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REPUBLIC OF LATVIA

EVALUATION OF THE INSOLVENCY FRAMEWORK

José M. Garrido, Amira Rasekh, Adolfo Rouillon

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GLOSSARY

EBRD	European Bank for Reconstruction and Development
EC	European Commission
EU	European Union
GDP	Gross Domestic Product
IMF	International Monetary Fund
LPP	Legal Protection Proceedings (Reorganization)
MoJ	Ministry of Justice
SMEs	Small and Medium Enterprises
TA	Technical Assistance
UNCITRAL	United Nations Commission for International Trade Law
WB	World Bank

PREFACE

At the request of the Latvian authorities, the IMF engaged in an evaluation of key aspects of the insolvency regime of Latvia, focusing especially on the regime of insolvency administrators, the general efficiency of the insolvency system and the collection of data and statistical reports on insolvency.

The IMF team conducted the following missions: October 2017 (Mr. Rouillon); May 2018 (Mr. Rouillon); Sept-Oct 2018 (Mr. Garrido, Ms. Rasekh and Mr. Rouillon). During the missions in Latvia, the team met with the government authorities with direct competences over the matters covered in the current report. In addition, meetings were held with other authorities, such as the judiciary, the registries, as well as with various private sector stakeholders, including credit institutions, business associations and specialists from law firms.

The team would like to thank all the institutions and individuals for their warm hospitality and courtesy extended throughout its work, and for the comprehensive and candid discussions held. Particular thanks go out to the staff of the Ministry of Justice, the Insolvency Control Service and the Court Administration for their excellent support and their assistance in organizing the mission schedule.

EXECUTIVE SUMMARY

1. **Latvia has undertaken ambitious reforms of its insolvency framework.** These important reforms have affected multiple parts of the insolvency system. The Latvian authorities adopted Insolvency Policy Development Guidelines for the period 2016-2020 with the objective of assessing the issues in the insolvency system and the priorities and outcomes to be achieved.

2. **An evaluation of the reforms and their implementation presents a unique opportunity of taking stock of the reform efforts and their results**. The IMF team has worked with the Latvian authorities in the analysis of key areas of the insolvency system: the regime of insolvency administrators; the general efficiency of the insolvency system, including Legal Protection Proceedings, no-asset cases, and going-concern sales of businesses in liquidation[1]; and the data collection and statistical systems.

3. **The regime of insolvency administrators has been strengthened.** Special circumstances have increased the attention on the situation of insolvency administrators in Latvia. The authorities have devoted considerable resources and efforts to the improvement of the regulation and supervision of insolvency administrators.

4. **There are numerous areas of the regime of insolvency administrators where the positive effects of reforms are noticeable**. These include: the qualification requirements, including the conduct of examinations; the requirements to renew the license; the enhanced supervision by the Insolvency Control Service; and the system for the appointment of insolvency administrators. The Insolvency Control Service has increased its resources for the supervision of insolvency administrators, on-site and off-site; and has dealt effectively with the complaints against insolvency administrators.

5. **There are still some areas for improvement in the regulation of insolvency administrators.** The assessment of the reputation of candidates to obtain or renew an insolvency administrator license would benefit from clear and objective rules. The licensing period should be extended beyond the current 2-year period, and in any case insolvency administrators should be allowed to conclude the cases for which they were validly appointed. The appointment system could introduce categories of insolvency administrators, to prevent that a purely random mechanism results in the appointment of inexperienced insolvency professionals for complex cases. Expenses in the insolvency procedure should be contained, so as not to absorb all resources and leave insolvency

[1] In this Report, "liquidation" refers to a winding up or bankruptcy procedure governed by the Law on Insolvency, which is aimed at liquidating the assets of an insolvent debtor to pay off creditors claims prorated. This Report does not cover liquidation of solvent companies, governed by Commercial Law.

administrators without remuneration. The rules on insurance should be modified to ensure adequate coverage in all cases.

6. **The performance of the insolvency system is not entirely satisfactory**. The authorities have identified a number of issues that require careful monitoring and possibly also targeted legal and regulatory reforms. These issues include: the general efficiency of the system, as evidenced in the creditors' recovery rates; the lack of use –and misuse- of Legal Protection Proceedings; the high number of no-asset cases; and the difficulties in selling businesses as a going concern. These issues are analyzed in this report.

7. **The general efficiency of the system needs to be evaluated on the basis of data**. There has been some analysis on the efficiency of the insolvency system in Latvia. Some of its conclusions are adequately supported by data, but others –such as the recovery rates for secured creditors- have been influenced by the methodology used to assess the verifiable data. For this reason, it is extremely important to establish robust foundations for the data collection and statistical methodology.

8. **Legal Protection Proceedings present several challenges**. Legal Protection Proceedings, as the main instrument for the reorganization of viable enterprises in Latvia, do not seem to be fulfilling that function. The number of cases where a plan is concluded is limited, and this suggests that the procedure is used, in many cases, just as a delaying tactic against creditor action. A series of changes would be required to introduce a proper balance between reorganization and liquidation in the Latvian insolvency system, facilitating the rehabilitation of viable businesses and long-term growth.

9. **The high number of no-asset insolvency cases in Latvia can be explained by factors outside the insolvency system**. The elevated numbers of filings of no-asset cases could be connected to some tax rules that require the completion of an insolvency process in order to deduct tax payments. Use of "shell companies" can also contribute to the high percentage of cases with no assets. There are also tax rules establishing the liability of directors that may motivate an inefficient use of insolvency proceedings. The problem of no-asset cases could be tackled by establishing a presumption of deliberate insolvency in such cases and, especially, by introducing special summary proceedings that would allow closing no-asset cases with minimum use of scarce public resources and ensuring that there is always the possibility of recovering assets and pursuing those responsible for the insolvency of the company.

10. **Incentivizing the sale of businesses as a going concern could contribute to the effectiveness of the liquidation regime**. Most liquidations result in the piecemeal sale of assets of the insolvent enterprise. The sale of the business as a going concern –or the sale of business units- should be privileged as a more efficient solution of the liquidation of enterprises. Going-concern sales require clear rules for the continuation of the business in

insolvency proceedings, the possibility of including encumbered assets and contractual relationships, and flexibility in both the time and modality of the sale. Sales of businesses require the implementation of proper safeguards, and adequate protection of the position of acquirer.

11. **Latvia has a sophisticated data collection system**. The Latvian authorities have devoted resources to the establishment of insolvency data collection systems: the Insolvency Register captures important information on all insolvency proceedings; the Insolvency Control Service gathers abundant data from the insolvency administrators' reports and compiles comprehensive statistical reports on the Latvian insolvency system.

12. **There are some issues in data collection and the methodology for the elaboration of statistical reports**. A description of procedures and the representation of procedures with flowcharts allows for the identification of milestones and data collection points: this would result in a more granular data collection system, able to determine the duration of each procedural phase and to extract significant information from each relevant moment in the proceedings. The methodology for statistics needs some adjustments, particularly in the measurement of costs and of the recovery of secured credit. The contents of reported data could include economic information –this would increase the use of statistical reports, raising awareness about the importance of the insolvency system among other authorities.

13. **The integration of the different data systems would increase the effectiveness of supervision**. The data collection system could be further improved with the integration of the Court Information system, which provides additional information and allows for the verification of information reported by insolvency administrators. The supervision of insolvency administrators can be enhanced by expanding their reporting duties in the electronic system. Controls over the supervisors of Legal Protection Proceedings could also be introduced in the electronic system. Reports can then be analyzed for statistical purposes.

14. **The process of revision and upgrade of the insolvency system is continuous.** Legal reforms take time to be absorbed by users of the system, and institutional changes take even longer to display full effects. For this reason, the commitment of the Latvian authorities to the development of the insolvency system should yield results. The performance of the system, however, depends on multiple factors that fall outside the powers of the courts or the Insolvency Control Service. Therefore, performance indicators for the courts or the insolvency regulator should focus only on actions that lie within the powers of such institutions.

15. **The analytical work done and the ongoing data collection efforts place Latvia in a privileged position to undertake further initiatives to improve its insolvency system**.

The future will bring additional challenges and opportunities for the development of the insolvency system. Latvia is well prepared to implement the future EU Directive on restructuring and should be more ambitious and go beyond European requirements to continue improving its system and achieve excellence.

Table 1. Main Recommendations

Recommendations	Competent Authority	Priority	Paras.
Insolvency Administrators' Regime			
Qualification criteria: establish objective grounds specified by the law or applicable regulation for the assessment of the reputation of candidates	Ministry of Justice (MoJ); Insolvency Control Service	High	23
Extend the 2-year period for the validity of insolvency administrators' licenses; and allow validly appointed administrators to conclude their insolvency cases	MoJ; Insolvency Control Service	High	29
Introduce categories of insolvency administrators in the random system for appointments	MoJ; Insolvency Control Service	High	31
Modify the rules for the remuneration of insolvency administrators in no-asset cases, reserving resources for the payment of the remuneration	MoJ; Insolvency Control Service	High	41
Avoid excessive expenses by establishing in the law that the maximum amount of expenses can only modified by unanimous consent of the creditors	MoJ; Insolvency Control Service	High	42
Ensure adequate insurance coverage for insolvency administrators	MoJ; Insolvency Control Service	High	50
Functioning of Insolvency Proceedings			
Reform Legal Protection Proceedings to introduce a better balance between reorganization and liquidation and avoid the misuse of these proceedings.	Government, MoJ	High-to-Medium	56

Recommendations	Competent Authority	Priority	Paras.
Tackle the high number of filings of no-asset insolvency cases by reviewing and, if needed, modifying tax legislation; -introducing a presumption of deliberate insolvency; and – introducing a summary proceeding for no-asset cases	Government, MoJ; Ministry of Finance	High-to-Medium	58
Reform the insolvency law to incentivize sales of businesses as a going concern	Government, MoJ	High-to-Medium	60
Insolvency and Data Collection Systems			
Introduce revisions to the methodology for the insolvency statistics	Insolvency Control Service	High	104-114
Increase the amount of data incorporated to the statistical reports, especially for Legal Protection Proceedings	MoJ, Insolvency Control Service	Medium	103
Increase the exchange of insolvency data among the systems of the Enterprise Register (Insolvency Register), Court Administration (Court Information System) and Insolvency Control Service	MoJ, Court Administration, Insolvency Control Service, Enterprise Register	Medium	106, 115
Make use of the existing and newly collected data to enhance the supervisory functions of the Insolvency Control Service	Insolvency Control Service	Medium	114-117
Revise the performance indicators for the insolvency system	Government	High	73

High priority: 6-12 months
High-to-Medium priority: 12-24 months
Medium priority: >24 months

INTRODUCTION

A. General Background

16. The Latvian Ministry of Justice (MoJ) sought the assistance of the IMF for an evaluation of some key areas of the insolvency system. The authorities' decision to start a reform process of the regulatory framework for insolvency was a result of the general perception that implementation of insolvency proceedings has been negatively affected by the lack of effectiveness of a number of insolvency administrators and abuses of the system. Different types of abuses of the insolvency system in the period 2008 – 2014 would have produced significant losses to creditors, estimated in the range of EUR 580.000.000 to EUR 750.000.000 with the mean of EUR 665.000.000.[2]

17. The Cabinet adopted the Insolvency Policy Development Guidelines (2016 – 2020) to lead the reform process. The Guidelines include recommendations on: (i) increasing the use of rehabilitation and out-of-court restructuring mechanisms; (ii) strengthening the liquidation procedure, particularly increasing the creditor recovery rate and reducing costs of proceedings; (iii) strengthening licensing and supervision of the insolvency administrators; and (iv) assessing whether personal insolvency proceedings are too flexible and may be subject to abuse by bad faith debtors.

18. As agreed with the Latvian authorities, this Report is aimed at assessing the implementation of a number of important aspects of the insolvency system. The scope of the TA evaluation is the following:

I. The insolvency administrators' regime, including licensing, appointment, remuneration, liabilities and supervision system;
II. Some issues that are negatively affecting the efficiency of insolvency proceedings for legal entities, namely: high number of insolvency proceedings of assetless enterprises; low use of going concern sales in liquidation; and misuse and challenges of reorganization proceedings;
III. Insolvency and data collection systems, with a focus on the performance of insolvency proceedings and administrators.

19. This report focuses on the practical aspects of the operation of the insolvency system, especially on the regulation and supervision of insolvency administrators and the collection of data. Because of the specific focus of this report, the recommendations included in it are based on the analysis of the Latvian system and do not refer to the international insolvency standard (WB Principles and UNCITRAL Recommendations) or other conceptual frameworks (such as the EBRD Insolvency Office Holder Principles), since the standards typically provides high-level recommendations.

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[2] This calculation takes into account financial loss (direct and indirect loss to secured and unsecured creditors) and non-financial loss (due to depreciation of assets, due to opportunity cost of capital and due to GDP multiplier effect). See: Foreign Investors Council in Latvia and Deloitte, *Insolvency Abuse Report 2016*, available at http://www.ficil.lv/wp-content/uploads/2017/04/16-04-06-FICIL-Insolvency-Abuse.pdf.

B. Overview of Latvian Insolvency Proceedings

20. Latvian insolvency law contemplates three insolvency proceedings for legal entities, namely:

- **Legal entity insolvency (liquidation) procedure.** The insolvency procedure for legal entities is aimed at liquidation of the assets of an insolvent legal person in order to distribute the proceeds among its creditors, according to the ranking of claims specified in the law. It is a full in-court procedure where an insolvency administrator takes over the administration of the insolvency estate and must realize all the debtor's assets within a short time period. Insolvency administrators must be licensed professionals. At any stage of the process, liquidation may be converted into a rehabilitation proceeding according to a plan approved by the creditors.
- **Legal protection proceedings (LPP).** The LPP is a full in-court rehabilitation proceeding where the debtor and its creditors negotiate a rehabilitation plan which should be voted and approved by unsecured creditors representing more than half of unsecured claims and secured creditors representing two thirds of secured claims. Upon court confirmation of the plan, it will be binding on all creditors including those who did not approve the plan. The law allows a flexible content for the plan, but it must be completed in 2 years and, with creditors consent, it can be extended for another 2 years. The plan is overseen by a supervisor who does not need to be a licensed insolvency professional.
- **Extrajudicial (out-of-court) legal protection proceedings (ELPP).** The ELPP is a hybrid out-of-court / in-court rehabilitation proceeding akin to an expedited or abbreviated reorganization procedure intended to process a prepackaged plan. Negotiations are conducted out-of-court and, upon approval of a plan by the same majorities of creditors that apply in an LPP, a brief in-court proceeding is initiated to obtain court confirmation of such a plan. Otherwise, the legal requirements of a plan under an LPP and its effects also apply to an ELPP plan upon its confirmation by the court.

