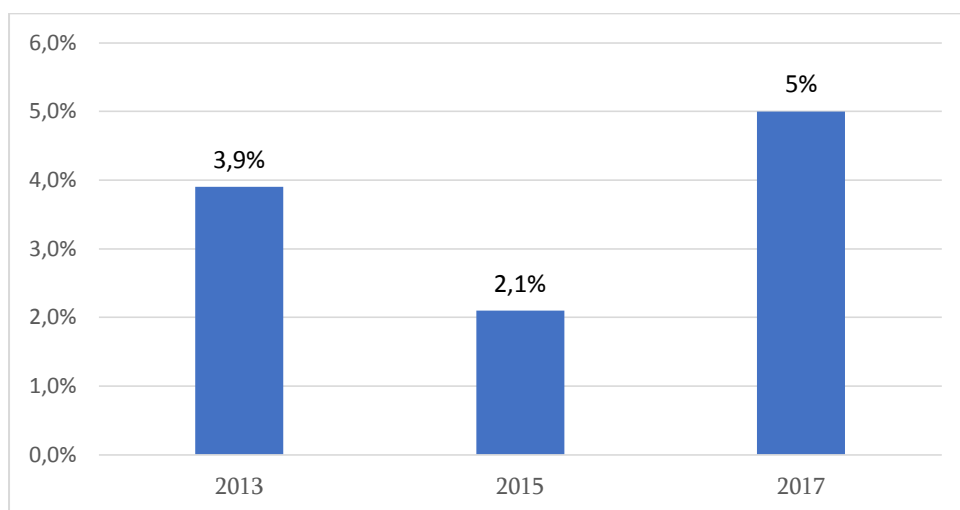
¹⁰² UNDP, *Human Development Reports, Human Development Index*, available at: <https://bit.ly/3oFof5S>, last access on February 1, 2021.

¹⁰³ UNDP, *Human Development Report 2020, The Next Frontier, Human development and the Anthropocene*, pg. 343, available at: <https://bit.ly/3tjGNfK>, last access on February 1, 2021.

The poverty level is more a result of social vulnerability than its assessment criterion. Social vulnerability is defined as the risk of being unable to participate fully in economic, social, and civic life and, by itself implies economic vulnerability. The level of economic and social vulnerability depends on household resilience to risk and the ability to withstand shock effects. Consequently, the household's ability to withstand the negative consequences of risk realization depends significantly on the available resources and the ability to use these resources.¹⁰⁴

The last relevant survey to determine the level of social vulnerability in Georgia was conducted in 2017 by the United Nations Children's Fund (UNICEF).¹⁰⁵ The study showed a growing trend of extreme poverty in the entire population.¹⁰⁶

Chart 7. The population is in extreme poverty



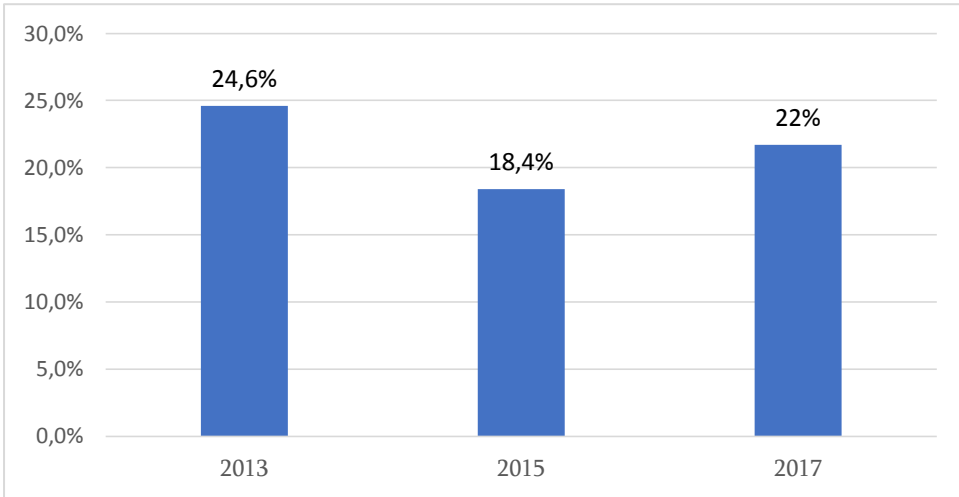
¹⁰⁴ Gassmann, Franziska, Berulava, George, Tokmazishvili, Michael, *Economic and Social Vulnerability in Georgia*, Chapter 3.1, available at: <https://bit.ly/3oJah2S>, last access on February 1, 2021.

¹⁰⁵ UNICEF, *The Welfare Monitoring Survey*, June 2018, available at: <https://uni.cf/3oJaCTc>, last access on February 1, 2021.

¹⁰⁶ *Ibid.* pg.12

There is also a significant increase in the general poverty level tendency in 2017, compared to the situation in 2015.¹⁰⁷

Chart 8. General poverty rate %

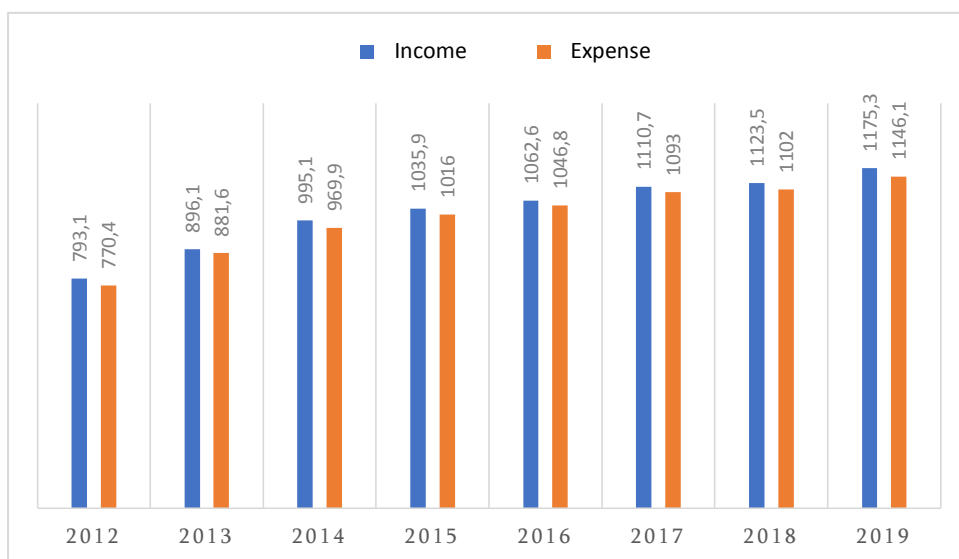


One of the indicators of the social status assessment in the country is the average monthly income of households and the average monthly income per capita, which is published annually by Geostat. According to the data of 2019, compared to 2015, the average income increase is 139.4 GEL, compared to 2017 - 64.6 GEL, and compared to 2018 - 51.8 GEL.¹⁰⁸ With a small increase in the average monthly income of households, the average monthly expenditure has been increasing every year since 2012. According to the data of 2019, compared to 2015, the average expenditure increased by 130.1 GEL, compared to 2017 - by 53.1 GEL, and compared to 2018 - by 44.1 GEL.¹⁰⁹

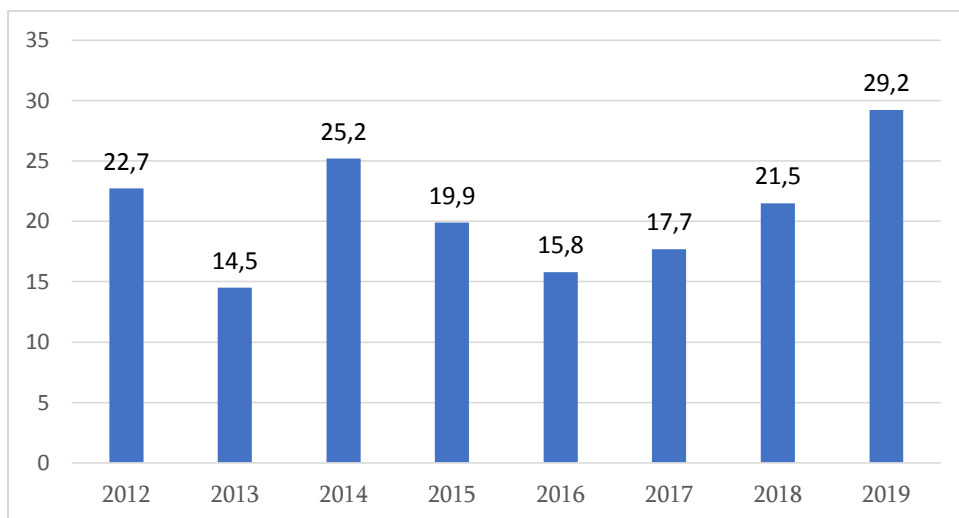
¹⁰⁷ *Ibid.* pg.12

¹⁰⁸ Geostat, *Household Income*, available at: <https://bit.ly/2Zb1e0g>, last access on February 1, 2021.