I. THE INSOLVENCY ADMINISTRATORS' REGIME

A. Licensing and Registration of Insolvency Administrators

i) Legal Framework

21. The Latvian legal framework governing the insolvency administrators' system is comprehensive and detailed. This regime is developed in the Insolvency Law[3] and several regulations issued by the Cabinet of Ministers.[4] The Insolvency Law contemplates two types

[3] The Insolvency Law entered into force on 1 November 2010 and has been amended several times. The latest amendments considered at the time of drafting this Report, entered into force on 1 July 2018.

[4] Regulation No. 246 (19 April 2016) regarding the Operational Report of the Administrator of Insolvency Proceedings and the Procedures for Filling in Thereof. Regulation No. 233 (3 May 2017) on Disciplinary

of professionals for insolvency proceedings of legal entities; namely: (i) a supervisor of Legal Protection proceedings[5], and (ii) an administrator of Insolvency (liquidation) Procedure.[6] The law does not establish any licensing or registration requirement with respect to supervisors of LPPs. Insolvency administrators, on the other hand, must satisfy strict legal requirements to obtain a license and be qualified to act as such. The Director of the Insolvency Control Service is the authority in charge of "appointing an administrator to the office" (licensing) after he or she passed an examination specified in the law.[7] The Director of the Insolvency Control Service also issues an "administrator's office certificate" which expires after two years.[8]

ii) Selection: Qualification Criteria

22. The law specifies qualification criteria for obtaining a license that are consistent with generally recognized good practices. An Examination Commission appointed by the Minister of Justice evaluates persons who wish to take the office of an administrator.[9] Only a natural person may be licensed (certified) to act as an insolvency administrator, if he/she: (i) is at least 25 years old, (ii) has obtained a high degree in law, (iii) is fluent at the highest level in Latvian language, (iv) has at least three years of work experience, (v) has passed the insolvency administrators' exam, and (vi) enjoys impeccable reputation.[10]

23. The criteria and procedure for evaluating a candidate's reputation are not well-defined. The Insolvency Control Service must provide the Examination Commission with information that could indicate that an applicant's reputation is not impeccable.[11] It is not clear however, if the Insolvency Control Service should gather or request information on each applicant's reputation and what data should be considered as relevant to negatively

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Proceedings of Insolvency Administrators and Supervisors of Legal Protection Proceedings. Regulation No. 286 (30 May 2017) on Rules for the Supervisor of the Legal Protection Proceedings and the Administrator of the Insolvency Procedure. Regulation No. 288 (30 May 2017) on Procedures for Training Applicants for the Office of Administrator of Insolvency Proceedings, for Examining Them, Procedures for the Operation of the Examination Commission and Procedures for Appointing, Releasing, Removing and Discharging from Office and the Suspension of Professional Activity of the Administrators of Insolvency Proceedings.

[5] Insolvency Law, Chapter I[1] "Person Supervising Legal Protection Proceedings".

[6] Insolvency Law, Chapter II "Administrator".

[7] Insolvency Law, Section 13.[1] (1).

[8] Insolvency Law, Section 13.[1] (2).

[9] Insolvency Law, Section 16.[1] (1). The Examination Commission is composed of one representative from each of the following: the Ministry of Justice, the Insolvency Control Service, academic staff of higher education institutions, and the Association of Administrators. The examination commission also includes a judge from a district (city) court specified by the Judicial Council and a representative of a non-governmental organization appointed by the Advisory Council on Insolvency Matters.

[10] Insolvency Law, Section 13. (1).

[11] Regulation No. 288, 15. Available in English at https://likumi.lv/ta/en/en/id/291198-procedures-for-training-applicants-for-the-office-of-administrator-of-insolvency-proceedings-for-examining-them-procedures-for-the-operation-of-the-examination-commission-and-procedures-for-appointing-releasing-removing-and-discharging-from-office-and-the-suspension-of-professional-activity-of-the-administrators-of-insolvency-proceedings

affect such reputation. The elements on which the Examination Commission should base its opinion regarding compliance or non-compliance with the requirement of impeccable reputation are not clearly defined. A negative opinion from the Examination Commission prevents the applicant to take the exam and, consequently, excludes him or her from being licensed as an insolvency administrator.[12] This decision should be based on objective grounds specified by the law or applicable regulation. Clear and publicly known guidelines should make the evaluation system more objective and prevent arbitrary decisions.

iii) Examination and Licensing

24. Licensing of insolvency administrators is adequately linked to a well-organized and rather strict examination procedure. Before being licensed, candidates are examined on insolvency law and practice, and other subjects relevant for performing insolvency administrator functions. A pre-condition for the examination is attending a training course and obtaining a certification issued by the organizer of such course.[13] The Examination Commission develops the curriculum for the exams, which are conducted by the Insolvency Control Service and evaluated by the mentioned commission. The exam consists of three parts, namely: (1) a general examination of the applicant's theoretical knowledge, in writing; (2) resolving a practical task (a case), also in writing; (3) oral examination of the applicant's theoretical knowledge, and an interview in which several competencies are verified (motivation to hold an administrator's office, communication and organizational skills, systematic thinking skills, and dispute resolution skills) as well as other questions related to the administrator's profession.[14] If an applicant fails one of the above-mentioned exam parts, the Insolvency Control Service cannot appoint him/her into office. Upon receipt of the exam evaluations submitted by the Examination Commission, the Director of the Insolvency Control Service must immediately issue an order appointing (licensing) the applicant who passed the exam.[15]

iv) Registration

25. All licensed insolvency administrators are registered at the Insolvency Register, which is electronic, up to date, accessible online and free of charge. The Insolvency

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[12] Regulation No. 288, 17.6.

[13] Insolvency Law, Section 15 (1). According to Regulation No. 288, II. 3, an administrator applicant must receive training in at least the following areas: (1) insolvency and professional ethics of administrators (30 academic hours); (2) accounting and finance (20 academic hours); (3) the special procedure for civil procedure (10 academic hours); (4) taxes and their administration (10 academic hours); (5) economics and business administration (10 academic hours); (6) labor law and employee protection in the event of employer's insolvency (10 academic hours); and (7) record keeping and archiving (10 academic hours).

[14] Each part of the examination takes place on another day (Regulation No. 288, 33). The first part of the exam (20 questions) takes one hour, the second part of the exam three hours, and the third part of the exam takes half an hour (Regulation No. 288, 35).

[15] Regulation No. 288, 70.

Register[16] is held by the Register of Enterprises of the Republic of Latvia.[17] It is expected that upon the implementation of the Electronic Insolvency Accounting System[18] in 2019, all data concerning insolvency administrators will be uploaded in such system and directly transferred to the Insolvency Register online.

v) *Continued Education and Revalidation of License*

26. Continued education and revalidation of license are mandatory for insolvency administrators. All insolvency administrators must periodically revalidate their license by passing a so-called qualification exam every two years.[19] During the license validity period (2 years), an insolvency administrator has to attend at least 32 academic hours of "qualification improvement activities"[20] as a pre-condition for taking the qualification exam to renew their license.[21] The Insolvency Control Service organizes and administers the process of the qualification examination at least three times per year. The Examination Commission evaluates an administrator's theoretical knowledge necessary for performing the duties of the office of an administrator, as well as the abilities to use this knowledge in practice. Insolvency administrators who, due to objective reasons, are not able to take the qualification examination or fail to pass the exam may take it the next time these examinations are organized. The Insolvency Control Service may extend the period for taking the next qualification examination, and in the meantime, administrators will be able to continue performing the insolvency administrator's functions.[22]

27. The license revalidation process is contributing to improve the insolvency administrators' reputation. As a result of numerous cases of inefficient performance as well as serious abuses of the insolvency system and some criminal activities of a reduced number of insolvency administrators, members of the insolvency profession have been (and still are) experiencing low reputation in Latvia. The revalidation process started in 2017 is producing favorable effects in terms of both reducing the number of certified administrators and canceling the license of some professionals who did not perform well in the recent past. Since the revalidation process started, 218 insolvency administrators took qualification exams: of these, 32 failed and 186 revalidated their license. Other licenses have been canceled because a number of insolvency administrators did not take the qualification exam or voluntarily requested termination of their certificates. As a consequence of the mentioned process, the number of certified insolvency administrators has diminished from 312 (January 2017) to 216 (October 2018).

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[16] Information on certified and registered insolvency administrators is available in English at https://maksatnespeja.ur.gov.lv/insolvency/practitioner/en

[17] Governed by the Law on the Enterprise Register of the Republic of Latvia, available in English at https://likumi.lv/ta/en/en/id/72847-on-the-enterprise-register-of-the-republic-of-latvia

[18] Insolvency Law, Section 12^1.

[19] Insolvency Law, Section 16^2, (1).

[20] To be considered as "qualification improvement activities", these should coincide with the areas specified in Regulation No. 288, II. 3 (see: *Examination and licensing*, above, 24).

[21] Insolvency Law, Section 16^2, (2).

[22] See Insolvency Law, Section 16^2; Regulation No. 288, IX.

28. Although the performance of insolvency administrators is not yet perceived as being fully satisfactory, it has improved over the past couple of years. Most key players of the insolvency system interviewed during the missions in 2017 and 2018 evaluated the tightened license revalidation process, including cancellation of licenses of insolvency administrators who failed the exam or chose not to submit to the examination, as a positive step towards the enhancement of the insolvency administrators' profession and the improvement of its reputation. Assigning and strengthening the licensing and supervisory authority to the Insolvency Control Service appears to be achieving its intended results.

29. The current validity period of an insolvency administrator license –two years– is not optimal. Having to revalidate the license every two years may make sense for the transition period started in 2017. In the near future, however, an excessively short validity period could make the recertification process too burdensome and complex to implement for both the Insolvency Control Service and the insolvency administrators. Moreover, removing insolvency administrators from insolvency proceedings when their license is not renewed could be problematic for the effectiveness of ongoing proceedings. An insolvency administrator appointed in a proceeding when just a few months (or even days) remain until his or her license expires will have little incentive to take mid- or long-term measures aimed at improving the outcome of the process –such as promoting actions to recover assets or pursue the directors' personal liability, which typically are long lawsuits. Repeatedly changing insolvency administrators in a proceeding is not an ideal solution either. If a license is not renewed, it would be better to allow the insolvency administrator to continue acting in the proceeding where he or she was already appointed and until the case is terminated – unless the revalidation was denied for misconduct. This approach would imply that in most instances the lack of revalidation will have no retroactive effects: the administrator who did not renew his / her license will be excluded from the lists for future appointments and not removed from unfinished insolvency proceedings.

B. Administrators in Insolvency Proceedings

i) Appointment System

30. A new procedure for appointing administrators will enhance transparency and consistency with the requirements of a random appointment system. There are clear legal provisions concerning the manner in which an insolvency administrator is selected for appointment and appointed.[23] In each particular case, only the court appoints an insolvency administrator. Until December 2018, however, the court appointed an administrator at the recommendation of the Insolvency Control Service, which selected the candidate following an order established in a list previously prepared and publicly available. [24] The law has been

[23] Insolvency Law, Section 19. Regulation No. 1001 (26 October 2010) on "Procedure in accordance with which the Insolvency Administration selects and recommends to the court a candidate to the office of an administrator of insolvency proceedings".

[24] Several stakeholders interviewed by the mission criticized the old appointment system as being potentially vulnerable to manipulation.

recently amended, specifying a new procedure according to which the Insolvency Control Service will no longer recommend any candidate to the court.[25] After January 2019, each insolvency administrator will be directly selected by the court (from a list maintained in the Insolvency Control Service System), using a fully automatic and electronic mechanism of the Court Information System.

31. Random selection from a common list does not always guarantee the suitability of an administrator, especially in complex cases. Many users of insolvency proceedings complain about insufficient expertise or lack of resources of some insolvency administrators appointed in cases involving large legal entities. This weakness of a purely random selection system could be resolved by establishing different lists according to years of experience and specific skills of candidates as well as considering the type of debtor involved in insolvency proceedings (legal entities or natural persons). Separate lists according to diverse territorial jurisdiction of the courts with competence on insolvency proceedings may also be advisable.[26]

ii) Conflicts of Interest

32. The law contemplates in detail several restrictions preventing an insolvency administrator from acting in certain insolvency proceedings, including classic conflict of interest situations.[27] An insolvency administrator appointment may be reviewed upon grounds of conflicts of interest such as: (i) the administrator is an interested party with respect to the debtor, (ii) the administrator and the debtor have been engaged in labor legal relationships during the last five years before the date of announcement of the respective insolvency proceedings, (iii) a debtor has rights to claim against the administrator or vice versa (iv) the administrator is personally interested in the insolvency proceedings or there are other circumstances giving grounds to doubts about the administrator's objectivity, (v) family relationships between the administrator and the debtor or the debtor's administrators.[28] If any of the aforementioned situations apply to an appointed insolvency administrator, he or she must immediately notify the court and the Insolvency Control Service. Otherwise, the court on its own initiative or at the request of the Insolvency Control Service or the creditors' meeting may review the appointment and remove an insolvency administrator affected by a conflict of interest.[29] The review procedure is always conducted, and the decision issued by the court.[30]

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[25] Insolvency Law, Section 19.

[26] Since there is more than one judicial district in the country, organizing an administrators' list for each district would allow each administrator to decide if he will work in cases dealt with by courts of any district or only in one judicial district.

[27] Insolvency Law, Sections 20 – 23. Law on the Prevention of Conflicts of Interest in Activities of Public Officials, Sections 20 and 21.

[28] Insolvency Law, Section 20.

[29] Insolvency Law, Section 22.

[30] See Articles 363.[14] and 363.[28] of the Civil Procedure Law.

iii) Resignation

33. The system deals adequately with the resignation of insolvency administrators. An administrator is entitled to withdraw from the performance of duties in an insolvency proceeding at any given moment, if due to objective circumstances he or she is unable to fulfil the duties of an administrator. To withdraw from the proceedings, an administrator must lodge a justified application with the court which must assess whether the mentioned circumstances are indeed justifiable. There is jurisprudence considering that the absence of assets ("empty proceedings" where an administrator typically receives small remuneration) or the unwillingness of an administrator to act in a particular case, are circumstances that do not justify a resignation.[31] When resigning from insolvency proceedings, an administrator must attach to the application an overview of his or her activities and an acceptance and delivery statement for documents and properties, so that the court can assess the administrator's activities in the proceedings.[32]

iv) Removal

34. The law effectively specifies the grounds upon which an insolvency administrator may be removed from an insolvency proceeding. Such grounds include several breaches of duty (not complying with the requirements of the laws and regulations governing insolvency; not executing a court decision; not fulfilling a legal obligation imposed by the Insolvency Control Service); negligence or undue delay (not ensuring the effective course of insolvency proceedings); bad faith; criminal activities, etcetera.[33] An administrator will be removed by the court upon its own initiative, by application of the Insolvency Control Service or the administrator or at the proposal of the creditors' meeting. The process for removal of an insolvency administrator should be conducted speedily and transparently, and the court decision on removal may be appealed.[34]

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[31] Information provided by staff from the Insolvency Control Service (opinion based on several court rulings, e.g., Zemgale District Court decision in civil caseNr.C15162414 from April 25, 2018, Vidzeme Suburb Court of Riga City decision in civil case Nr.C27158112 from December 7, 2018 and Vidzeme Suburb Court of Riga City decision in civil case Nr.C-5799-18 from July 16, 2018).

[32] Insolvency Law, Section 23.

[33] Insolvency Law, Sections 22 and 20.

[34] See Article 363^{14}(12) and Article 363^{28}(8) of the Civil Procedure Law. The court must examine an application concerning the removal of an administrator within 15 days from the receipt of the application. The court examines the application via a written procedure, unless the administrator requests to examine the application in a verbal procedure or the court sees it necessary. The administrator has a right to be heard in a court hearing which secures transparency of the proceedings and allows for a full examination of the facts specified in the application, taking into consideration the arguments of all parties in the procedure. An appeal against a removal decision has no suspension effects. Consequently, a decision revoking the removal (at appeal level) will just liberate the administrator from any negative consequences but it will not allow him or her to continue acting as administrator in the same proceeding.

v) Replacement

35. When an insolvency administrator dies, retires, resigns or is removed, the legal framework correctly provides for the prompt appointment of a new administrator. Until the appointment of a new administrator, the previous administrator must continue to fulfil the duties thereof. The new administrator is entitled to the delivery, without delay of: (i) the assets, books and records of the debtor which are in possession of the former administrator, and (ii) the books and records of the former administrator which are related to the insolvency proceeding. The retiring or removed insolvency administrator must cooperate with and assist the new administrator in the transfer and transmission of the conduct of the insolvency proceeding.[35] If the former administrator does not transfer assets and documents to the new one, a sanctioning procedure for an administrative offense can be initiated against the former administrator.[36]

vi) General Duties

36. The Insolvency Law provides basic standards that are critical for the proper professional conduct of insolvency administrators. An administrator must conduct the insolvency proceeding effectively and according to the law. To this end, the law specifies, among others, duties to: (i) participate in court hearings; (ii) provide information related to the course of the proceedings to the court, the creditors, the Insolvency Control Service and others; (iii) take, without delay, a decision to determine a representative or representatives of the debtor and submit this decision to the court and the representative or representatives of the debtor; (iv) commence, without delay, the full inventory of the documents and property of the debtor and draw up the balance of the debtor; (v) accept, register and verify creditors´ claims; (vi) take over the administration of all the property of the debtor, as well as the property possessed or held by the debtor that belongs to third persons.[37]

vii) Reporting Duties

37. An insolvency administrator should provide regular reports on the work undertaken and progress of the insolvency proceeding.[38] Until recently, the administrator had to prepare a report of his or her activities every quarter and send it to the Insolvency Control Service. Such report should be produced in a standardized form containing a broad

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[35] The previous administrator must compile a deed of documents and property delivery and acceptance which should be signed by the previous administrator and the new administrator. A review of the activities of the previous administrator must be appended to the deed of property delivery and acceptance (the court specifies the deadline, not exceeding 10 days).

[36] Insolvency Law, Paragraph 1, Section 17^1; Clause 9, Paragraph 1, Section 17^2; Clause 8^1, Paragraph 2 and Paragraph 4, Section 22; and Paragraph 1 and 3, Section 24. Civil Procedure Law, Clause 1 and 2, Paragraph 1 and Paragraph 3, Article 363^{14}.

[37] Insolvency Law, Sections 26, 65, 74, 75, 78, 81 and 83.

[38] Insolvency Law, Section 85. Regulation No. 247 (19 April 2016) Regarding the Operational Report of the Administrator of Insolvency Proceedings and the Procedures for Filling in Thereof (available in English at https://likumi.lv/ta/en/id/281843-regulations-regarding-the-operational-report-of-the-administrator-of-insolvency-proceedings-and-the-procedures-for-filling-in-thereof).

range of information related to the administrator's activities in the reviewed period and overall in the process. Since May 2016, all periodic reports had been uploaded in the electronic register maintained by the Insolvency Control Service. Amendments introduced on May 2018 to Section 85 of the Insolvency Law establish that, starting on January 1, 2019 these reports should be prepared every month. A draft regulation of such provision specifies that reports will be generated automatically in the Electronic Insolvency Accounting System. The Insolvency Control Service uses information from these reports to gather statistical data and supervise the performance of administrators (see below, part III of this report).

viii) Code of Ethics

38. There is a comprehensive Code of Ethics which is recognized as binding on insolvency administrators. The Code of Ethics was adopted by the Disciplinary Matters Commission[39] on 14 July 2017 and contains a detailed description of general rules of conduct that administrators should comply with both in their professional activities and in their private life.[40] A disciplinary matter against an insolvency administrator may be initiated on the grounds of significant violation of the mentioned rules.[41] Complaints regarding non-compliance of an insolvency administrator with the rules of professional ethics have to be submitted to the Insolvency Control Service and will be considered and decided by the Disciplinary Matters Commission.[42]

ix) Remuneration and Expenses

39. The law provides that insolvency administrators are entitled to be remunerated for their work and to recover expenses properly incurred in an insolvency case.[43] The entitlement for remuneration of an insolvency administrator and the remuneration amount are determined by the creditors' meeting and may be appealed before the court.[44] The law provides the basis upon which the remuneration of an insolvency administrator should be calculated. It also contemplates different types of remuneration (fixed amount or variable percentages) that apply in diverse situations and stages of insolvency proceedings, as well as a decreasing scale to determine the remuneration of an insolvency administrator for the sale

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[39] The Minister of Justice must approve the composition of the Disciplinary Matters Commission for a period of three years. Its members are: (i) one representative from the Ministry of Justice; (ii) two representatives of the Insolvency Control Service; (iii) one judge of the Supreme Court appointed by the Chairperson of the Supreme Court; and (iv) one representative of the Association of Administrators (Insolvency Law, Section 31^4).

[40] The Code of Ethics is available in Latvian at http://mkd.gov.lv/lv/_59/link_part_188/ .

[41] Insolvency Law, Sections 31^6 and 31^7.

[42] Regulation No. 233 (3 May 2017) Regarding Disciplinary Matters of Administrators of Insolvency Proceedings and Persons Supervising Legal Protection Proceedings (available in English at: https://likumi.lv/ta/en/en/id/290563-regulations-regarding-disciplinary-matters-of-administrators-of-insolvency-proceedings-and-persons-supervising-legal-protection-proceedings).

[43] Insolvency Law, Sections 168, 169 and 170.

[44] Insolvency Law, Section 89, (1) and Section 91.

of pledged property.[45] Expenses of insolvency proceedings should also be recognized as justified by the creditors' meeting, and its decision may be appealed.[46] Expenses of the proceeding and the administrator's remuneration are considered as being 'costs of insolvency proceedings'. As such, both enjoy the first level of priority for payment.[47]

40. The law also provides for the payment of the administrator's remuneration and the expenses of the proceeding out of the insolvency estate and other sources. In principle, the administrator remuneration and expenses of the proceeding should be paid out of the assets of the insolvency estate, excluding the encumbered (pledged) assets of the debtor.[48] Other sources of financing such costs are funds that could be provided by creditors or other persons.[49] Otherwise, the costs of insolvency proceedings will be covered by the amount of two minimum monthly salaries that the petitioner of an insolvency proceeding must deposit at the time of filing for such process, in an account created by the Insolvency Control Service.[50] Only if the mentioned deposit has not been paid or has been paid partly[51] the costs of the proceeding will be covered using resources from the Employee Claims Guarantee Fund.[52]

41. In cases with no assets, the system for determining and paying the administrator remuneration and expenses of the proceeding could be improved. In such cases, both the expenses and the administrator remuneration should be paid out of the deposit of two minimum monthly salaries. According to information provided by several practitioners, it is frequent[53] that the mentioned deposit is used to satisfy the expenses of the proceeding and consequently nothing is left to pay the administrator remuneration.[54] This lawful but unfair outcome could be somewhat remedied by establishing in the law that in cases with no assets (i) the expenses should not exceed fifty percent of the deposit, and / or (ii) the deposit should be divided in equal parts to satisfy, out of each part, the administrator remuneration and the expenses of the proceeding, pro rata.

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[45] Insolvency Law, Section 169.

[46] Insolvency Law, Section 89, (3) and Section 91.

[47] Insolvency Law, Section 118, (1).

[48] Insolvency Law, Section 118, (1).

[49] Insolvency Law, Section 168, (3).

[50] Insolvency Law, Section 168 (1) and (2). The objective of the deposit is to meet the costs of the insolvency proceedings if the debtor has no property or its value is lower than the deposit amount, and the creditors have not decided to use another source of financing.

[51] In some exceptional situations, the court may fully or partly exempt an employee who files an insolvency application from payment of the insolvency proceedings deposit (Insolvency Law, Section 62, 7^{1}).

[52] Insolvency Law, Section 168 (2).

[53] Currently, the majority of insolvency proceedings are no-asset cases (see *Liquidation: assetless cases*, below, 57 ff.).

[54] According to the Insolvency Law, Section 170, (1), (2), if there is a report on the non-existence of a debtor's property, the expenses should not exceed the amount of the insolvency deposit.

42. Expenses can be problematic in cases where an insolvency administrator spends excessively, particularly in cases with low value assets. In theory, the law allows the creditors' meeting to control this malpractice denying consent to expenses that exceed five per cent of the estimated property value, but it may also justify expenses above that ceiling.[55] In practice, the latter situation is rather frequent and expenses that are too high are approved to the detriment of the final net amount to be distributed among the creditors.[56] Creditors' rights and interests would be better protected if the maximum amount of expenses specified in the law could not be modified by a decision of the creditors' meeting, unless such decision would be unanimous.[57]

C. Supervision of Insolvency Administrators

i) Supervisory and Regulatory Authority

43. The Insolvency Control Service is a state authority entrusted with appropriate regulatory, supervisory and disciplinary powers in respect of insolvency administrators.[58] Within the scope of the competence specified in laws and regulations[59], the Insolvency Control Service implements the state's policy in the field of insolvency proceedings. Among other regulatory and supervisory functions, the Insolvency Control Service appoints to office (licensing[60]) and removes administrators; initiates disciplinary cases against administrators; controls the lawfulness of activities of administrators in insolvency proceedings; monitors insolvency proceedings progress, and examines complaints about decisions taken and activities performed by administrators.[61] Powers of the regulatory

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[55] The creditors' meeting may not recognize as justified the expenses that exceed: (1) five per cent of the estimated property value, if a property sale plan was drafted; or, (2) the amount of the insolvency deposit, if there is a report on the non-existence of a debtor's property (Insolvency Law, Section 170 (1) and Section 89, (3).

[56] Anecdotal evidence provided by several users of the insolvency system interviewed in Riga.

[57] Unanimous voting may be an effective requirement to protect all creditors (including absent or dissident creditors) from a decision on expenses that goes beyond the law cap –negatively affecting the recovery rate of creditors.

[58] The Insolvency Control Service was established in 2002 (before July 1, 2018, "Insolvency Administration"), under the control of the Minister of Justice. It is governed by the State Administration Structure Law, the Law on the Protection of Employees in the Event of the Insolvency of their Employer, the Insolvency Law and other regulations.

[59] Insolvency Law, Sections 16^1, 16^2, 31^1, 31^4, 80, 91, 174^1, 174^2. Regulation No. 233 (3 May 2017) on Disciplinary Matters of Administrators of Insolvency Proceedings and Persons Supervising Legal Protection Proceedings, available in English at: https://likumi.lv/ta/en/en/id/290563-regulations-regarding-disciplinary-matters-of-administrators-of-insolvency-proceedings-and-persons-supervising-legal-protection-proceedings .

[60] See: Licensing and Registration of Insolvency Administrators, above, 21 ff.

[61] Other regulatory functions of the Insolvency Control Service include the organization and development of methodical and informative materials relating to insolvency proceedings; organization of exams for administrator applicants and qualification exams for administrators; organization of educational events for administrators; exchange of information in the field of insolvency proceedings by means of cooperation with

body include the power to: (i) investigate the conduct of an insolvency administrator upon a referral from a court, complaint of an affected party or on its own motion; (ii) intervene and be heard on any application to court concerning the conduct of an insolvency administrator; and (iii) initiate a disciplinary matter against an insolvency administrator.[62]

ii) Inspections

44. The Insolvency Control Service has been significantly empowered to supervise insolvency administrators and it has been active in doing so through both unannounced and planned on-site inspections of administrators' offices.[63] These inspections are an important component of the supervisory role of the Insolvency Control Service and are aimed at monitoring the activities of an administrator in insolvency proceedings and detecting potential violations of legal duties in particular cases. On-site inspections also verify that insolvency administrators are completing their reports according to the legal requirements.[64] These on-site inspections have been successful in identifying violations of the insolvency law, and some have led to the removal of an insolvency administrator and even the opening of criminal cases in ten instances.[65] These examples of active supervision and control, and the threat of criminal prosecution, help strengthen the integrity of the insolvency administrators´ profession and build public trust in the supervisory authority.