¹⁰⁹ Geostat, *Household Expenses*, available at: <https://bit.ly/375VARL>, last access on February 1, 2021

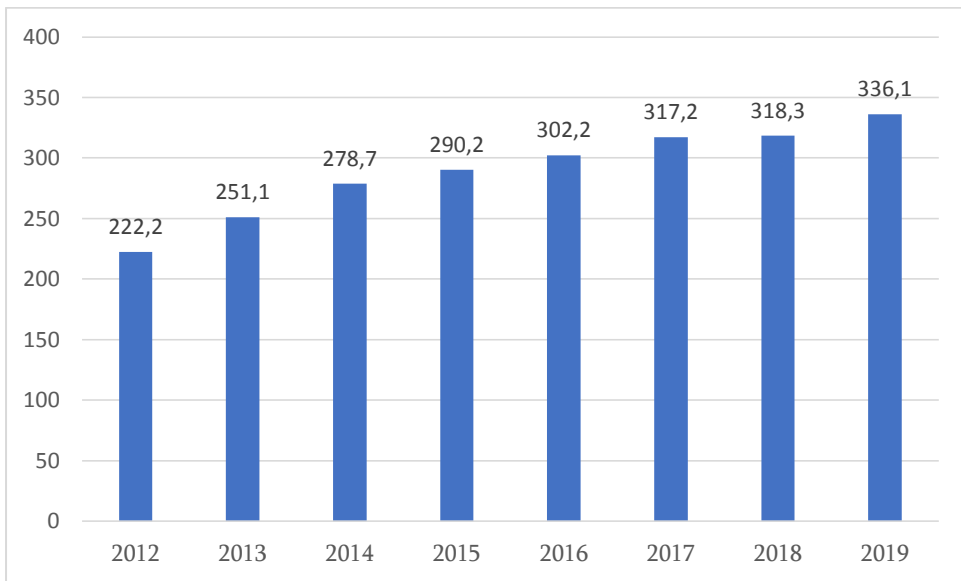
Chart 9. Average monthly income and expenditure of households by years

By analyzing the average household income and expenses, we may determine the average annual amount that a household would have left on a monthly basis after incurring expenses.

Chart 10. Average monthly free amount

In this regard, in order to determine the standard of living, the average monthly income per capita is also interesting. According to the data, the average monthly income per capita in 2019 was 336.1 GEL, which is 45.9 GEL more than in 2015, 18.9 GEL more than in 2018, and 17.8 GEL more than in 2019.¹¹⁰

Chart 11. Average monthly income per capita

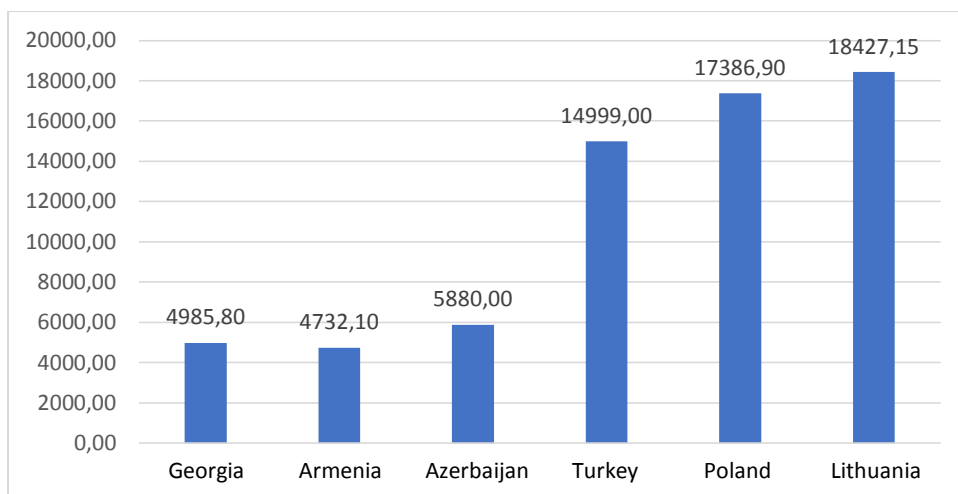


It should be noted that in terms of GDP per capita, Georgia is only ahead of Armenia in the region, and 3.5 times lower than the data of Poland and Lithuania.¹¹¹

¹¹⁰ *Ibid.*

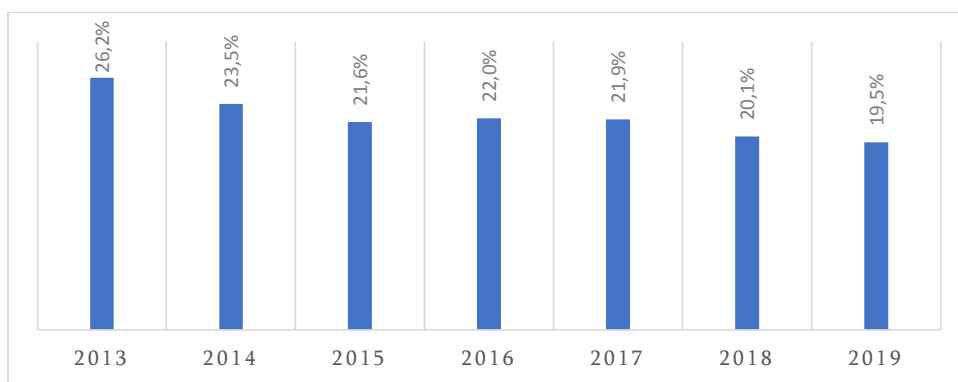
¹¹¹ Trading Economies, *Georgia GDP per capita*, available at: <https://bit.ly/3aaLn8k>, last access on February 1, 2021; Trading Economies, *Armenia GDP per capita*, available at: <https://bit.ly/2MPyojO>, last access on February 1, 2021; Trading Economies, *Azerbaijan GDP per capita*, available at: <https://bit.ly/3tPF55X>, last access on February 1, 2021; Trading Economies, *Poland GDP per capita*, available at: <https://bit.ly/3qdzZxX>, last access on February 1, 2021; Trading Economies, *Turkey GDP per capita*, available at: <https://bit.ly/3dhq1bB>, last access on February 1, 2021; Trading Economies, *Lithuania GDP per capita*, available at: <https://bit.ly/3tNo6Bb>, last access on February 1, 2021;

Chart 12. GDP per capita (USD)



Several additional statistical indicators are relevant to the analysis of the social vulnerability of the Georgian population determining the standard of living, which ascertains the level of poverty. According to 2019 data, 19.5% of the population lives below the absolute poverty line in Georgia, which is 2.1% less than in 2015, 2.4% less than in 2017, and 0.6% less than in 2018.¹¹²

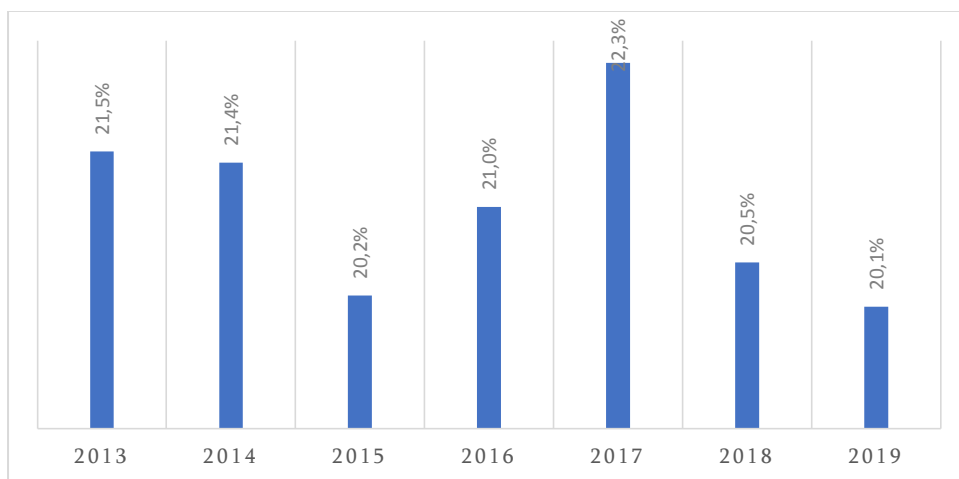
Chart 13. Population living below the absolute poverty line



¹¹² Geostat, *Standard of living*, available at: <https://bit.ly/2MGJLKh>, last access on February 1, 2021.