45. The main findings of inspections conducted in 2017 include the following incidences[66]: (i) Procedural actions not performed in a timely manner, including preparation of procedural documents; (ii) Creditors and the Insolvency Control Service not being informed of the progress of the insolvency process; (ii) Failure to execute the property sale plan or the statement of the absence of property; (iv) Auction procedures not being observed,

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international institutions; compiling and submitting proposals to improve the insolvency legislation; etcetera. See: http://mkd.gov.lv/lv/link_part_166/ .

[62] According to Section 31.[4] of the Insolvency Law, the Disciplinary Matters Commission examines a disciplinary matter initiated against a person supervising legal protection proceedings or an insolvency administrator and imposes disciplinary sanctions upon them.

[63] The Insolvency Law established that on-site inspections should be conducted starting on July 1, 2017. In 2017, 23 inspections were conducted (10 planned and 13 unannounced visits). In 2018, (until October), 50 inspections had been completed. The Insolvency Control Service staff dedicated to inspections is composed of 10 – 12 lawyers who are full-time employees and cannot practice law privately. Two inspectors jointly perform each visit and prepare a joint report. In most cases insolvency administrators cooperate with the inspectors; otherwise, the report would be negative. (Source: information provided by staff from the Insolvency Control Service).

[64] As explained above, insolvency administrators must periodically submit to the Insolvency Control Service a report detailing all activities performed in each insolvency proceeding. This report is filed electronically in a system run by the Insolvency Control Service. See *Reporting duties*, above, 37.

[65] As a result of onsite inspections, 21 violations of the law were identified in 2017, and 45 in 2018. In 2017, in 1 case and in 6 cases in 2018 (until October), the Insolvency Control Service applied to the Court requesting the removal of an insolvency administrator, and in 9 instances, a criminal case was opened (2017).

[66] Source: Insolvency Administration, Annual Report 2017.

including delayed payments to secured creditors; (v) Unreasonable costs incurred, including failure to re-evaluate contracts concluded by the former administrator, and failure to terminate contracts in cases where service has not been received; and, (vi) Powers of attorney have been issued which raise doubts about the lawfulness of the administrator's actions.[67]

iii) Handling Complaints

46. The number of complaints handled by the Insolvency Control Service has decreased since 2015. This is likely because the Insolvency Control Service has been proactively supervising the administrators´ activities in 2017 and 2018. In 2018 (January-October), the Insolvency Control Service received 104 complaints and only 28 violations were identified, which are significantly less than in previous years (see Table 2 below).

Table 2: Handling Complaints at the Insolvency Control Service[68]

	2015	2016	2017	2018 (January-October)
Received complaints	319	219	132	104
Identified violations	57	90	50	28
Duration of examining complaints (in days)	-	36	38	47,56
Applications to Police about possible crimes	13	6	6	1

iv) Administrative Violations

47. The transfer of the authority to pursue and punish insolvency administrators for administrative violations from the State Police to the Insolvency Control Service has further enhanced the supervisory control of the regulatory body. In this area the Insolvency Control Service has taken a proactive approach, issuing 122 decisions in 2017, of which 88 imposed administrative penalties. As of October 2018, 38 administrative sanctions have been imposed. Most of the administrative violations concern the failure to submit the necessary reports to the Insolvency Control Service, and the failure to submit various documents to relevant institutions (e.g., Latvian National Archive, Register of Enterprises) or to transfer documentation to a successor administrator.

[67] Extensive or repeated use of powers of attorney typically indicates that, by authorizing another insolvency administrator, the insolvency administrator appointed in a particular case is either selectively performing his duties or is actually delegating all his or her legal functions. Some licensed administrators used to resort to the mentioned authorizations because they were not interested in practicing as insolvency administrators. One of the beneficial effects of recertification exams has been the elimination of such administrators from the register – mainly because they did not apply for the exams.

[68] Information provided to the mission by the Insolvency Control Service.

v) Disciplinary Proceedings

48. The Insolvency Control Service is also initiating professional disciplinary cases against insolvency administrators. In 2017, the Insolvency Control Service initiated, and the Disciplinary Commission examined 7 disciplinary cases against insolvency administrators, 4 of whom have been subject to disciplinary sanctions (including 2 censures without imposing a fine, and 2 reprimands applying a fine of a total amount of EUR 10,200). In 2 cases, the Insolvency Control Service was instructed to explain to the person the inappropriateness of his/her actions, while in one case the disciplinary case was terminated with no sanction or any other consequences. Another two cases concluded because the administrators requested that the Insolvency Control Service terminate their certificate.[69] In 2018, the Insolvency Control Service initiated, and the Disciplinary Commission examined one disciplinary case against an insolvency administrator, which was terminated with no sanction or any other consequences.[70]

vi) Personal Liability vis-à-vis Third Parties

49. Recent judicial decisions have imposed personal liability on insolvency administrators. The law correctly specifies that an insolvency administrator is liable for losses caused to the State, the debtor, creditors or other persons due to culpable activity or inaction (failure to act) of the administrator or his / her authorized representative.[71] This personal liability has been rarely applied until recently, but a number of recent judicial decisions have imposed on insolvency administrators an obligation to indemnify damages caused to a particular creditor[72] or the debtor.[73]

vii) Insurance

50. The insurance coverage for potential damages caused by an insolvency administrator to third parties may be insufficient in some cases. To cover his / her personal liability, an insolvency administrator should contract an insurance policy and

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[69] Insolvency Administration, Annual Report 2017.

[70] As of 1st October 2018.

[71] Insolvency Law, Section 29 (1).

[72] Latgale Regional Court in case No. C04460913 (left as not amended by the Supreme Court on 21 June 2018), decided that an insolvency administrator has to compensate the losses caused to a bank that had a secured claim not timely recognized and which became impossible to satisfy after the insolvency administrator distributed all the funds obtained as a result of the liquidation of the debtor' assets. (Source: information provided by staff from the Insolvency Control Service).

[73] On 27 November 2017, the Riga District Court in case no. C33436417 decided that a previous insolvency administrator caused losses to the debtor because some funds obtained through realization of the debtor's property were not handed over to the new insolvency administrator. Thus, the new administrator could not settle the claims of creditors in accordance with the Insolvency Law. The court considered that in such circumstances the previous administrator produced damage to the debtor who was left without property or equivalent funds to settle the creditors' claims. (Source: information provided by staff from the Insolvency Control Service).

maintain its validity during the insolvency proceedings in which the administrator acts.[74] The regulation states that the insurer must bear the losses caused by the professional activity of the administrator, irrespective of the administrator's criminal liability.[75] This aspects merits clarification: typically professional liability insurance excludes willful criminal actions from its coverage. In this regard, if one of the concerns is potential fraud, the authorities may need to consider additional instruments to protect users of the system, such as a bond to be posted by insolvency administrators. This would complement insurance, which typically covers instances of negligence. At present, the minimum amount of insurance covering all proceedings where an administrator acts is EUR 42,600, per year.[76] This sum could be too low to offer adequate protection in cases with high amount claims or very valuable assets. The regulation should establish that in specific and well-defined cases, the insurance coverage should be increased according with the value of assets involved or any other adequate criteria, in order to offer real protection against potential damages (to creditors, in particular). An insolvency administrator without an insurance policy with sufficient coverage should be replaced by another one who can satisfy such requirement.

Recommendations:

- Qualification criteria: establish objective grounds specified by the law or applicable regulation for the assessment of the reputation of candidates
- Introduce categories of insolvency administrators in the random system for appointments
- Extend the 2-year period for the validity of insolvency administrators' licenses; and allow validly appointed administrators to conclude their insolvency cases
- Modify the rules for the remuneration of insolvency administrators in no-asset cases, reserving resources for the payment of the remuneration
- Avoid excessive expenses by establishing in the law that the maximum amount of expenses can only modified by unanimous consent of the creditors
- Ensure adequate insurance coverage for insolvency administrators

II. Some Aspects of the Functioning of Insolvency Proceedings

A. Overview of the Efficiency of the Insolvency System

51. The Latvian insolvency system continues to suffer from certain inefficiencies. The majority of the system users consider that recovery rates of creditors' claims in insolvency proceedings are very low. This general perception accurately reflects the

[74] Insolvency Law, Section 31. Regulation No. 1005 (1 November 2010) on the Procedure of Civil Liability Insurance of an Insolvency Administrators and Minimum Insurance Amount.

[75] Regulation No. 1005 (1 November 2010) on the Procedure of Civil Liability Insurance of an Insolvency Administrators and Minimum Insurance Amount.

[76] Regulation No. 969 (24 September 2013).

inefficient outcome of most insolvency proceedings with respect to certain creditors, but it is necessary to distinguish different situations, namely:

- **In insolvency proceedings with no assets - which are strikingly numerous since they represent more than sixty percent of the liquidation processes[77] - there is no recovery for creditors.** Naturally, no legal framework, however, can cause creditors to recover their claims, totally or partially, in a liquidation process in which there are no assets to liquidate. Therefore, it must be understood why the insolvency procedure is used so frequently when there is nothing to liquidate; and analyze if the law could contemplate a different way to deal with these cases (see below, 57 ff.). The relationship between liquidations with no assets and the limited use of rehabilitation procedures should also be considered, since if the latter were used early and often the number of insolvency proceedings with no assets would probably decrease.
- **In insolvency proceedings in which there are assets to be liquidated, statistics show low recoveries for secured creditors, but actual recoveries may be higher.[78]** The percentages recorded in official statistics are very low –in particular, taking into account that the legal system grants these loans the highest priority in the ranking of creditors, and that the costs of liquidating an encumbered asset (including the remuneration of the insolvency administrator and deductible expenses) rarely exceed 10 percent of the amount obtained from the sale of that asset.[79] However, these percentages seem to be excessively low, and anecdotal evidence suggests that the recovery rates are much higher. [80] It is quite likely that the methodology for the elaboration of statistics is the explanation for the low recovery rates recorded in them (see below, 79 and 113).
- **Unsecured creditors recover on average only 4 percent of the amount of their claims in insolvency proceedings in which there are assets to be liquidated.[81]** In some cases, this meager percentage could be due to excessive expenses authorized in certain procedures (see *Remuneration and expenses*, above, 39 ff.). In most

[77] The Insolvency Administration (now Insolvency Control Service) Annual Report 2017 statistics show that "empty cases" (i.e., insolvency proceedings of debtors with no assets) represented 63 per cent of all insolvency proceedings in 2016, and 61 per cent in 2017.

[78] According to the Annual Report of the Insolvency Administration, 2017, secured creditors would have recovered an average of 23 percent of their loans in 2016, and 31 percent in 2017. See below, part III of this report.

[79] Information provided by insolvency administrators and representatives of banks interviewed. This information is consistent with Sections 169 and 170 of the Insolvency Law.

[80] Banks have clarified that recovery percentages of a properly secured loan in an insolvency procedure are between 50 and 75 percent of the principal amount of a secured loan. Similar recovery rates were mentioned in the responses to a questionnaire prepared by the IMF team. A representative of a bank mentioned that *if the initial evaluation of collateral is done properly and the creditor does not take excessive risk (i.e., keeps the loan to value rate in the region of 70 per cent), the loan recovery in insolvency proceedings should be –actually is— good. Something must be wrong with the methodology officially used to calculate recovery rates*."

[81] This information, taken from the Insolvency Administration Annual Report 2017, is consistent with the unanimous opinion of different users of the insolvency system who were interviewed by the mission.

insolvency proceedings with assets, however, these are all encumbered, so the amount obtained from its liquidation is allocated in full (or almost totally) to pay secured claims and the costs of the procedure –very little or nothing is left to satisfy unsecured claims.[82] If an insolvent debtor typically has all of its assets encumbered, unsecured creditors could only raise their expectation of recovery in a successful rehabilitation process through which the debtor recovers ability to pay unsecured debts –even though these are restructured or its amount reduced under a reorganization plan.

B. Legal Protection Proceedings: Misuse and Challenges

52. Reorganization (rehabilitation) of insolvent or financially distressed legal entities is exceptional in Latvia. In practice, most insolvency proceedings end up as asset liquidations because Legal Protection Proceedings and Extrajudicial Legal Protection Proceedings are not workable mechanisms to restore financial health to distressed companies. The number of such reorganization proceedings initiated is in the region of 140 – 160 per year.[83] However, only 25 per cent (approximately) of these proceedings are "announced" or "declared" (i.e., a plan is timely proposed to, and accepted by the creditors).[84] Furthermore, it is hard to establish exactly how many of these "announced" proceedings have been able to restore the solvency of the debtor, but anecdotal evidence and other sources of information indicate that the number of LPPs and ELPPs successfully concluded –i.e., terminated with a reorganization plan approved, implemented and fulfilled— is marginal.[85] The insolvency system has therefore been insufficiently protective of companies undergoing financial difficulty which, if rehabilitated, could contribute to economic growth in the longer term. Small and medium sized enterprises, for example, are particularly vulnerable in such circumstances.

53. There is evidence of improper use of reorganization procedures. In approximately 75 percent of the initiated reorganization cases, the debtor does not intend to offer a serious

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[82] Anecdotal evidence gathered from several players during missions in Riga in 2017 and 2018. A seasoned insolvency administrator interviewed said that, according to its experience, "*in over 90 per cent of insolvency proceedings all assets are pledged*".

[83] According to statistics provided by staff from the Insolvency Control Service, 163 LPPs and ELPPs were initiated in 2016; 148 in 2017, and 115 in 2018 (as of October).

[84] Statistics provided by staff from the Insolvency Control Service indicate that 27 LPPs and 6 ELPPs were declared in 2016; and 35 LPPs and 11 ELPPs in 2017. These numbers are largely consistent with statistics prepared by a representative of the Section of Advocates dealing with Insolvency Law of the Latvian Collegium of Sworn Advocates: out of 331 LPPs initiated in the period July 2015 – December 2017, 245 had been rejected (74%) and 84 announced (25%) –1% was terminated for other reasons. (Evita Ostrovska, ¨Legal Protection Aspects for 2015 – 2017: Stated Problems and Possible Solutions¨, presentation at a Conference on ¨Legal Protection Proceedings: Exploring Approaches to Debt Restructuring¨, hosted by the Insolvency Control Service in Riga, 26 and 27 September 2018).

[85] Practitioners interviewed could hardly mention more than 3 or 4 successful LPPs. A judge that had dealt with 50 LPPs over a number of years could recall only one fully successful LPP. The presentation cited in the previous footnote indicates that just 3 LPP and 8 ELPP plans had been fully executed in the researched period.

plan to the creditors to overcome the financial difficulties of the company. Sometimes it does not even have the possibility of offering a viable plan because the activity of the company is languishing or has stopped, and the assets have disappeared. Consequently, there is a general perception that reorganization proceedings are mostly initiated only to obtain a short legal moratorium[86] that allows the debtor to lift the blockade of its bank accounts and delay creditors' executions or the commencement of insolvency (liquidation) proceedings.[87]

54. Promoting timely and proper use of reorganization proceedings is essential to improve the recovery of creditors' claims and restore the solvency of financially distressed enterprises. When an enterprise is viable and can be rehabilitated, its assets are often more valuable if retained in a rehabilitated business than if liquidated in insolvency proceedings. The rescue of a business preserves jobs, provides creditors with greater recovery rates and may produce a return for owners. A renewed and effective system of reorganization of viable businesses would increase the appropriate use of these procedures, diminishing the current high percentage of improperly used and unsuccessful reorganization proceedings. It should also reduce the number of insolvency (liquidation) proceedings with no assets that do not produce any return to creditors and overburden the institutions dedicated to insolvency resolution.[88] Given Latvian lending practice where usually all assets of a debtor are encumbered to secure bank loans, rehabilitation of a viable company seems to be the best way (if not the only one) to improve the currently very low recovery rate of unsecured creditors' claims in liquidation proceedings (See *Overview of the efficiency of the insolvency system*, above, 51).

55. Designing and implementing an effective reorganization procedure is the main challenge to be addressed in the near future. An effective insolvency system should generally favor reorganization of distressed but viable businesses, aiming at a drastic change of the current practice in Latvia, where the vast majority of cases end up as liquidation without assets. This particular emphasis on reorganization is intended to achieve several objectives, such as: (i) enhancing the value of creditors' claims as part of an ongoing business concern, providing a second chance to the shareholders and management of the debtor; (ii) providing strong incentives for the adoption by entrepreneurs and managers of appropriate attitudes to risk; and (iii) protecting the debtor's employees from the effects of business failure.

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[86] Insolvency Law, Section 37 regulates such stay, which is an automatic effect of the court decision on initiation of an LPP. The stay is in place until an LPP plan is approved by the creditors within the period of two months (it may be extended by one month) from the day the court initiated the LPP (Insolvency Law, Section 40 (2).

[87] Information provided by users of the system during the missions.

[88] Several stakeholders interviewed mentioned that in lieu of attempting a true restructuring, many insolvent debtors prefer using a "phoenix solution" for their companies –filing for an insolvency liquidation proceeding after having transferred the most valuable assets to a new entity where they can continue doing business without the burden of the old liabilities.

56. Some issues that will likely need to be addressed in a legislative reform of reorganization proceedings include:

- *Establishing an adequate balance between liquidation and reorganization*. Contrary to the modern trend supporting reorganization or rehabilitation, the Insolvency Law in force is significantly tilted towards liquidation. A well-balanced insolvency system should reduce the stigma associated with bankruptcy and encourage debtors to take advantage of the rehabilitation aspects of the law. The adoption of a system that will favor reorganization, however, should not result in establishing a safe haven for non-viable enterprises: enterprises that are beyond rescue should be liquidated as quickly and efficiently as possible.
- *Providing incentives for early and appropriate use of reorganization proceedings*. Under the current legal framework, even debtors willing to rehabilitate a business usually file for Legal Protection Proceedings when it is too late for restoring the business viability.
- *Facilitating access to finance upon commencement of a reorganization proceeding, and also after a plan is approved*. The Insolvency Law is silent on this matter and new money for funding a business under rehabilitation proceedings is generally unavailable. Maximizing the returns to creditors demands, in most cases, that the business be kept as a going concern, with a view either to sell it out or to reorganize it. This cannot be done unless the legal system provides a correct framework, whereby post-commencement finance is allowed and protected. The law should address this issue, providing the legal instruments to obtain new financing with assurances and safeguards for the eventual repayment of the new loans. This is usually done recognizing the need for and authorizing such funding, and by specifically creating a priority for its repayment to the provider of post-commencement finance.
- *Protecting assets of the insolvency estate from the date when the court initiated a reorganization proceeding*. At present, such protection is established vis-à-vis creditors' enforcement actions[89], but restrictions on potentially harmful activities of the debtor only apply during the plan implementation period.[90]
- *Providing for adequate supervision from the early stages of reorganization proceedings.* This is also needed to ensure that the process is not subject to abuse, and that the insolvency estate is fully protected. Creditors' confidence is vital to developing and approving a rehabilitation plan that creditors will support. In order to achieve this, the law should establish management oversight through an independent supervisor that should be appointed to oversee the ongoing operations of the debtor from the date of initiation of the reorganization proceeding. Under the current law, upon filing for a Legal Protection Proceeding and until after a plan is approved, there is no control of debtor's activities which can put at risk its assets –the supervisor is appointed mainly to control plan implementation, not the previous administration of the distressed entity during the initial stages of a Legal Protection Proceeding.[91] In a

[89] Insolvency Law, Section 37 (1).

[90] Insolvency Law, Section 49 (1).

[91] Insolvency Law, Section 50 (2).

future system, the debtor's management may remain administering the business through and out of the procedure, but under the supervision of an independent insolvency professional as already mentioned. The law should also specify an administration regime, applicable before plan implementation, which would differentiate between transactions that require court approval and those that the debtor´s management will be able to freely perform in the ordinary course of business.

- *Providing for effective control of claims*. The lack of a proper mechanism for recognizing creditors' claims may facilitate the fabrication of claims.[92]
- *Establishing a voting system that effectively enables approval of sound rehabilitation plans*. A voting system should consider the interests of the different classes of creditors and allow classification of creditors for the purpose of voting a plan. The current law contemplates the classification of claims for voting a plan, but it may be necessary to assess carefully the majorities required for plan approval, to find a balance approach between minority protection and realistic prospects for the approval of plans.[93]

C. Liquidation: Assetless Cases

57. Some provisions of the tax legislation could explain why 60 percent of insolvency proceedings are no-asset cases. A liquidation procedure with no assets to liquidate does not add any value: it generates costs and overloads the institutions that implement the insolvency legislation (in particular, the judiciary and the regulatory agency), leaving creditors without recovery of their claims. It is not easy to understand why a debtor or its creditors would generally file for assetless insolvency proceedings, but even more striking is the fact that in Latvia most insolvency proceedings are empty cases. Some provisions of tax legislation could be unintentionally producing –as side effects— incentives that could be one of the main reasons explaining such high number of useless insolvency proceedings initiated. The VAT exemption, for example, requires the completion of insolvency proceedings.[94] Many creditors with no expectation to recover their claims in no-asset cases, may however be initiating such proceedings seeking an exemption for the VAT corresponding to goods or services provided to the insolvent debtor. A different factor affects the directors of debtor companies: directors of insolvent companies would typically initiate these empty cases to avoid being personally liable for the tax debts. Tax legislation would thus be unintendedly creating incentives for the use of the insolvency system in cases where there are no assets.

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[92] See: Insolvency Law, Section 40 (1).

[93] The majority required is two thirds of secured claims, as established by the Insolvency Law, Section 42 (2) 2). Over mission meetings, several users of the system mentioned that such majority has been difficult to obtain in a number of cases.

[94] Paragraph 5 Section 105 of the Value Added Tax Law, available in English at: https://likumi.lv/ta/en/en/id/253451-value-added-tax-law.

Also, a taxpayer may exclude doubtful claims from the corporate income tax base if the taxpayer has carried out all the corresponding debt collection and recovery activities and the debt amount has been recognized in accordance with the Register of Creditors' Claims when a court has confirmed the completion of the debtor's insolvency proceedings (Paragraph 3 Section 9 of the Corporate Income Tax Law, available in English at: https://likumi.lv/ta/en/en/id/292700-enterprise-income-tax-law.III).

58. The problem of assetless insolvency proceedings could be alleviated if at least three issues are tackled, namely:

- *Tax legislation*. If side effects of tax legislation could currently be one of the main reasons behind the mentioned misuse of most insolvency proceedings, such legislation should be revisited and modified contemplating alternative solutions to discourage creditors and debtors from initiating empty cases.
- *Simplified proceeding*. A simplified and expedited insolvency proceeding for low value or no-assets cases should be created. Information provided by the debtor is not always reliable and an insolvency administrator ought to be appointed to scrutinize the accounts and find out what the real situation is and how the debtor arrived at that point. It might be the case that value can be brought back to the insolvency estate, either by avoiding transactions or by means of liability actions against the company directors, its shareholders or even third parties whenever fraud is involved. In simplified proceedings, the insolvency administrator should report after a short investigation period if there might be ways to generate a return for creditors and, ultimately, to punish the debtor's misbehavior –and promote judicial actions accordingly. A simplified insolvency proceeding should be rapidly terminated as soon as the administrator reports that there are no assets to be liquidated and there is no expectation to recover any other value.
- *Presumption of deliberate insolvency*. The insolvency legislation may also specify that a no-assets insolvency procedure creates a (rebuttable) presumption that insolvency had been deliberately produced or aggravated. This presumption should oblige the insolvency court and / or the insolvency administrator to give notice to the Prosecutor Office to investigate if the debtor, its administrators or third parties had been involved in criminal activities and should be prosecuted. Thus, an assetless simplified insolvency proceeding will be rapidly closed by the insolvency court, and the Prosecutor or a criminal court will have to decide whether a criminal investigation must be commenced.[95]

D. Liquidation: The Problem of Going Concern Sales

59. The sale of the functioning enterprise ('going concern') should be preferred over liquidation of assets individually ('piecemeal liquidation'). An enterprise is in most cases more valuable as a going concern than if it is liquidated piecemeal. The value of the whole is greater than the value of the parts since the know-how, clients and other non-material assets are not lost. Tangible assets such as industrial machinery and other movable assets almost invariably worth more as part of a manufacturing plant or establishment than sold separately. In liquidation proceedings, the sale of the entire business as a going concern or some

[95] If the term "presumption" could create confusion it would be better not to use it. Otherwise, the law provisions governing simplified proceedings should just specify that the insolvency administrator and/or the insolvency court should always refer no-assets cases to the Prosecutor Office to investigate if a crime has been committed by the debtor, its administrators or third parties.

operating or productive units typically realizes the greatest value for the benefit of the creditors. This approach also reflects other objectives, such as preserving jobs. In this way, even though a rehabilitation procedure may fail, the aim of business rescue and reorganization could still be achieved in liquidation. Until now, however, the Insolvency Law has been heavily weighted in favor of strict piecemeal liquidation, with assets being sold individually in the majority of cases.

60. The Insolvency Law provisions currently governing the sale of the debtor's establishment or a permanent part of it could be further improved.[96] To this end, several amendments may be considered including the following:

- *Continuation of the business activity*. In order to allow the sale of the business as a going concern, the law should specify the circumstances and regime under which the business activity will continue upon commencement of insolvency proceedings.
- *Preferred liquidation method*. The sale of the business as a going concern or, as a second-best option, the sale of an establishment as a unit should always be the preferred liquidation method in insolvency proceedings. Assets would be liquidated individually only if the insolvency administrator could justify that the sale of the business or establishment unit is not practicable in a particular case.
- *Assets included*. The sale of the business or its productive units may include all tangible and intangible assets of the insolvency estate, including executory contracts where the acquirer can replace the debtor as a contracting party.
- *Secured creditors*. The law should allow assets to be sold free and clear of security interests, charges or other encumbrances, subject to preserving the priority of interests in the proceeds from the assets disposed.
- *Timing*. The sale of the business or its productive units could be done at early stages within the insolvency proceeding, provided that the list of creditors has been formed and the creditors' meeting is operative.
- *Valuation*. The business or the productive unit must be properly appraised, either by the insolvency administrator or by an independent third party.
- *Public and private sales*. A transparent and reliable mechanism to receive, process and analyze offers should be contemplated in the law and implemented in practice. Public sales should be a preferred method when significant assets are involved. Private sales negotiated between the insolvency administrator and one or more potential buyers could also be allowed. Because private transactions are potentially more vulnerable to abuse, careful consideration should be given to ensure proper notice to the creditors and that the sale terms are fair.[97] All sales should be subject to: (i) notice to and review by the creditors and other interested parties; and, (ii) court approval.
- *Obligations of the acquirer*. The acquirer's exclusive obligation should be paying the sale price. The acquirer should not be principally or subsidiary liable or obliged to

[96] Insolvency Law, Section 114.

[97] Private sales can work effectively (even more than other means of liquidation) if the system provides the instruments to adequately monitor the operation and the law provides means to ensure that the insolvency administrator (or the person in charge of executing the sale) is technically capable and honest.

pay any of the claims against the debtor or the costs of the insolvency proceeding. The claims against the insolvent debtor should be paid out of the price paid by the acquirer, according to the hierarchy of the creditors' claims in the insolvency process.