As of 2019, the share of the population living below 60% of median consumption is 20.1%.¹¹³

Chart 14. Share of population below 60% of median consumption



50% of median consumption is taken to determine the level of relative poverty in the comparison countries, instead of the 60% in Georgia. With this figure, the poverty rate is 12% in the UK, 10% in Poland, and 17% in Lithuania.¹¹⁴

The various mentioned data indicating social status of the population are developed according to the principle of equal distribution of income per capita. However, there is income inequality between different strata and groups of the population, which exacerbates the vulnerability of specific groups compared to the others. The GINI index estimates the deviation of the total income distribution between households or natural persons from the perfect equal distribution. GINI Index from 0 (per-

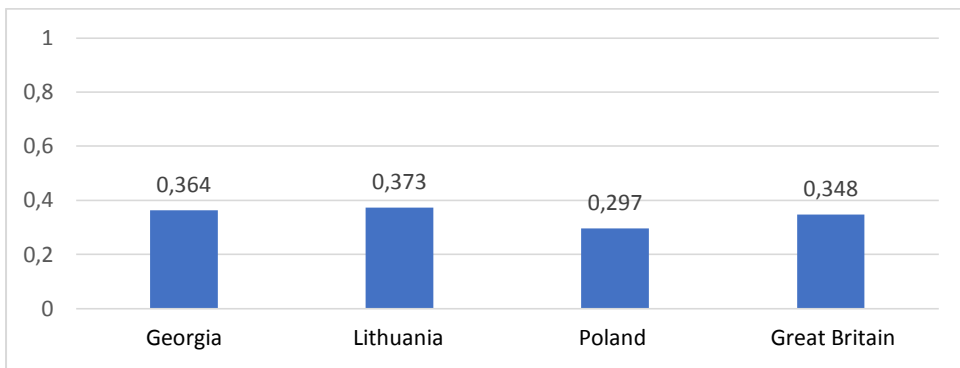
¹¹³ *Ibid.*

¹¹⁴ OECD, *How's Life? 2020, Lithuania*, available at: <https://bit.ly/3oHfxUE>, last access on February 1, 2021.

fect equality) to 1 (complete inequality) measures the level of inequality of income distribution among people in a particular state.¹¹⁵

According to the data of 2018, the GINI index of Georgia is 0.364. Based on this data, we can conclude that income distribution in Georgia is more equal than unequal.

Chart 15. GINI index in comparison countries



¹¹⁵ The World Bank, *Data Catalog, GINI Index (World Bank Estimate)*, available at: <https://bit.ly/3rfkDta>, last access on February 1, 2021.

Chapter VI. Analysis of the legal feasibility of the physical person insolvency reform

6.1. Relation of the physical person insolvency legislation with the corporate insolvency legislation in Georgia

Since 2007, corporate insolvency in Georgia has been regulated by the Law of Georgia on Insolvency Proceedings.¹¹⁶ On September 18, 2020, a new legal act regulating the field - the Law of Georgia on Rehabilitation and Collective Satisfaction of Creditors was adopted.¹¹⁷

The new law will come into force on April 1, 2021, and will apply only to cases on which insolvency applications will be filed after the effective date.¹¹⁸ Accordingly, all insolvency cases that start before April 1, 2021 will be regulated by 2007 Law.

The need to reform corporate insolvency legislation was driven by outdated approaches of 2007 Law and by the inconsistency with the international best practices, which is mainly due to focusing on the liquidation of the enterprise instead of the rehabilitation regime. Also, 2007 Law did not provide for the involvement of private insolvency specialists in the process and the full procedure was conducted only by the National Bureau of Enforcement. As a result, the system failed to enable businesses to use the insolvency procedure effectively.¹¹⁹

¹¹⁶ Law of Georgia on Insolvency Proceedings, 28.03.2007.

¹¹⁷ Law of Georgia on Rehabilitation and Collective Satisfaction of Creditors, 18.09.2020.

¹¹⁸ *Ibid.* Article 121.1.

¹¹⁹ German Economic Team Georgia, *Reform of the insolvency law: A priority for economic policy*, Issue No. 9, March – April 2016, pg. 1, available at: https://www.get-georgia.de/wp-content/uploads/2016/04/Newsletter_09_2016_GET-Georgia.pdf.

2007 Law distinguishes between insolvency and bankruptcy cases. The term "insolvency" is used as a generic name for a proceeding that could lead to bankruptcy proceedings or the rehabilitation of a debtor. However, one of the main reasons for criticizing the law was focusing (in whole or in part) on the realization of the debtor's assets in both cases, which made the debtor's rehabilitation a more exceptional case.¹²⁰

Annual publication of the World Bank - Doing Business In may be considered as one of the main indicators of the assessment of the insolvency system in Georgia. According to the 2020 report, Georgia ranks 64th among the surveyed countries in terms of the insolvency system. The World Bank research shows that insolvency is resolved in only 56.2 out of 100 cases (an improvement of 0.2 compared to the 2019 report data), creditors' satisfaction is \$ 40.5 cents per dollar, the insolvency case lasts approximately two years, and the cost of the process is 10% of the entire property of the debtor.¹²¹

One of the reasons for the reform of the insolvency system in Georgia has become the minimum and sometimes zero rate of rehabilitation cases. Out of 41 cases started in 2016, 2 were completed with rehabilitation, in 2017 – 25, and out of 8 cases opened in 2018 - 0, whereas, as of June 1, 2019, none of the 19 cases started in 2019 were completed with rehabilitation.¹²²

From January 1, 2020 to December 31, 2020, a total of 22 insolvency applications were submitted, 19 of which were filed by the legal entity debtor, 2 by the legal entity creditor, and 1 by the individual entrepreneur. In 12 out of 22 cases, the court accepted the application and start-

¹²⁰ *Ibid.*

¹²¹ World Bank, *Doing Business in Georgia, 2020*, pg. 4, available at: <https://bit.ly/3rfc0i4>, last access on February 1, 2021.

¹²² Parliament of Georgia, *Explanatory Card on the Draft Law of Georgia on Rehabilitation and Collective Satisfaction of Creditors*, March 20, 2020, pg. 3, available at: <https://bit.ly/3tcR6lr>, last access on February 1, 2021.

ed proceedings, and in 10 cases - refused.¹²³ A total of 3 insolvency cases were completed by 2020: 2 - by declaring the debtor bankrupt and 1 - by terminating the proceedings on the grounds that the debtor's property was well above the debt owed to the creditor.¹²⁴

Adopted in the light of the challenges, the 2020 Law aims at facilitating rehabilitation, protecting creditors' rights and encouraging timely court applications.¹²⁵ The new regulation contains several important novelties, which, in the opinion of the legislator, should increase the efficiency of the process. In particular, these novelties are:

- Insolvency practitioner - a specially authorized person who will perform the function of a rehabilitation/bankruptcy manager;
- Regulated agreement - an out-of-court agreement between the debtor and the creditor that simplifies the insolvency process;
- Prioritization of rehabilitation - an application for the commencement of the rehabilitation regime is considered as having priority over the application for the commencement of the bankruptcy;
- Transparency of the process – electronic system of the proceeding, which will include all documents of the proceeding;
- Possibility of adapting the moratorium rule to a specific case - discretion defined by the law to use the moratorium rule and or apply other measures in a specific case;
- Insolvency mass differentiation- persons with substantive rights to the debtor's property are not restricted by the regime applicable to creditors in insolvency proceedings;
- Commencement of the rehabilitation/bankruptcy regime - contrary to the powers of the insolvency conciliation board under 2007 Law, the decision under the new law to initiate the relevant regime is taken by the court;

¹²³ Legislative Herald of Georgia, *court rulings on acceptance and refusal of insolvency applications. Electronic platform for information on insolvency cases of common courts as of December 31, 2020.*

¹²⁴ *Ibid.*

¹²⁵ *Ibid.* pg. 5-6.

- Disputable actions - contrary to the existing regulations, the new law only allows the bankruptcy manager to challenge the transaction.

Entrepreneurial and non-entrepreneurial natural persons are directly excluded from the scope of 2020 Law.¹²⁶ In the countries discussed above, there are two forms of insolvency regulation of natural persons: regulation by one piece of legislation (Poland, UK) or by a separate legislative acts (Lithuania). Despite the form of legislative regulation, it is important that the personal insolvency regime to be in compliance with the corporate insolvency legislation already in place in the country.

By reviewing the key characteristics of 2020 Law, we may identify the systemic changes that have already been made to insolvency legislation in Georgia and maybe relevant in defining the vector of insolvency regulation of natural persons.

One of the key novelties of the insolvency reform is the encouragement of the rehabilitation process. The purpose of this regulation is relevant even in the case of personal insolvency. 2020 Law, as one of the insolvency regimes, is introducing regulated agreement - an out-of-court procedure that should facilitate the most effective rehabilitation, through the approval of the agreement reached between the debtor and the creditors by the court, with the participation of the relevant special supervisor.¹²⁷ This mechanism, which is characteristic of English legislation, may also be applied to the cases of personal insolvency, as provided for in the English Insolvency Act. Such an opportunity to relieve the burden of the court and increase the efficiency of the process is especially relevant in the event of an insolvency regime for natural persons, when an increase in the number of insolvency cases and a court overload is expected.

One of the main novelties of the reform of Georgian insolvency legislation is the insolvency practitioner, who should replace the National Bu-

¹²⁶ 2020 Law, Article 4.

¹²⁷ *Ibid.* Article 21.

reau of Enforcement as the Rehabilitation/Bankruptcy Case Manager. The establishment of an insolvency practitioner institute guarantees the participation of qualified candidates in the process and, consequently, the more efficient management of cases, as the insolvency process will no longer depend solely on the resources of the state with the participation of the National Bureau of Enforcement.¹²⁸ It is important that the new legislation on personal insolvency also shares the approach of the implemented reform and involves such insolvency practitioners in the management of insolvency cases of natural persons, who will have the necessary qualifications and authorization to manage general insolvency cases or the ones with natural persons.