Recommendations:

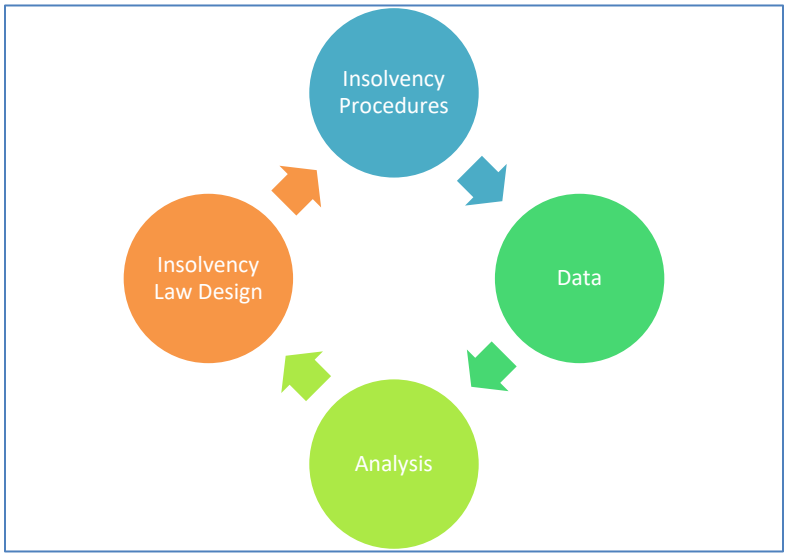
- Reform *Legal Protection Proceedings,* to achieve a better balance between reorganization and liquidation, providing incentives for early use of rehabilitation, regulating post-petition finance, protecting the assets in the estate and supervising the procedure adequately; controlling the claims in reorganization and reforming the system for approval of plans.
- The issue of the high number of *no-asset insolvency ca*ses should be tackled by: a) reviewing and, if needed, modifying tax rules that may be inducing debtors and creditors to use insolvency proceedings even where there are no assets; b) establishing a presumption of deliberate insolvency in no-asset cases; c) introducing a simplified proceeding to close the no-asset cases, while examining potential sources of value for the insolvency process.
- *Going-concern sales in liquidation* should be incentivized by: a) regulating the continuation of the business activity in liquidation; b) prioritizing the sale of the business as a going-concern or of business units; c) including assets and contracts in the sale; d) including encumbered assets in the sale, with adequate safeguards for secured creditors; e) allowing for the sale to be conducted as early as possible; f) including a proper valuation of the business; g) allowing public and private sales to be conducted, with proper safeguards; and h) protecting the legal position of the acquirer of the business.

III. INSOLVENCY AND DATA COLLECTION SYSTEMS

61. Data collection systems are essential for the assessment of the insolvency regime. Hard data are essential for evidence-based policy-making[98]. The collection of relevant data provides the empirical foundation for the identification of issues in the insolvency system and allows for the proper design of changes that bring improvements to it. The collection and analysis of data makes it possible to create a feedback loop between the formulation of reforms and the assessment of the efficiency of the insolvency system.

[98] See: *The Use of Data in Assessing and Designing Insolvency Systems* (upcoming IMF Working Paper).

Figure 1: Data and Design Loop



62. The collection of data relative to the insolvency system is fundamental for the supervision of insolvency administrators. The improvement of the regulation of insolvency administrators has been a major objective of the reform efforts of the Latvian authorities. Improving the data collection systems could make a major contribution to the effective supervision of insolvency administrators. For this reason, this section also covers the use of data for the purpose of monitoring the activities of the insolvency administrators and the compliance with their duties.

A. Sources of Data and Statistical Reports

63. There are multiple sources of data in the current Latvian system. These sources include: the statistical report produced by the Insolvency Control Service, the data included at the Insolvency Register of the Register of Enterprises; and the data on insolvency proceedings collected by the Court Administration of the Ministry of Justice.

64. The Court Administration collects data on insolvency proceedings. The Court Administration records data on every procedure, including insolvency proceedings. The Court Administration platform collects and organizes documents and data on the time to complete proceedings, including the number of hearings. Presumably, this information is integrated in the general statistical analysis, focused on the efficiency of the courts, produced by the Court Administration. However, while available upon request, the Court Administration does not publish the full sets of data and does not elaborate advanced insolvency statistics based on the data collected. The Court Information System is designed for the internal needs of the courts, and the large amount of information existing in the system is not integrated in the statistical analysis of insolvency cases. For the purposes of

insolvency data collection and production of insolvency statistics, the system is not connected to the one operated by the Insolvency Control Service.

65. The Insolvency Register includes valuable information on insolvency proceedings. The Insolvency Register is part of the Register of Enterprises: according to the Latvian insolvency law, the mandate of the Insolvency Register is to ensure the public awareness of the different types of insolvency proceedings. [99] The information collected and published by the Register promotes the course of insolvency proceedings, the protection of the lawful interests of persons in relation to these proceedings, the performance of the Insolvency Control Service, and advances cooperation on insolvency matters. All the information included in the Register is available to the public, free of charge.

66. The Insolvency Register records information to provide full legal effects to acts done in the course of insolvency proceedings. From a legal perspective, this is the fundamental role of a commercial or corporate register: by providing legal publicity to certain acts, the register ensures that the effects of those acts are full and recognized by all persons. This is evident in the registration of acts such as the declaration of insolvency or the appointment of an insolvency administrator[100].

67. However, the information registered can also be used to assess the performance of the insolvency system. An analysis of the data collected by the Register shows that there is a wealth of information that can be used for the analysis of the performance of the insolvency system. The categories of information included in the Insolvency Register are the following:

i) Legal Protection Proceedings (Reorganization):[101]

- Identification data of the debtor;[102]
- Date of initiation of the proceedings, and identification of the court;
- The date of the decision of the court on the implementation of legal protection proceedings;

[99]See Insolvency Law, Section 12(1).

[100] According to Section 18 of the Insolvency Law, the Insolvency Register must include the identification data of every appointed insolvency administrator, including the administrator's certificate and the contact details for the administrator. The suspension, release, revocation or discharge from office must be registered too.

[101] See Insolvency Law, Section 36. The law authorizes the use of the data by other registers, information systems or databases.

[102] Only the legal form of the debtor is entered in the register but not its economic activity.

- Identification data of the person acting as supervisor;
- The methods specified in the plan to achieve the rehabilitation of the debtor[103];
- Period for the implementation of the plan;
- Data corresponding to amendments of the plan[104];
- Date of termination of legal protection proceedings, specifying the grounds for termination.

ii) Insolvency proceedings (Liquidation):[105]

- Identification data of the debtor;[106]
- Date of initiation of insolvency proceedings, and the identification of the court;[107]
- Identification data of the insolvency administrator, including the data of the insolvency administrator's license;
- Period for the submission of claims;
- Notice and details of the creditors' meeting;
- Date of termination of the proceedings;[108]
- Date for the submission of a plan to liquidate the debtor's assets

68. The law orders the Insolvency Control Service to publish certain items of information on its website. In order to protect the rights of creditors, facilitate the selection of professionals, and inform society about the results of its activities, the website of the Insolvency Control Service publishes the following information:[109]

[103] The plan itself needs to be registered by the supervisor of legal protection proceedings – see Insolvency Law, Section 50.

[104] The law establishes the obligation of the supervisor to register the amendments to the plan (Insolvency Law, Section 50).

[105] See Insolvency Law, Section 58. These data refer to the insolvency of legal persons. A separate provision lists the data on the insolvency of individuals, which is outside the scope of this report (see Insolvency Law, Section 132).

[106] Only the legal form of the debtor is entered in the register but not its economic activity.

[107] The register also includes the required data according to the European Regulation on insolvency proceedings. See also Insolvency Law, Section 66, on the register of cross-border insolvency cases.

[108] The law refers to the date of termination of "legal protection proceedings" – This could be a translation error.

[109] See Insolvency Law, Section 12(4).

- Identification data of administrators or supervisors in legal protection proceedings, including information on the qualifications of the supervisors;
- Information on the results of the activities of administrators in insolvency proceedings (coming from the final review of their activities);
- Information regarding violations of persons supervising legal protection proceedings or administrators in the performance of their duties;[110]
- Number of legal protection proceedings for each supervisor;
- Legal protection proceedings converted in insolvency cases, per supervisor;
- Legal protection proceedings concluded with full performance of the plan, per supervisor;
- Number and length of insolvency proceedings (of companies and natural persons) per insolvency administrator;
- Information on the time a person has been practicing either as a supervisor or an insolvency administrator.
  This information is given to the public for a better assessment of the insolvency administrators, rather than referring to the insolvency system as a whole.[111]
  Publication of this information has no effects on the rights of any persons.

69. The report of the Insolvency Control Service is the best available statistical resource. The Insolvency Control Service includes a statistical report as part of its annual report. This report represents the best source for statistical data on the insolvency system in Latvia. Its contents and structure serve as the basis for the analysis developed in the next section.

70. The national statistics agency does not produce insolvency statistics. Contrary to most European countries, the central Statistical Bureau of Latvia does not elaborate general insolvency statistics (i.e. statistics showing the evolution of the number of insolvency cases).

71. The central bank makes use of insolvency statistics in their financial stability reports. There are connections between the data on non-performing loans and the performance of the insolvency system; the elaboration of more detailed insolvency statistics, as suggested in this report, would provide opportunities for a deeper analysis of these connections between the insolvency system and the financial sector.

[110] Violations are only published when the decisions establishing them are final.

[111] The law indicates that the Insolvency Control Service needs to comply with data protection and commercial secrecy rules in publishing this information (Insolvency Law, Section 12(2)).

B. Coverage and Methodology of Statistical Reports

72. The statistical report of the Insolvency Control Service provides useful information on a variety of aspects of the insolvency system. The work on statistics and indicators is a consequence of the Insolvency Development Guidelines adopted by the Latvian authorities.

73. The Latvian authorities have developed a framework where statistics represent a fundamental tool for the analysis of the insolvency system. The authorities should be commended for this focus on fact-based policy making, and the impulse to create better and more detailed statistical reports[112]. The introduction of targets for indicators of performance of the insolvency system, however, may result in an expectation gap: as insolvency regulators know, the performance of an insolvency system does not only depend on the efforts of the courts, the insolvency professionals and its supervisors, but also on the behavior of debtors and creditors, and on the general and firm-specific economic circumstances. For this reason, the use of performance targets should be revisited in the Insolvency Development Guidelines. The authorities should identify targets that are attainable for the courts and the Insolvency Control Service: for instance, the clearance rate in insolvency cases; the clearance rate of the Insolvency Control Service in handling complaints against insolvency administrators; or the number of on-site and off-site supervisory actions taken by the Insolvency Control Service.

74. One of the key topics is the use of the insolvency system, and more specifically, the use of reorganization proceedings. The authorities have set an indicator to measure the relative use of reorganization proceedings in the context of the insolvency system. This indicator is based on the proportion of the legal protection proceedings (reorganization) against the total number of insolvency proceedings registered yearly.[113] This indicator gives a sense of the percentage of reorganization cases, but this may be the result of multiple circumstances, not just the overall efficiency or attractiveness of the reorganization procedure.

75. The Insolvency Control Service elaborates an indicator based on the adoption of reorganization plans. This indicator measures the proportion of reorganization cases where a reorganization plan has been submitted and adopted against the total of reorganization

[112] This is the result of the Insolvency Development Guidelines adopted by the Government of Latvia (see Cabinet Order No. 527 of 21 September 2016 "On *Guidelines* for *Insolvency Policy Development* for *2016-2020* and *Implementation Plan* thereof").

[113]This ratio is obtained as follows: the number of legal protection proceedings commenced in a given year x 100 / the number of insolvency proceedings of a legal entity declared in a given year. The source of the data is the Insolvency Register.

cases.[114] This indicator can inform about the quality of the plans proposed and the confidence of creditors in the process. It can also point to an abuse of the process by debtors (i.e. commencement of legal protection proceedings just to delay enforcement by creditors, without any realistic prospect of reorganization).

76. The proportion of successfully completed reorganization proceedings against the total of terminated reorganization proceedings represents another indicator. The proportion of successfully completed cases as against the total of reorganization proceedings terminated by all causes[115] gives a sense of the likelihood of success of reorganization plans: this may be influenced by the realism (or lack of realism) of the reorganization plans, but the relative success of reorganization plans also depends on many other circumstances beyond the control of the debtor.

i) General Indicators of Efficiency of Insolvency Proceedings

77. The statistical reports of the Insolvency Administrator recognize the importance of the fundamental indicators of efficiency of the insolvency process. These indicators include the time to complete insolvency proceedings, the recovery rate for creditors, and the costs of the process.

78. The indicator of the average duration of insolvency proceedings is a straightforward measurement based on empirical data. The indicator is formed using the data from the insolvency administrator reports, as incorporated in the Electronic Insolvency Surveillance System maintained by the Insolvency Control Service[116].Duration is simple to establish and provides an objective metric of one of the main factors to assess the efficiency of the insolvency process.

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[114] According to the Insolvency Control Service, this ratio is obtained the number of Legal Protection proceedings **declared** in a given year x 100 / Total number of Legal Protection proceedings per proposed year. The term "declared" refers to the adoption of the reorganization plan. The data for the indicator are obtained from the Insolvency Register.

[115] The indicator comes from the ratio between the number of Legal Protection Proceedings successfully completed in a given year x 100 / Legal Protection proceedings terminated in a given year. The data for the indicator are obtained from the Insolvency Register.

[116] According to the Insolvency Control Service, the indicator is obtained by dividing the duration of the insolvency proceedings completed in a given year in a division of 365. This methodology is not particularly clear – it is necessary to specify that the duration of the proceedings comes from the data recorded for each insolvency process as stated in the insolvency administrator report (where the commencement date and the termination date are recorded). The data for the indicator are indeed taken from the reports of insolvency administrators filed in the electronic system.

79. The statistics also include the recovery rates for secured creditors. As set out in the Insolvency Policy Development Guidelines 2016-2020, this indicator is represented as cents on the euro recovered by secured creditors. In the methodology for this indicator, the amount of recognized secured claims is compared with the amount recovered for secured creditors[117]. Only those processes where a secured claim for at least 1 euro was recognized are taken into account. There appears to be an application problem in the definition of what a "secured claim" is: the methodology does not indicate this expressly, but it seems that the whole amount of the claim submitted by the secured creditor is taken into account, without regard to the value of the collateral. This has important implications for the accuracy of the indicator (see below, 113).

80. Recovery rates for the rest of the creditors are also calculated. The indicator seems to cover the recovery obtained by all creditors who are not secured, therefore putting in the same category the unsecured creditors and other creditors who may have priorities, but not security interests. The indicator is based on the data included in the insolvency administrator reports on the claims submitted and the payments made to creditors.[118]

81. The statistical report considers the costs of the insolvency process. The insolvency costs are measured as costs incurred (in cents) for a euro of recovery.[119] The methodology for the indicator is based on the proportion between the full amount of payments made to all classes of creditors and the total costs incurred in the process. The report excludes the cases where no payments were made to creditors.

82. Finally, the report also includes data on no-asset cases. Instead of providing just the number of no-asset cases, the statistical report provides an indicator based on the proportion of no-asset cases against the total number of insolvency cases.[120]

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[117] The ratio is obtained from the amount of a secured claim (in euros) x 100 / the amount of payments made to the secured creditor (in euros).

[118] The methodology calculates the recovery rate as cents from one euro, comparing the amount of submitted claims and the amounts satisfied to the creditors.

[119] The calculation is done by obtaining the ratio of the amount of total (secured and unsecured) satisfied claims x 100 / total (secured and unsecured) costs. The data for the calculation are those included in the insolvency administrators' final reports.

[120] The indicator is based on the following ratio: number of insolvency processes that ended due to the lack of assets in a given year x 100 / total number of insolvency cases in a given year. The data is obtained from the insolvency administrators' final reports.

ii) Performance Indicators

83. The Latvian system has incorporated performance indicators relative to the insolvency system. [121] These performance indicators were approved in the Insolvency Development Guidelines. Table 3 includes the performance indicators for 2015-2020, together with the empirical information on indicators for years 2016 and 2017. [122]

Table 3: Policy results and performance indicators (reorganization and insolvency of legal persons)[123]

1. Policy result (PR) **Companies regain solvency by means of LPP**								
Performance indicator (PI)	2015	2016	Fact 2016	2017	Fact 2017	2018	2019	2020
1. Number of declares LPP (ELPP) versus number of declared insolvency process of legal persons	5%	5%	5%	7%	8%	9%	11%	13%
2. Percentage of initiated and declared LPP (ELPP)	28%	28%	19%	30%	24%	32%	34%	36%
3. Number of successfully completed LPP (ELPP) versus terminated LPP (ELPP)	2%	2%	8%	9%	10%	16%	23%	30%
2. Policy result (PR) **Maximum of satisfied creditors' claims, economically valuable assets returned to economic circulation (insolvency processes of legal persons)**								
Performance indicator (PI)	2015	2016	Fact 2016	2017	Fact 2017	2018	2019	2020
1. Average duration of insolvency process	1,5	1,5	1,67	1,5	1,67	1,5	1,3	1,3
2. Recovery rate for secured creditors (cents per one euro)	X	X	23	X + 0,05	31	X + 0,05	X + 0,07	X + 0,07
3. Recovery rate for non-secured creditors (cents per one euro)	X	X	4	X + 0,02	(4	X + 0,02	X + 0,05	X + 0,05
4. Insolvency proceedings costs (cents per one euro)	X	X	1.46 Euro	X - 0,05	2.17 euro	X - 0,05	X - 0,07	X - 0,07
5. Percentage of processes where reports on absence of assets are made	39%	39%	63%	38%	61%	37%	36%	35%

[121] See Insolvency Administration, Annual Report 2017, at 23 ff.

[122] Since the reporting system was overhauled in 2016, there may be some transition issues for that year. The accuracy of the results is expected to improve over time.

[123] The indicators also include information and performance indicators on the insolvency of individuals, but that topic is outside the scope of this report.

84. The use of performance indicators raises difficult issues in the measurement of the efficiency of the insolvency system. In principle, the performance indicators increase the accountability of the Insolvency Control Service and all the other institutions in charge of applying and enforcing insolvency law[124]. However, because of the multiple factors that affect the performance of the insolvency system, it is extremely difficult, if not impossible, to ensure that these performance targets are achieved. The information compiled in the statistical reports must be carefully analyzed to identify practical problems or to assess progress in the system.

85. The report also includes information and performance indicators relative to insolvency administrators. Given the importance of the role of insolvency administrators in the Latvian system, a special focus on the conduct of insolvency administrators is entirely justified. The indicators are included in Table 4.

Table 4: Information and performance indicators on insolvency administrators

4. Policy result (PR) **Administrators are highly qualified professionals, performing their duties efficiently (ensuring prestige of the profession)**								
Performance indicator (PI)	2015	2016	Fact 2016	2017	Fact 2017	2018	2019	2020
1. Number of administrators who handle an amount of processes that differs from the average number of processes per administrator	27	27	-	25	7	23	21	20
2. Number of penalized administrators versus total number of administrators (percentage)	21%	21%	26%	25%	26%	27%	21%	19%
3. Number of processes where administrators have been replaced due to violations versus the number of active processes	2,5%	2,5%	1.6%	2,8%	2.2%	2,8%	2,3%	2,1%

86. The indicators on insolvency administrators point to issues of concern to the Latvian authorities. These can be summarized as follows: the concern that certain insolvency administrators may have a dominant position; the proper sanctioning of insolvency administrators who engage in illegal or irregular conduct, including the administrators' removal from the insolvency process.

87. These indicators provide useful information about the situation of insolvency

[124] This is the reason why the Insolvency Control Service must report on the performance indicators: On 15 March 2017, the Cabinet of Ministers issued Order No. 125 "On the Plan for Improvement of the Business Environment". Paragraph 3.9.1 includes an obligation to submit information on certain indicators twice a year.

administrators in Latvia. It is interesting to observe whether some insolvency administrators manage more insolvency cases than the average, although that fact requires further analysis to extract conclusions. It is also appropriate to understand how many insolvency administrators are sanctioned, although it is not necessarily helpful to formulate this as a percentage of the total number of administrators.[125] Replacement of the insolvency administrators in the insolvency process is also an important development. The statistics only reflect the removal of the administrator as a consequence of a sanctioning process, so this represents a subset of sanctioned administrators – those responsible for serious infringements.

88. However, the use of performance indicators, or targets, in this context, can be misinterpreted. A target set for the percentage of sanctioned insolvency administrators may be misinterpreted as conditioning the supervisory work of the Insolvency Control Service. The drafters of the report are aware of this and indicate that the "*purpose of the supervisory measures is to ensure that insolvency process is performed lawfully and efficiently rather than to penalize administrators. Shown indicators are chosen to describe the quality of supervisory activities and the professional performance of administrators not being set as a goal itself*". The supervisor must combat all illegal conduct -and only the illegal conduct-, irrespective of the fact that that means that a certain performance indicator, or target, is not met or is surpassed. Similar considerations can be made on the removal of insolvency administrators, with the added caution that removal of the administrator may not always be the consequence of the actions taken by the Insolvency Control Service. Finally, the target of the number of insolvency administrators with more cases than the average can be influenced by the changes to the system of appointment of insolvency administrators, but there are also factors beyond the control of the supervisor (for instance, resignation of the insolvency administrator, although the law has curtailed the ability to resign).[126]

89. In general, the system provides extremely useful information, based on reliable collection methods. The Latvian authorities are convinced of the merits of collecting data on insolvency proceedings and using the data to measure the extent to which the insolvency system attains its policy objectives. The study of the data also offers the opportunity of understanding better the challenges and opportunities of development of the insolvency system. The statistical reports offer information on the fundamental indicators of time, cost and recovery rate, and Latvia has gone beyond that basic information to provide additional data on legal protection proceedings, no-asset cases, and certain aspects of the performance of insolvency administrators.

90. The reports of the Insolvency Control Service include other general data that is

[125] As the total number of administrators is also a variable, a potential increase in the number of sanctions could be offset by an even larger increase in the total number of administrators. For this reason, it is preferable to indicate just the number of sanctioned administrators.

[126] The deviation from the average would be important to analyze (i.e. it is not the same thing to have five administrators with five cases each, when the average is four cases than having one administrator with ten cases, when the average is four cases).

not integrated in the indicators. This information is extracted from the insolvency administrators' reports. [127] Some of this information is extremely useful to gain a better understanding of the insolvency system, including the following items:

- Total amount of claims (and average amount of claims in an insolvency case);
- Total amount of secured debt;
- Total amount of recovered secured debt;
- Total amount of unsecured debt;
- Total amount of recovered unsecured debt;
- Total costs.

91. The reports include other information items relevant to the analysis of regulatory and supervisory actions. These include the following:

- Qualified administrators (success rate in exams);
- Termination of insolvency administrators' certificates (broken down by causes);
- Supervisory actions (including on-site), results and violations;
- Cases of removal of administrators;
- Complaints against administrators and sanctions (broken down by individual/corporate insolvency; and by who presents the complaint);
- Appeals in sanctions;

Finally, the report also includes other aspects of interest:

- Payments to employees;
- Decisions on deposit disbursement;
- Conduct of the Insolvency Administration as a creditor.

C. Issues in Coverage and Methodology

92. As indicated before, the Latvian system has developed high standards in data collection and elaboration of insolvency statistics. Generally, the system is successful in collecting abundant information of excellent quality; and integrating the information in well-conceived statistical reports. What follows is a description of some issues in the coverage and methodology that can be usefully addressed to further enhance the data coverage and the statistical reports. In some cases, there is important information that is not being collected by the Insolvency Control Service. In other cases, the information is actually being collected, but is not incorporated to the statistical analysis.

[127] See Cabinet Regulation No. 247, Adopted 19 April 2016, on Regulations Regarding the Operational Report of the Administrator of Insolvency Proceedings and the Procedures for Filling in Thereof.

93. The statistics and the data gathered do not cover economic information on the insolvent companies. The information gathered from insolvency cases can be used not just for the analysis of the insolvency system itself, but also for the analysis of economic trends. However, the current system does not include information about the economic activities conducted by debtor companies, or any other economic information beyond the data strictly related to the insolvency process.

94. There is not sufficient information on the assets of debtor companies. The statistical reports do not include the average value of assets in insolvency cases, or the value of assets encumbered to secured creditors. These data are important for the elaboration of statistics, and affects the accuracy of other data (especially, the rates of recovery for secured credit).

95. Information on creditors does not reflect the existence of different creditor classes. The statistical reports include information on the recovery of secured creditors and of "non-secured" creditors. This latter category seems to include unsecured creditors and also preferential creditors with a higher position in the creditors' hierarchy.

96. The information on Legal Protection Proceedings is limited. The fact that there is no appointment of administrator in Legal Protection Proceedings (and therefore no administrator's report), means that the data on LPPs is restricted to the information that the law requires to file at the Insolvency Register.

97. The methodology to measure costs is not entirely clear. The statistical report seeks to measure costs by establishing the amount of money it takes to generate a payment to creditors (expressed as a cents/euro ratio). Essentially, the comparison is between costs of the procedure and the payments received by creditors, instead of comparing the value of the assets, as converted into proceeds, to determine the proportion of proceeds that are absorbed by the costs, before any payment is made to the insolvency creditors. The process to obtain the values for the cost indicator in the statistical report needs to be revised, as it makes the costs appear higher than they are.

98. All statistical indicators are based on averages. While this is correct and in line with the practice of most statistical reports in other countries, the problem with relying entirely on averages is that there may be situations where single insolvency cases may distort the image provided by averages. For instance, a large insolvency case can alter the averages significantly, especially if the sample of cases is small.

D. Suggestions for Enhancing Data Collection and Statistical Analysis

99. The solid foundations of the current data collection and statistical system provide opportunities for its enhancement. The suggestions included in this section of the

report are based on an examination of the corporate insolvency procedures in Latvian law. This "audit" of procedures helps identify the different points of the procedure where information can be collected and the points to measure progress. The flowcharts provide an overview of the procedure and the ability to achieve granularity in the data information system.

i) Description of Procedures

100. Broadly speaking, there are two types of proceedings available for legal entities facing financial difficulties under the Latvian Insolvency Law; namely Legal Protection Proceedings and insolvency proceedings. In contrast to the insolvency proceeding, the LPP provides a framework for reorganization that is geared towards reestablishing a debtor's ability to meet its debt obligations rather than towards the liquidation of the estate for the satisfaction of the creditors' claims. Both Legal Protection Proceedings and insolvency proceedings need to be carefully dissected (See Annex 1) with the goal of establishing the sequence of events in each process, and the data inputs and outputs that are necessary for their completion. As a result of the better understanding of the different types of insolvency proceedings, it is possible to define the points where data can be obtained and the measurement of the efficiency of each phase of the proceedings, rather than the overall duration of insolvency proceedings.

ii) Flowcharts with Milestones and Data Collection Points

101. Flowcharts represent insolvency procedures and allow for the identification of milestones and data collection points. Flowcharts, together with the analysis of the procedures, help to define milestones and data collection points in the insolvency procedures.

- *Milestones* are points of progress in the insolvency procedure. With milestones it is possible to measure the time it takes to complete each phase of the process. Milestones provide essential information to identify bottlenecks and opportunities for time reduction.
- *Data collection points* are points in the process where information is being generated or incorporated to the process (for example, the declaration of insolvency; the decision on the admission and ranking of claims, the reorganization or liquidation plan). Data collection points can be incorporated in a data collection system to indicate the points where the relevant information can be extracted.

102. The new electronic system introduced in Latvia presents a unique opportunity to refine data collection. The Electronic Insolvency Accounting System[128] is an information system managed by the Insolvency Control Service. One of its purposes is to support the supervisory activities of the Insolvency Control Service by collecting data that assists in assessing the performance of insolvency administrators and the fulfilment of their duties. The

[128] See Insolvency Law, Section 12^1, as amended in 2016.

system also assists in measuring the extent to which the insolvency system achieves the objectives established in the law and set by the authorities. The system has a content prescribed by law:[129] however, the categories included in the law are broad and could easily incorporate the additional information recommended in this TA report. One of the key items included in the law is the insolvency administrator's report.

iii) Data to be Collected

103. The statistical report already includes the most significant data, but some additional information could be compiled. It should be possible to add the following items:

- *For all proceedings (insolvency/liquidation and legal protection/reorganization):*
  - *Economic data of the enterprises*: business activity, region where the enterprises is located, SMEs/ large corporates, number of workers.
  - Total *assets and liabilities* of enterprises.
  - Measurement of the *frequency of the use of the insolvency system*. There are different methods that can be used to assess the frequency of use: comparing the number of companies that commenced insolvency proceedings in a given year with the number of registered companies (if possible, excluding the dormant companies in the registry). Looking at the companies that have canceled their registration in a given year, and comparing the figure with the number of companies extinguished as a consequence of the termination of liquidation proceedings can also provide a sense of the relative use of insolvency proceedings.[130] It is also possible to look at the total of assets and liabilities of companies commencing insolvency proceedings in a given year and comparing it to the GDP. In this respect, it is important to take into account that in a crisis GDP

[129] Section 12 (3) of the Insolvency Law specifies the information to be included in the system:

1) information regarding persons involved in legal protection proceedings and insolvency proceedings;

2) information regarding the course of legal protection proceedings and insolvency proceedings;

3) information regarding a person supervising legal protection proceedings and an administrator;

4) information regarding violations of persons supervising legal protection proceedings and administrators in the performance of their duties in legal protection proceedings and insolvency proceedings and in the exercise of their rights, as determined by the court, the Insolvency Administration and the commission of disciplinary matters specified in this Law;

5) information regarding claims of employees in insolvency proceedings;

6) information included in an administrator's operational reports specified in Section 85 of the Insolvency Law.