One of the needs for the reform of corporate insolvency legislation in Georgia was also to establish adequate mechanisms to protect the interests of secured creditors in the insolvency process. The 2020 Law ensures a special role of secured creditors by the several guarantees:

- It is not allowed to approve a regulated agreement that affects the right of the secured creditor to enforce the security or by which an unsecured creditor is satisfied with priority over a secured creditor without the consent of such secured creditor;¹²⁹
- At the time of the rehabilitation plan, if the plan provides for a change in the terms of the agreement between the secured creditor and the debtor, the secured creditor has the right to vote on the draft plan. In such a case, approval of the plan will be allowed if the project is supported by a majority vote of the unsecured creditors and a majority vote of the secured creditors with the right to vote;¹³⁰
- The court will not approve a rehabilitation plan in which the secured creditor would receive less than he/she would have received

¹²⁸ *Ibid.* Article 11.

¹²⁹ *Ibid.* Article 35.7.

¹³⁰ *Ibid.* Article 82.

by selling the property used as collateral without the consent of such creditor;¹³¹

- The secured creditor is entitled to request exemption from the moratorium on the subject of collateral if such property is not necessary for the purpose of rehabilitation;¹³²
- If the debtor is in the agreement with secured creditor for a period of more than 5 years and the debtor fulfills the current contractual obligations, the relevant request must be satisfied by continuing the contractual relationship, regardless of the rehabilitation plan, unless there is obvious damage to the creditor;¹³³
- The secured creditor of the first line is entitled to apply to the bankruptcy manager and request satisfaction of his/her claim by the realization of the collateral. With the received money the creditor's claim will be met, whereas other creditor's claims will be satisfied with the excess amount. If as a result of the realization, the claim of the secured creditor is not fully satisfied, the unsatisfied claim will be considered as an unsecured claim.¹³⁴

Regulation of 2020 Law on the protection of secured creditors, as one of the major achievements of the insolvency reform, will become an essential feature of Georgian insolvency law after its enactment. Accordingly, while drafting insolvency legislation for natural persons, it is important to consider the safeguards provided for secured creditors under 2020 Law. Otherwise, in addition to violating the unequivocally recognized approach to the need for a special status of secured creditors in the insolvency process, access of natural persons to significant financial resources, usually issued in the case of collateral will be naturally limited.

¹³¹ *Ibid.* Article 83.

¹³² *Ibid.* Articles 87.1, 87.2.

¹³³ *Ibid.* Article 87.3.

¹³⁴ *Ibid.* Article 105.

6.2. Application of the regulation of insolvency of a natural person to the current legislation on enforcement

In Georgia, the regulation of personal insolvency should be assessed in accordance with the current general legislation on enforcement of claims against them. In the absence of special regulation, the Law of Georgia on Enforcement Proceedings (hereinafter - Law on Enforcement) applies to the enforcement of claims against natural persons.

As a result of the review of foreign legislation regulating the personal insolvency, one of the relevant issues was the definition of the list of property that is not subject to realization in order to meet the claims of the creditors. In this regard, the current legislation in Georgia is important, which does not provide for the possibility of discharge from the debts of individuals, but defines a list of assets, which may not be used in the process of enforcement.

According to the law on enforcement, the following property of the debtor may not be subject to putting arrest on and hence, enforcement on:¹³⁵

- Personal and household items necessary for the debtor's professional activity, personal life, and household;
- Four weeks' of food, fuel, and light for the debtor, his/her family and persons living with him/her or the money needed to buy them if there is no such supply for this period of time or they cannot be bought otherwise;
- Small livestock of limited quantity, also one dairy cow or the debtor's choice of two pigs, sheep, or goats, if they are necessary to feed the debtor, his/her family and persons living with him/her; also, three months' supply of forage and dry grass or the money needed to buy them if there is no such supply and it cannot presently be bought otherwise;

¹³⁵ Law of Georgia on Enforcement Proceedings, Article 2^{1.5} and Article 45.

- For persons engaged in agriculture – agricultural equipment and tools, cattle, fertilizers, and agrarian products insofar as they are needed to maintain the debtor, his/her family, and hired workers, or the same and/or similar products until the next crops are harvested from subsequent farming;
- For persons earning revenues from their physical or mental labour or other activity – the items needed for such activity;
- Special allowances granted by the State;
- The assets of a family member filed in the integrated database of socially vulnerable families (other than the assets used as security for claims) whose social-economic indicator is lower than the level fixed by the Government of Georgia;
- Revenues below the minimum subsistence;
- Pension assets accumulated in the accumulative pension scheme.

One of the main tasks of regulating the personal insolvency is to determine the criteria for insolvency. As evidenced by the foreign experience reviewed, one of the criteria for this purpose is usually the amount of the minimum wage. In this regard, two legislative acts are important: Decree N351 of the President of Georgia of 4 June 1999 On the Amount of the Minimum Wage and Law of Georgia on the Rule of Calculating the Subsistence Minimum.

It should be noted that the minimum wage in Georgia has been set as 20 GEL since 1999, which can not be considered as one of the criteria for assessing insolvency. Due to the importance of the established amount of the minimum wage, the law of enforcement links the amount of income excluded from compulsory enforcement to the subsistence minimum, which “reflects consumer goods per capita in value terms, which ensures the meeting of minimum physiological and social needs according to the level of the socio-economic development of the country.”¹³⁶ The subsistence minimum is calculated on the basis of a norma-

¹³⁶ Law of Georgia on the Rule of Calculating the Subsistence Minimum, Article 2.

tive-statistical method, in accordance with the current (purchase) average prices.¹³⁷

The data on the subsistence minimum in Georgia is published monthly by Geostat and is a variable number. Accordingly, the new legislation regulating the personal insolvency must, on the one hand, comply with the general rule of enforcement of claims and on the other hand, it has to take into consideration the existing features of the minimum wage and subsistence minimum in Georgia.

¹³⁷ *Ibid.* Article 4.1.

Chapter VII. Cost-benefit analysis

7.1. Three cost-benefit analysis scenarios

The main purpose of cost-benefit analysis is to measure the expected impact of the regulation of insolvent individuals on the economy in sectoral terms.

As of December 2020, 158 thousand natural persons are registered in the debtors' registry,¹³⁸ according to the NBG data, 472 thousand debtors in the banking sector have more than 30 days of overdue loans, out of which 130 thousand of them are debtors with more than 100 days overdue.¹³⁹ Some of these debtors, as of today, are economically inactive. As mentioned, their motivation to be economically active is not great, as in case of having a salary, it will be deducted to cover existing debts.

According to Geostat, the country has a workforce of 1,526,900 people. One-fifth of the workforce is either registered in the debtors' registry or on the list of bad debts in the banking sector.¹⁴⁰ This data was an indicator of an even worse situation at the end of 2018 when the government intervened once and repaid "overdue debt" (by buying a portfolio of overdue loans from commercial banks and microfinance organizations)

¹³⁸ Young Lawyers, *158,422 natural persons and 7,172 legal entities are registered in the debtors' register*, May 8, 2019; available at: <https://bit.ly/36w1TO1>, last access on February 1, 2021.

¹³⁹ Board of the National Bank of Georgia, *"Decree on the Approval of the Annual Report of the National Bank of Georgia for 2019"*, April 27, 2020, pg. 92, available at: <https://bit.ly/3mcwNlm>, last access on February 1, 2021.

¹⁴⁰ Geostat, *Employment and unemployment*, available at: <https://bit.ly/3acJgRn>, accessed on February 1, 2021.

of more than 600,000 citizens with more than one year of overdue loans, the principal amount of which did not exceed 2,000.¹⁴¹

Georgia's economy has the potential to grow rapidly but has grown by an average of only 5% in recent years.¹⁴² One of the reasons for the slow pace of development is the lack of motivation of insolvent natural persons to be economically active. Insolvency regulation will give individuals the motivation to become economically active and find job. This logic is the primary basis of cost-benefit analysis – natural persons who will be able to benefit from the regulation will start looking for a job and some of them will also succeed in the searching process.

The model envisaged three scenarios: the **optimal scenario**, when 3% of insolvent persons apply for the regulation in the first year, the **standard scenario** where 1% of insolvent persons are involved in regulation in the first year and a **pessimistic scenario** where the corresponding percentage is 0.5%. In all three scenarios, an increase in the level of involvement from year to year is envisaged, which will be caused by raising awareness about the regulation.¹⁴³

According to 2020 data, about 288 thousand individuals (158 thousand persons registered in the debtors' registry and 130 thousand persons holding overdue loans over 100 days in commercial banks) may benefit from this regulation. This number was predicted based on expert assessment of authors of this Study for the 10-year model, with the assumption that the number of insolvent individuals will be reduced inversely to GDP growth from year to year and, on average, we will have 5% fewer insolvent natural persons each year.

¹⁴¹ Forbes.ge, *How much did it cost to the Cartu Foundation to write off debts before election*, February 7, available at: <https://bit.ly/39xtEaA>, last access on February 1, 2021

¹⁴² Geostat, *Gross Domestic Product*, available at: <https://bit.ly/36R5uXI>, last access on February 1, 2021

¹⁴³ These scenarios are based on expert evaluation.

Table 1. Number of insolvent natural persons

2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
260,573	247,544	235,167	223,409	212,238	201,626	191,545	181,968	172,869	164,226

Each scenario of the cost-benefit model sets out the expected benefits and costs of regulation over a 10-year period. The benefits of regulation outweigh the costs of the regulation in both quantity and volume. This section of the report will discuss each benefit and cost and will review each economic variable involved in the cost-benefit calculation process.

As a result of the regulation, the sector of natural persons will benefit primarily at the expense of employment growth. The motivated natural persons freed from the bad loans will start looking for a job and some of them will succeed. According to Geostat, at the end of 2020, the average salary in Georgia was 1,150 GEL. According to the same source, wages have increased by an average of 7.4% over the last 10 years. This growth rate is used to forecast the average wage over a 10-year period (if the average wage was 1,150 GEL in 2020, it is projected to increase by 1,435 GEL by 2,4% in 2021, to 1,325 GEL increased by another 7.4% in 2022, and so on).¹⁴⁴

Table 2. Average salary forecast for the 10-year model (GEL)

2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
1,325	1,423	1,527	1,640	1,760	1,889	2,028	2,177	2,337	2,509

As mentioned above, the model envisages three different scenarios where the percentage of insolvent individuals involved in the regulation

¹⁴⁴ Geostat, *Wages*, available at: <https://bit.ly/2YyXuFP>, last access on February 1, 2021

differs. Insolvency regulation brings a variety of benefits to the natural persons involved. One of the most important benefits is an increase in employment motivation. The employment rate for insolvent individuals was set at 4.8% for the 10-year model, this figure is based on the expert assessment of authors of this Study.¹⁴⁵

If we multiply the number of insolvent natural persons by the share of involvement in the regulation based on the relevant scenario and then we multiply by the employment rate (on 4.8%), as a result of the enactment of the regulation, we will obtain employment forecasts for each scenario separately.

Table 3. Employment forecast for the 10-year model for three scenarios

	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
scenario 1	375	371	377	397	442	520	652	793	965	1,182
scenario 2	125	124	126	132	147	173	217	264	322	394
Scenario 3	63	62	63	66	74	87	109	132	161	197

7.2. Expected benefits as a result of the regulation

The first benefit calculated is the total salaries of natural persons who benefit from the regulation and will be employed in the private sector (number of natural persons multiplied by annual salary).

¹⁴⁵ Insolvency regulation in the US increases the annual employment rate by an average of 8.3%; These data were adjusted in proportion to the ratio of unemployment levels in Georgia to the United States. Unemployment rate in Georgia is 1.7 times higher than the unemployment rate in the US, therefore, the employment rate of regulated natural persons will be set at 4.8% over the 10-year period. (8.3% relative to 1.7). see. Dobbie, Will, Song, Jae, *Debt Relief and Debtor Outcomes: Measuring The Effects of Consumer Bankruptcy*, NBER Working Paper Series, pg. , available at: <https://bit.ly/2LbRQGx>, last access on February 1, 2021.

Table 4. Benefit N:1 Total salaries for natural persons (mill GEL)

Years	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
scenario 1	-	6.3	6.9	7.8	9.3	11.8	15.9	20.7	27.1	35.6
scenario 2	-	2.1	2.3	2.6	3.1	3.9	5.3	6.9	9.0	11.9
scenario 3	-	1.1	1.2	1.3	1.6	2.0	2.6	3.5	4.5	5.9

Note: With expert assumption, employment will only start from the year following the enactment of the regulation

The second benefit that has been monetized, is the profit of the banking sector under this regulation.¹⁴⁶ Natural persons who will be employed and will have a stable income, at the same time, according to the regulation, will pay the part of their salary left after providing for the family, to cover the debt. According to the data of 2020, the household consumption expenditure is 903 GEL, over the last 10 years, household consumption was increasing by an average of 6% from year to year. Accordingly, household consumption expenditures were forecasted at the 10-year model at this growth rate.¹⁴⁷

Table 5. Monthly expenditure forecast for one household (GEL)

2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
1,011	1,069	1,130	1,194	1,262	1,334	1,410	1,491	1,576	1,666

¹⁴⁶ In the Georgian financial market, there are not collected data on microfinance organizations, lending entities, and on such type of private lenders, which are not subject to registration at the National Bank of Georgia. Consequently, the data could not be analyzed by a group of researchers.

¹⁴⁷ Geostat, *Household expenses*, available at: <https://bit.ly/2MiSByb>, last access on February 1, 2021.

Each employed individual, after making the necessary expenses for the household can pay the remaining amount to the banks (in 2023, one employed person can pay $354 = 1,423 - 1,069$ GEL to the banks every month). Banks, in such a way, will be able to make a profit by the interest income received from borrowing funds (according to the National Bank of Georgia, the average annual interest rate on consumer loans is 15%).¹⁴⁸

Table 6. Benefit N: 2 Total banking sector profit (mill GEL)

Year	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
scenario 1	-	0.24	0.28	0.33	0.41	0.53	0.75	1.01	1.36	1.85
scenario 2	-	0.08	0.09	0.11	0.14	0.18	0.25	0.34	0.45	0.62
scenario 3	-	0.04	0.05	0.05	0.07	0.09	0.12	0.17	0.23	0.31

The third and fourth benefits are the social benefits of the community and the amount saved in the budget. Typically, insolvent unemployed citizens are helped by friends, relatives, neighbors, and so on. Subsistence minimum per capita according to 2020 data is 192 GEL per month and 2,304 GEL per year.¹⁴⁹ Insolvent natural persons will no longer need community assistance after being employed, and on average, the community will save GEL 2,300 per employee per year. The subsistence minimum has been rising, on average by 3% from year to year over the last 10 years, accordingly, this growth rate predicts the variable for the 10-year model.

¹⁴⁸ National Bank of Georgia, *Loans by purpose*, available at: <https://bit.ly/36zDabN>, last access on February 1, 2021.

¹⁴⁹ Geostat, *Subsistence minimum*, available at: <https://bit.ly/2MIC5NU>, last access on February 1, 2021

Table 7. Annual subsistence and social assistance forecast (GEL)

Year	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
Subsistence minimum	2,371	2,440	2,510	2,583	2,658	2,735	2,814	2,896	2,980	3,066
Social assistance	704	732	760	790	821	853	886	920	956	994

17% of the economically active population (labor force) receives social assistance from the state budget, which in 2020 amounted to 678 GEL per person per year.¹⁵⁰ The average inflation rate for the last ten years - 4% will be used to forecast this variable, according to which, the rate of social assistance was increasing from year to year.¹⁵¹ The budget will stop allocating funds to insolvent natural persons who started working and received social assistance before the regulation.

Table 8. Benefit N:3 and Benefit N:4 the community and budget savings (mill GEL)

Year	Benefit	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
scenario 1	Social benefit	-	0.90	0.95	1.03	1.17	1.42	1.84	2.30	2.88	3.63
scenario 2	Social benefit	-	0.30	0.32	0.34	0.39	0.47	0.61	0.77	0.96	1.21
scenario 3	Social benefit	-	0.15	0.16	0.17	0.20	0.24	0.31	0.38	0.48	0.60
scenario 1	Budget saving	-	0.05	0.05	0.05	0.06	0.07	0.08	0.10	0.13	0.15
scenario 2	Budget saving	-	0.02	0.02	0.02	0.02	0.02	0.03	0.03	0.04	0.05
scenario 3	Budget saving	-	0.01	0.01	0.01	0.01	0.01	0.01	0.02	0.02	0.03

¹⁵⁰ Social Service Agency, *Statistics on Subsistence Allowance 2020*, available at: <https://bit.ly/3cwwGy4>, last access on February 1, 2021

¹⁵¹ Geostat, *Consumer price index (inflation)*, available at: <https://bit.ly/2MS26Es>, last access on February 1, 2021.

The fifth benefit is the benefit of the business sector. Part of the insolvent natural persons will start working in the private sector after the introduction of the regulation. The first benefit was the total amount of salaries taken by these natural persons each year. In the cost-benefit model, the fifth benefit is the benefit received by the private sector as a result of the employment of these individuals. According to Geostat, the business sector created an additional value of 23.3 billion GEL in 2019, while intermediate consumption was 24.2 billion GEL.¹⁵² Each invested GEL brings $23.3 / 24.2 = 0.96$ GEL profit, accordingly, 96% of the total annual salaries paid by the business sector will be value-added and benefits created by the business.

Table 9. Benefit N: 5 additional value created by the business sector (mill GEL)

Year	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
scenario 1	-	6.1	6.6	7.5	9.0	11.4	15.3	20.0	26.1	34.3
scenario 2	-	2.0	2.2	2.5	3.0	3.8	5.1	6.7	8.7	11.4
scenario 3	-	1.0	1.1	1.3	1.5	1.9	2.5	3.3	4.3	5.7

Note: With expert assumption, employment will only start from the year following the enactment of the regulation.

7.3. Expected costs as a result of adopting the regulation

The regulation of insolvent natural persons differ from typical regulations and restrictions. The regulation does not constitute a restriction on the banking or business sector which could impede or adversely affect the activities of the private or financial sector. The costs of this regulation in terms of volume are significantly lower than the benefits.

¹⁵² Geostat, *Statistical survey of the enterprises*, available at: <https://bit.ly/39GCNhx>, last access on February 1, 2021.

The first expense, which the public will have, is the cost of filling out and registering applications. According to the first scenario, 7,817 individuals must apply for insolvency in 2022 (3% of 260 thousand insolvent persons by 2022). They have to fill out an application and hand over their case to the relevant institute.

Table 10. Forecast of the number of applicants of the regulation

Year	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
scenario 1	7,817	7,723	7,851	8,279	9,202	10,840	13,593	16,529	20,099	24,632
scenario 2	2,606	2,574	2,617	2,760	3,067	3,613	4,531	5,510	6,700	8,211
scenario 3	1,303	1,287	1,308	1,380	1,534	1,807	2,265	2,755	3,350	4,105

100 GEL was expertly (based on expert assessment of the authors of this Study) determined for the application filling fee,¹⁵³ in 2022, the total cost for 7,817 individuals will be 781.7 thousand GEL ($7,817 \times 100 = 781,700$).

Table 11. Expense N: 1 Registration fee paid by natural persons, (mill GEL)

Year	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
scenario 1	(0.78)	(0.77)	(0.79)	(0.83)	(0.92)	(1.08)	(1.36)	(1.65)	(2.01)	(2.46)
scenario 2	(0.26)	(0.26)	(0.26)	(0.28)	(0.31)	(0.36)	(0.45)	(0.55)	(0.67)	(0.82)
scenario 3	(0.13)	(0.13)	(0.13)	(0.14)	(0.15)	(0.18)	(0.23)	(0.28)	(0.33)	(0.41)

¹⁵³ The application fee in the US is \$ 338 (\$ 1,130). The cost of the service should be converted for the Georgian market in proportion to the difference between the US and Georgian GDP per capita, which approximately equals 100 GEL; According to Article 4 of the Law of Georgia on State Duties, 100 GEL is the minimum amount of duties on civil claims.

The second expense after the introduction of the regulation on personal insolvency, will be expenses related to the creation of a new administrative unit. Researchers' expert assumption is that 30 people will be employed in the new structure in the first year of the regulation's enactment and the number of employees will increase from year to year in proportion to the increase in regulation awareness and applications. The salaries of these civil servants in the first year of the regulation will be 1,420 GEL (average salary of the public sector) and will increase from year to year by the same rate as the average salary has increased over the last ten years (7.4%).¹⁵⁴

Table 12. Expense N2: The cost of maintaining a new administrative unit from the budget (mill GEL)¹⁵⁵

Year	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
scenario 1	(0.55)	(0.71)	(0.92)	(1.18)	(1.53)	(1.96)	(2.53)	(3.26)	(4.20)	(5.41)
scenario 2	(0.55)	(0.71)	(0.92)	(1.18)	(1.53)	(1.96)	(2.53)	(3.26)	(4.20)	(5.41)
scenario 3	(0.55)	(0.71)	(0.92)	(1.18)	(1.53)	(1.96)	(2.53)	(3.26)	(4.20)	(5.41)

The benefits and costs of regulating insolvent natural persons for each scenario were reviewed above. Naturally, there are other variables and indicators that will inevitably change after the regulation comes into force, but their monetization and reflection in cost-benefit analysis is impossible. All such indicators will be analyzed in the next subsection - SWOT analysis section.

For the user of the present Study, it is necessary to see the total economic cost-benefit effect and compare the results of different scenarios. If we summarize the benefits of each year and subtract the costs, we will get a net benefit for that particular year. As the model is for 10 years

¹⁵⁴ Geostat, *Wages*, available at: <https://bit.ly/3jcNwDC>, last access on February 1, 2021.

¹⁵⁵ The number of employees does not depend on the scenarios and each year is fixed for all three scenarios.

and it is important to know the results of the cost-benefit analysis today, the net present value calculation method will be used, which will discount each net benefit in the coming years and will give us its value for the year the regulation enters into force. The discount rate of 6.875% will be used for net interest discounting (government 10-year \$ 500 mill bond interest rate).¹⁵⁶

7.4. Summary of the results

Scenario - 1: In 2022, 3% of insolvent natural persons will apply for use of the regulation. This figure is growing and in 2031 will equal 15%.

Table 13. Summary table of cost-benefit analysis of the first scenario (mill GEL)

Cost-benefit analysis (mill GEL)	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
Total salaries	-	6.3	6.9	7.8	9.3	11.8	15.9	20.7	27.1	35.6
Profits of the banks	-	0.24	0.28	0.33	0.41	0.53	0.75	1.01	1.36	1.85
Social benefits to others	-	0.90	0.95	1.03	1.17	1.42	1.84	2.30	2.88	3.63
Budget-saved social cost	-	0.05	0.05	0.05	0.06	0.07	0.08	0.10	0.13	0.15
Business increase in salary	-	6.1	6.6	7.5	9.0	11.4	15.3	20.0	26.1	34.3
Application costs	(0.78)	(0.77)	(0.79)	(0.83)	(0.92)	(1.08)	(1.36)	(1.65)	(2.01)	(2.46)
Creation of new admin. Unit	(0.55)	(0.71)	(0.92)	(1.18)	(1.53)	(1.96)	(2.53)	(3.26)	(4.20)	(5.41)
Net benefits	(1.3)	12.1	13.1	14.7	17.5	22.1	29.9	39.2	51.3	67.6

The net present value of the 10-year cost-benefit model in the year of enactment (2022) of the regulation will be: **NPV=163.6 mill GEL.**

¹⁵⁶ Galt & Taggart, *Weekly Market Watch*, April 13, 2020, available at: <https://bit.ly/36CkR5z>, last access on February 1, 2021.

Scenario - 2: In 2022, 1% of insolvent natural persons will apply for the use of the regulation, the figure is growing and in 2031 will equal 5%.

Table 14. Summary table of cost-benefit analysis of the second scenario (mill GEL)

Cost-benefit analysis(mill GEL)	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
Total salaries		2.1	2.3	2.6	3.1	3.9	5.3	6.9	9.0	11.9
Profits of the banks		0.08	0.09	0.11	0.14	0.18	0.25	0.34	0.45	0.62
Social benefits to others		0.30	0.32	0.34	0.39	0.47	0.61	0.77	0.96	1.21
Budget-saved social cost		0.02	0.02	0.02	0.02	0.02	0.03	0.03	0.04	0.05
Business increase in salary		2.0	2.2	2.5	3.0	3.8	5.1	6.7	8.7	11.4
Application costs	(0.26)	(0.26)	(0.26)	(0.28)	(0.31)	(0.36)	(0.45)	(0.55)	(0.67)	(0.82)
Creation of new admin. Unit	(0.55)	(0.71)	(0.92)	(1.18)	(1.53)	(1.96)	(2.53)	(3.26)	(4.20)	(5.41)
Net benefits	(0.8)	3.6	3.8	4.1	4.8	6.1	8.3	10.9	14.3	18.9

The net present value of the 10-year cost-benefit model in the year of enactment (2022) of the regulation will be: **NPV=45.3 mill GEL.**

Scenario - 3: In 2022, 0.5% of insolvent natural persons will apply for use of the regulation. This figure is growing and in 2031 will equal 2.5%.

Table 15. Summary table of cost-benefit analysis of the third scenario (mill GEL)

Cost-benefit analysis(mill GEL)	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
Total salaries		1.1	1.2	1.3	1.6	2.0	2.6	3.5	4.5	5.9
Profits of the banks		0.04	0.05	0.05	0.07	0.09	0.12	0.17	0.23	0.31
Social benefits to others		0.15	0.16	0.17	0.20	0.24	0.31	0.38	0.48	0.60
Budget-saved social cost		0.01	0.01	0.01	0.01	0.01	0.01	0.02	0.02	0.03
Business increase in salary		1.0	1.1	1.3	1.5	1.9	2.5	3.3	4.3	5.7
Application costs	(0.13)	(0.13)	(0.13)	(0.14)	(0.15)	(0.18)	(0.23)	(0.28)	(0.33)	(0.41)
Creation of new admin. unit	(0.55)	(0.71)	(0.92)	(1.18)	(1.53)	(1.96)	(2.53)	(3.26)	(4.20)	(5.41)
Net benefits	(0.7)	1.4	1.4	1.5	1.6	2.1	2.9	3.8	5.0	6.8

The net present value of the 10-year cost-benefit model in the year of enactment (2022) of the regulation will be: **NPV=15.8 mill GEL.**

7.5. SWOT analysis

SWOT analysis is the managerial method used to assess the regulation of insolvent natural persons taking into account internal and external factors. The present analysis examines in detail the strengths, weaknesses, opportunities/prospects, and main threats of the regulation. A SWOT analysis is necessary to consider all the indicators that are not considered in the economic model (monetization of certain variables is not possible) and which will be affected by regulation.

Strengths: The regulation of insolvent natural persons has strengths that cannot be reflected in cost-benefit analysis, as monetization of the effects of these strengths and calculation of the benefits in numbers is impossible. In particular:

- Enforcement processes will be suspended for natural persons benefiting from the regulation and **the total number of cases of appropriation of natural person's property will decrease**, which of course will be a great benefit and emotional relief for households (due to lack of data, this effect could not be reflected in the economic model. Most cases of the appropriation of the natural person's property come from the private lenders, lending entities and microfinance organizations. This data is not available and therefore it is impossible to quantify the benefits and consider them in the model);
- After the enactment of the regulation **the number of active job seekers will increase**. There will be more competition in the labor market and the employer will be able to recruit better staff on the relevant vacancy and thus, increase the efficiency of the work process.
- **GINI index will be decreased**, which according to the latest data is 0.37. This coefficient measures the inequality between the incomes of the population (the number 0 indicates the most equal, the number 1 the most unequal). The decrease of GINI index means more equitable and sustainable economy.

Weaknesses: The regulation of insolvent natural person has weaknesses, analyzing of which is necessary. International experience shows that even in developed countries, regulation has shortcomings that hinder the operation of regulation.

- **Only certain categories of borrowers** will be able to benefit from the regulation of insolvent natural persons. Potentially, the insolvency process may affect natural persons whose loans are not se-

cured, who do not own the assets and their loan is recognized as bad, or they own assets, realization of which is possible.

- The weak part of the regulation could be **bureaucratic barriers** that hinder the regulation process. For insolvent natural persons, bureaucratic procedures should be simplified and accessible as much as possible (filling out the application, finding the required documents should not be difficult and should not pose **additional material burden**).
- The decision-making body should consider each case individually with the direct involvement of the lending financial institutions. It is expected this procedure not to be easy and to take time. **The time-consuming process** will be an additional stress for the natural person.

Opportunities: With the enactment of the regulation, the public will have the opportunity to receive a variety of significant benefits in the long run. To this end, it is necessary for the regulation of insolvent natural persons to work effectively and function more smoothly from year to year.

- In the countries where natural persons are able to benefit from similar regulations, society is less stressed. The enactment of the regulation **will have a positive impact on the happiness index**, according to the UN 2019 data, Georgia ranks 116th out of 156 countries according to this index and lags behind all neighboring countries.¹⁵⁷
- The regulation of the effectively working insolvent natural persons **reduces mortality rates and increases life expectancy**. The new regulation will give more individuals a second chance, as a result, more people will be employed and their household members will have access to better medical services.
- Effective operation of this regulation will ensure more individuals to become economically active and more employed. It is im-

¹⁵⁷ <https://s3.amazonaws.com/happiness-report/2019/WHR19.pdf>

portant that the level of involvement and employment of natural persons will maintain a growing tendency from year to year. In the long run, more employed people means that their family members **will have access to better education.**

Threats: Some of the effects of regulating insolvent natural persons may be negative, therefore, it is necessary to analyze them in order to take into account and prevent these factors in the future.

- Regulation should be a second chance only for good faith payers who have become insolvent only due to unforeseen circumstances. There is a possibility **that some individuals will approach the loan repayment process with less responsibility,** as they will have the expectation that they will benefit from this regulation in the future. This effect does not align with the main objectives of the regulation and more control will be needed in the future.
- Showing less responsibility on the part of natural persons for meeting obligations increases financial risk for the banking sector. If the increase in risk is significant, **commercial banks will raise interest rates on consumer loans to insure their risk.**
- Commercial banks will tighten lending conditions for certain categories of individuals. Lending procedures for the rich people with reliable credit history will not change, and for beginners with a limited credit history, it will be difficult to get a loan. All these means **reducing healthy competition between individuals when taking a loan on the market,** which by itself will hinder the development of the financial market.

Chapter VIII. Conclusion and recommendations

This report provides an overview of the feasibility study results on the regulation of personal insolvency. The aim of the Study was the preparation of a justification for the legislative regulation of personal insolvency. For the achieving of the set goals, the issue was studied by a multidisciplinary team of experts.

In order to prepare a comprehensive analysis of the issue, the research team primarily studied the international experience on the regulation of personal insolvency using the examples of selected jurisdictions. The relevant analysis of the economic and social situation of our country was carried out to determine the expediency of sharing the best foreign experience in Georgia. To assess the need and importance of the reform, interviews with stakeholder representatives were conducted. In order to develop a new regulatory framework, the report also provides an overview of existing legislation on insolvency and enforcement in Georgia. To demonstrate the economic and social justification of the reform, considerable attention was paid to the cost-benefit analysis of the regulation.

Despite the possibility of extending the insolvency regime to non-entrepreneurial natural persons under Georgian law of 1996-2007, the study has shown that there is no experience in the successful regulation and practice of personal insolvency in the country. Even though the legislation in force from 2007 to April 1, 2021 provided for the possibility of insolvency of entrepreneurial natural persons, conducted research has shown that the existing legal environment could not ensure adequate use of the insolvency regime, even by individual entrepreneurs. It should be noted that from April 1, 2021, the insolvency regime will be available only to entrepreneurial legal entities, and Georgian legislation will not provide for insolvency even for individual entrepreneurs, despite having more than two decades of experience in such regulation.

There are various approaches to legal regulation of personal insolvency in the world. Despite the different legal frameworks, the experience of foreign countries and the existing scientific literature in this field indicates one of the main characteristics that good legislation should have in this regard - giving the opportunity to a “fresh start” or “second chance” to a good faith debtor in the presence of adequate debt discharge regulation.

Three jurisdictions were selected to study the foreign experience of personal insolvency regulation: Lithuania, England and Wales, and Poland. The difference in the relevant legal frameworks was clearly observed. However, at the same time, several regulatory similarities have been identified, which should not be ignored in the Georgian reality: different regulation of insolvency of entrepreneurial and non-entrepreneurial natural persons, special protection guarantees for secured creditors and the need for debt discharge after the reasonable possibility of repaying debts.

Surveys on the potential regulation of personal insolvency have revealed that, so far, in Georgian society, there is a strong fear of abuse of this opportunity. It is necessary to establish effective mechanisms to prevent dishonest actions, as well as to set up an adequate rule for finding and selling property. In the opinion of stakeholder representatives, bankruptcy should not be available to natural persons until a reasonable opportunity to satisfy creditors on an agreed schedule is exhausted. As it turned out, debt collection from natural persons in practice, mainly lasts from 3 to 5 years. Therefore, respondents believe that attempts to satisfy creditors by paying off debts under the new regulation during this period are appropriate considering the amount of liabilities in each case.

Debtor insolvency is an economic event. Consequently, it is impossible to assess the need for an insolvency regime without analyzing the key indicators determining the economic situation of the country. The Study clearly showed the trend observed in terms of loans given to natural

persons. Analysis of various indicators of the financial market shows the need for the regulation in the near future, in particular:

- The average number of borrowers per 1,000 natural persons in Georgia is growing the fastest in the last 10 years compared to the other countries in the region;
- The share of loans taken by natural persons in GDP has increased from 14% to 37% since 2012;
- According to the data for the third quarter of 2020, 48% of loans to households are secured by residential real estate or commercial real estate;
- According to the Financial Stability Report 2020 of the National Bank of Georgia, as of December 31, 2018, more than 700,000 people have overdue loans;
- According to 2019 data, 158, 422 natural persons are registered in the debtors' registry;
- 62% of low-income borrowers (with a salary of less than GEL 1,000) have to pay 35% of their income in loan servicing and with the remaining amount it's hard for them to pay daily expenses. 10% of low-income borrowers pay 45-55% of their income on loan servicing.

The personal insolvency regulation should become a second chance for honest natural persons who, under the influence of external factors, have been unable to repay their loan obligations. An important factor is that in many developed countries this regulation has been operating for several decades. Also, some countries have adopted the regulation a few years ago. For the effective functioning of the regulation, just adoption of the regulation is not enough. In parallel with the regulation, it is important that other, seemingly insignificant, but essentially necessary related links also work effectively.

Procedures for collecting the required documentation should be simple for the potential applicant and initiating the process should not constitute a material burden that individuals cannot bear. International expe-

rience reveals that procedurally incorrect regulations lead to unfavorable results (in Poland, only 2.8% of applications for the use of the regulation were approved in 2009-2012).

Natural persons benefiting from insolvency regulation in different countries enjoy a compiled payment schedule, which is prescribed for a period of 3 to 8 years, in most cases, the duration is 5 years.

It is important that all stakeholders are well aware that personal insolvency regulation is a reform aimed at long-term benefits and, consequently, it would be wrong to have false expectations from the public in the short term.

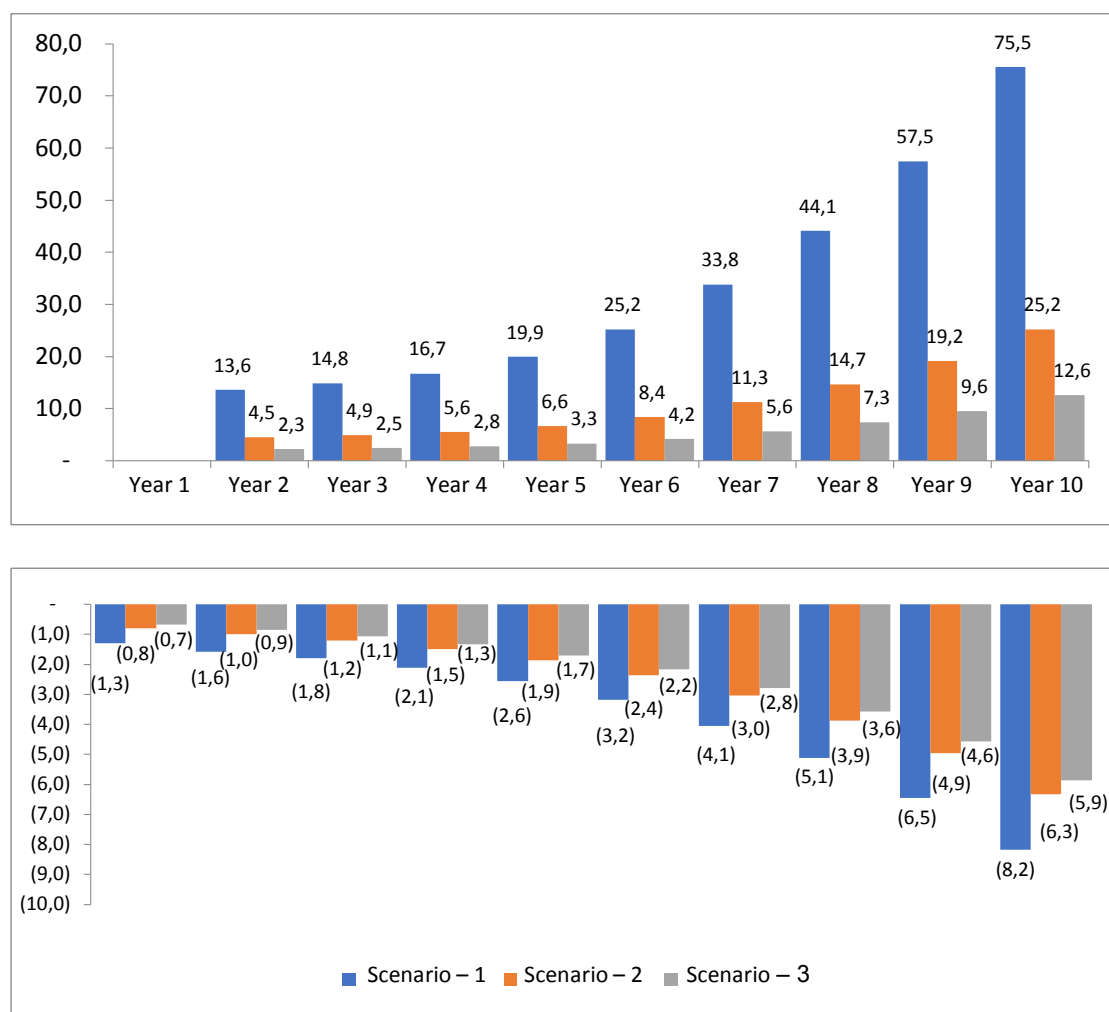
In parallel with the enactment of the regulation, it is necessary to launch an information campaign aimed at raising awareness about the new regulation. The public should have a good understanding of how the regulation works, who can benefit, which documents to submit, how to make a complete application, payment of the registration fee, etc. Individuals should not have the feeling that the use of regulation is unattainable. They must believe in a second chance and in the possibility to actually return to a perfect, economically active life.

An economic cost-benefit analysis (and not financial cost-benefit) was conducted as part of the study. In a 10-year period, economic benefits and expenditures were modeled for different segments: for natural persons, the banking sector, the public, the business sector, and the state (budget savings).

Economic cost-benefit analysis was performed for three different scenarios: optimal scenario when initially 3% of insolvent persons fill out an application for a regulation (in the 10th year the level of involvement reaches 15%); standard scenario, where 1% of insolvent persons benefit from regulation (5% in the 10th year); and a pessimistic scenario where the corresponding percentage at the beginning is 0.5% (up to 2.5% in the 10th year). Benefits and costs were calculated for each scenario and

the net present value of the 10-year model was calculated using the discount method.

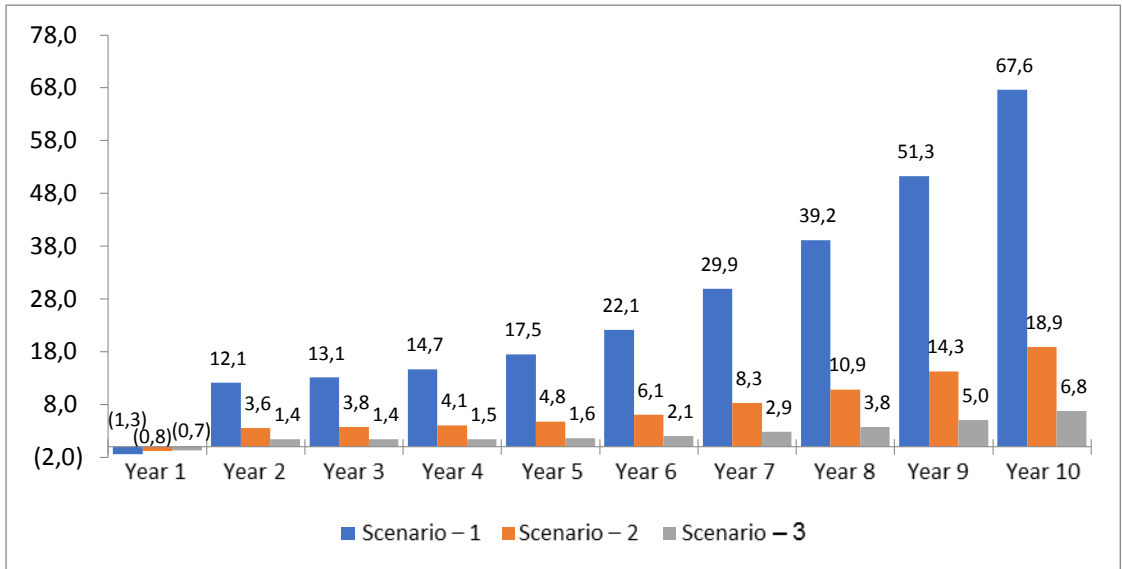
Chart 16. Total benefits and expenses by years and scenarios (mill. GEL)



The first part of graph 16 shows the total benefits to the economy for each year and scenario (cumulatively for all segments). The second part

of the same chart for the relevant scenarios and for years shows the cost figures as well. Data are given in million GEL.

Chart 17. Net benefits according to years and scenarios (mill GEL)



Graph 6 shows the net benefit (benefit less expenses) by scenarios and years. The net cost for each scenario was calculated by discounting the net cost-benefit of the 10-year model for the year the regulation enters into force:

- Optimistic scenario **NPV=163.6** mill. GEL
- Standard scenario **NPV=45.3** mill. GEL
- Pessimistic scenario **NPV=15.8** mill. GEL

Conducted study and economic cost-benefit analysis show that the introduction of the personal insolvency regulation is necessary. Regulation, even in the development of the most pessimistic scenario, will have a positive economic and social effect. An important factor is that this

regulation will improve the welfare of society from year to year and make the sector of natural persons more resilient to economic shocks.

As a result of the feasibility study, a group of researchers elaborated the following conceptual recommendations for the development of insolvency legislation in Georgia:

Scope of the regulation

The regulation of insolvency of entrepreneurial and non-entrepreneurial natural persons should be implemented differently. Natural persons who do not engage in entrepreneurial activities while taking on commitments act to meet personal and family needs, whereas entrepreneurial individuals enter into relationships with lenders to make a profit from running a business. Therefore, it is recommended to treat the insolvency of consumers and the self-employed differently. Given the substantive differences of the available regimes, the determination of the form of regulation depends on the discretion of the legislator and was not the focus of the present study.

Prerequisites for using the insolvency regime

The research team believes that the insolvency proceedings should be available only to good faith debtors who have become insolvent due to circumstances unrelated to their bad faith actions. Despite the foreign experience, determining the minimum amount of debt owed by the debtor to initiate the procedure is not recommended in the Georgian reality. However, in order to initiate insolvency proceedings by creditors, it is advisable to set a minimum amount of claim to avoid damaging the substantial interests of the debtor or other creditors as a result of regulatory manipulation by small lenders.

Protection of creditors

The insolvency regime should not violate the substantive norms of the sequence and priority of creditor satisfaction established by the Georgian legislation. Therefore, it is necessary for the new regulation to unequivocally define the mechanisms for securing the claims of secured creditors, which are already available to secured creditors in case of corporate insolvency according to 2020 Law of Georgia on Rehabilitation and Collective Satisfaction of Creditors.

Consequences of initiating insolvency proceedings

The personal insolvency regulation should share the protection mechanisms of the insolvency legislation in force in Georgia, which are available to legal entities in case of initiation of the process. In particular, the commencement of insolvency proceedings should result in a moratorium on current and future enforcement proceedings against debtors and the accrual of interest and penalties.

Consequence of completion of insolvency proceedings

To provide a second chance and a fresh start for good faith debtors, it is essential that insolvency regulation envisages full discharge of debt (with legitimate exceptions such as secured claims) after the expiration of the period specified in the debt repayment plan. Upon the commencement of the insolvency proceedings, a court-appointed insolvency specialist must search for the debtor's entire property, identify creditors' claims, and assess the debtor's future income. If the court finds that the debtor has the ability to repay the debt, the repayment schedule should be determined for a specified period, after which the debtor must be discharged from unpaid debts. The law should determine the upper limit of the time allowed for the debt payment plan. According to the conducted research, it is recommended to be up to 3-5 years period.