According to the Insolvency Law (Section 12(8)), the Cabinet of Ministers shall determine the extent of information to be included in the System as well as the procedure in accordance with which information is to be submitted for inclusion in and received from the System.

[130] This metric must be qualified in light of the relevant corporate practice: there may be other reasons for which the registration of companies is canceled, and therefore there may not be a direct relationship between enterprise distress and de-registration of companies.

will contract, so this metric can exaggerate the relevance of the use of insolvency proceedings (the reverse can also happen).

- *For insolvency proceedings*:
  - Information on *who requests commencement of the insolvency case*. At the very least, the reports could distinguish between debtor- and creditor-initiated cases. It is even possible to distinguish among different types of creditors (for instance, financial creditors, trade creditors, public creditors).
  - *Assets*: as part of the insolvency administrators' role, there should be an assessment of the value of the assets that comprise the insolvency estate. The value of the total insolvency estate should be taken, not just as self-standing information, but also to be used for other purposes (for instance, comparison between the value of the assets and the amounts distributed to creditors). In addition, the value of assets subject to a security interest needs to be recorded for the purposes of the insolvency proceedings. This is also relevant to measure the extent to which secured creditors have claims larger than the value of the collateral (undersecured creditors) or claims smaller than the value of the collateral (oversecured creditors).
  - *Proceeds*: proceeds are defined as the sums of money generated by the sale of the assets from the insolvency estate. *Gross total proceeds* represent all sums of money, and after costs of the insolvency process are paid, *net proceeds* are distributed to creditors. Proceeds are crucial to determine the costs of the process and the recovery of claims. Differences between the valuation of assets and the proceeds obtained in the liquidation should represent a warning from the supervisory point of view.
  - *Claims*: it is possible to take the value of total claims from the insolvency administrators' reports. Currently, the claims are divided between secured claims and the "non-secured claims". In practice, this means that privileged creditors are merged with unsecured creditors. It would be preferable to distinguish among creditors according to their ranking, and this will result in different recovery rates for each creditor class.
  - *Sale of assets*: it would be useful to distinguish the cases in which a sale of the whole business is achieved (or a sale of business units). In addition, the reports could include information about the types of sale used in the proceedings (auctions or alternative mechanisms).
  - *Costs*: It should be possible to have a breakdown of costs in the insolvency administrator's report, according to basic categories (remuneration, maintenance costs, legal fees, etc.). This information is useful for supervisory purposes.
- *For Legal Protection Proceedings*: the data at the Insolvency Register on Legal Protection Proceedings needs to be supplemented by new data from other sources. It should be possible to capture the data relative to the assets and liabilities from the documents presented at the court case. There is additional data to be collected:

- *Legal Protection Proceedings and the reorganization plan:* the current system distinguishes cases where the proceedings are commenced and proceedings where a plan is adopted. It should be possible to determine too the cases where no plan is presented, and the cases where a plan is rejected. This would provide a full view of an important feature of the Legal Protection Proceedings.
- *Type of plans:* according to the law, the Insolvency Register includes information on the type of plans. It would be useful to incorporate the information about the types of reorganization plans used to the statistical reports.
- *Success of Legal Protection Proceedings:* It would be possible to measure the rate of success of Legal Protection Proceedings, but that requires a longitudinal study, spanning over the years since the reorganization plans are adopted until the plans are successfully completed.

iv) Methodology

104. Some revisions to the methodology would reinforce the statistical model. The first step would be to reassess the available resources. The electronic system provides an excellent platform with abundant and reliable data in an accessible format. As a matter of fact, the insolvency administrator's report, which provides most of the information, could be used more efficiently to extract additional information for statistical analysis. The information provided by the insolvency register should be completed by data from the Court Information System. It should be possible to extract precise information about the different steps in the proceedings (including the hearings) to populate the milestones in the system. At the same time, this avoids complete reliance on the insolvency administrator's report as a single source of information.

105. The statistical reports could also include median values for some of the data. Average values for the basic indicators (time, cost and recovery rate) represent standard practice. However, in order to present a full undistorted picture of insolvency proceedings, it is also useful to include median values, at least for some of the indicators. For instance, the median values for assets and liabilities in insolvency cases offer a complementary view of the challenges experienced in a typical case.[131]

106. With a revised infrastructure, the statistical reports could incorporate additional information on legal protection proceedings. A deeper analysis of the legal protection proceedings would require setting up some data collection points, so as to have information on the assets and liabilities of the company at the commencement of the case, information of the costs incurred over the course of the proceedings, and information on the contents of the plan –especially, the payments offered to the different classes of creditors. This could be done through coordination with the systems of the Register of Enterprises (Insolvency Register), the

[131] The fact that the statistics are already excluding the no-asset cases contributes to reduce the gap between average and median values.

Court Administration (the Court Information System) and maybe through additional reporting duties for the debtor or the supervisor.

107. More information can be extracted from the administrators' reports. Since the administrators' reports are being submitted through the electronic system, there is an opportunity of "mining" the data included in them. For instance, it would be possible to generate reports on the number of creditor meetings, or information on the criminal proceedings. The reports could be amended to expand its scope: it would be important to have information on avoidance actions, and a typical responsibility of insolvency administrators in numerous legal systems is to report on the causes of the insolvency of the company. This information is extremely useful, and it could be easily integrated in the report.

108. A distinction must be drawn between the use of information for supervisory purposes and the publication of statistical reports. The statistical reports can focus on aspects that are relevant for the general public and the insolvency community: these highlight the efficiency of the insolvency system by measuring the fundamental indicators of time, cost and recovery rate, for both reorganization and liquidation proceedings.

109. Some adjustments would improve the measurement of the fundamental indicators in the statistical reports. These adjustments would improve the measurement of time, costs and recovery rate for creditors.

110. The methodology to measure the duration of insolvency proceedings could be completed with granular information. The current methodology gives the total duration of insolvency proceedings. This should also be extended to legal protection proceedings, by measuring the time between the commencement of proceedings and the approval of the plan or the termination by other means. The measurement of the duration of the reorganization and liquidation proceedings can be measured in more detail for supervisory and analytical purposes. In this regard, setting several milestones, segmenting the process in different sequences, provides an accurate reading of the different steps of the process, which is invaluable for the identification of bottlenecks and the introduction of efficiency gains. As illustrated in the description of procedures and flowcharts, there are clear sequences that can be analyzed to understand the functioning of procedures better, and this may also serve the purpose of supervising the activity of insolvency administrators (i.e. an excessive amount of time in a certain procedural step should be taken as a warning of potential issues). For the calculation of average and median values of the duration of insolvency proceedings, no-asset cases should be excluded.

111. The methodology to assess the costs of the insolvency proceedings could also be refined. Costs should not be measured as a percentage of recovered euros –and the arithmetic should be, in any case, revised. It is submitted that costs should be measured as a percentage of the proceeds in the liquidation of the insolvency estate, since the costs must be deducted

before there is any return to creditors. The costs are represented as a percentage of the value of the insolvency estate, but the value of the estate is really manifested when it is converted into proceeds. The costs of legal protection proceedings should be calculated as a percentage of the value of the assets, since there is no liquidation of the entity. In this way, both in liquidation and in reorganization proceedings, the costs would be measured as a percentage of the value of the estate, which provides a better sense of the efficiency of the process. It should be possible to distinguish total costs, and costs that affect certain classes of creditors, such as secured creditors. For the calculation of average and median values of costs, no-assets cases should continue being excluded. For supervisory purposes, it is useful to analyze the breakdown of the costs, which can be done thanks to the information in the insolvency administrators' reports.

112. Some changes to the methodology of the calculation of recovery rates would be appropriate. Once costs are deducted, the remaining amounts are to be distributed among creditors *(proceeds - costs=recovery of claims).* The calculation of average and median recovery rates must take into account the existence of different creditor classes. Recovery rates in legal protection proceedings must be established in accordance with the information included in the plan. No-assets cases should be excluded.

113. The approach used for the calculation of the recovery of secured claims needs to be revised. The practical implementation of the methodology requires, for secured credits, a distinction between the amount of the claim and the value of the collateral. This can be determined by reference to the documents produced in the insolvency proceedings –and referenced in the administrator's report. As a result, there may be a portion of the claim that is unsecured (the part of the claim exceeding the value of the collateral). The recovery of secured credit must be calculated only taking into account the amount of the claim that is covered by the value of the collateral. The fact that there is a portion of the claim that is not covered by the collateral has nothing to do with the insolvency process: it may be caused by the lending practice of the creditor, or by the depreciation of collateral, among other reasons. Once the secured credit is determined, the recovery would be calculated by reference to the proceeds obtained in the sale of the collateral, deducting the relevant costs. It would be important to record the time when secured creditors receive payment within the insolvency process. Time of payment is a crucial factor for secured creditors, and it is not correct to assume that payment takes place when the process in concluded: generally, secured credit can be satisfied by way of enforcement of the collateral within the insolvency process, before the insolvency procedure is concluded.

v) Data collection and Supervision

114. The collection of data is an essential tool for the supervision of insolvency professionals. One of the main objectives of the reforms adopted by Latvia is to increase the efficiency of insolvency procedures and the quality of the work of insolvency professionals.

The Insolvency Control Service has a crucial role in supervising the compliance of insolvency professionals with the requirements of the law. The oversight of the Insolvency Control Service extends not only to insolvency administrators in insolvency proceedings, but also to supervisors in LPPs.

115. The effectiveness of supervision increases with adequate data collection systems. As explained in this report, the Insolvency Control Service relies on different supervisory techniques and conducts both off-site and on-site supervision of insolvency professionals (see above, 43 ff.). The Latvian system includes a wide range of duties for insolvency professionals, and compliance with these duties can be verified with the assistance of data collection systems. This may require increasing the exchange of insolvency data among the systems of the Enterprise Register (Insolvency Register), Court Administration (Court Information System) and the Insolvency Control Service and the development or improvement of reporting requirements by insolvency professionals.

116. In Legal Protection Proceedings, the duties of supervisor need to be examined with a view to increasing data for their verification. The supervisor of an LPP is required to perform various duties and functions under the Insolvency Law. It is possible to examine whether enough data is currently being generated or reported so as to allow for the verification and effective supervision of its duties (Table 5).

Table 5. Duties of LPP Supervisors and Data Collection for Supervision

List of Duties of an LPP Supervisor	Data Collection and Compliance
• Preparation of an opinion on the plan within the period specified by court (Insolvency Law, Sections 43 and 47)	Need to collect data from the Court Information System (timeliness of the submission; contents of the opinion)
• Submit an approved plan/amendment thereto to the responsible authority administering the Insolvency Register within five days following the court decision to implement the proceeding/approving the amendments (Insolvency Law, Section 50(2))	Verifiable through the Insolvency Register
• Supervise the implementation of the plan (Insolvency Law, Section 50(2))	Unclear whether the supervisor produces regular reports. Copies of reports should be submitted to the Insolvency Control Service
• Inform the creditors upon their request about the implementation of the plan and examine related	The supervisor should include information about creditors' requests and his/her responses in some form of periodic report, submitted to the Insolvency Control Service

complaints (Insolvency Law, Section 50(2))	
• Participate in court hearings (Insolvency Law, Section 50(5))	Compliance with this duty should be verifiable through the Court Information System
• Provide information on the course of the proceedings to the court, the Insolvency Control Service and other persons and institutions specified by the law (Insolvency Law, Section 50(5))	Compliance with this duty is verifiable through the interactions with each institution; it would be better if the supervisor included a summary of these interactions in a report.
• Notify within five business days the authority responsible for administering the Insolvency Register and creditors regarding changes in the contact information specified in a plan (Insolvency Law, Section 50(5))	Verifiable through the Insolvency Register
• Provide information and materials to law enforcement institutions regarding facts that transpire over the course of the proceedings and which may serve as grounds for initiation of criminal proceedings (Insolvency Law, Section (50(5))	A summary of these actions should be included in a report produced by the supervisor.
• The supervisor also has a duty to notify creditors without a delay when (i) in the implementation of the proceeding, the debtor has not performed the activities specified in the law or provided false information; (ii) the debtor has not implemented the plan for more than 30 days and submitted no amendments of the plan to the court; or (iii) if the debtor violates the restrictions on its actions as specified in the Insolvency Law (Insolvency Law, Section 51(3))	The supervisor should include these facts in the periodic reports produced on the monitoring of the implementation of the plan.
• The supervisor is required to send a copy of the decision to terminate the proceeding no later than five days	Verifiable through the Insolvency Register

after the relevant court's decision to (i) the relevant public register along with an application for the deletion of the notation of insolvency; and (ii) the bailiff managing the recovery of any amounts adjudged but not yet recovered from the debtor and matters regarding the payment of the debtor's obligations through the court (Insolvency Law, Section 51(6))	
• The supervisor is responsible for organizing the case file of the proceeding and including all related information and documents and a list thereof (Insolvency Law, Section 12.^{6}(1))	This duty should be verifiable by including a reporting requirement to the Insolvency Control Service
• The supervisor is required to keep records and account for all revenue and expenditure incurred in the performance of its duties (Insolvency Law, Section 12.^{7}(1))	This duty should be verifiable by including a reporting requirement to the Insolvency Control Service
• The supervisor is required to ensure access to an administrator to its place of practice entered in the Insolvency Register and to the location of a debtor (Insolvency Law, Section 11(4))	Verifiable. This duty does not require special reporting.

117. A similar analysis can be conducted for the duties of administrators in insolvency proceedings. The administrator of an insolvency proceeding is assigned various duties, functions and rights under the Insolvency Law. The control over administrators is more intense than over LPP supervisors, and the Insolvency Control Service relies on reporting duties (insolvency administrators' reports) that include abundant information for oversight purposes. In any case, it is possible to examine whether enough data is currently being generated or reported so as to allow for the verification and effective supervision of its duties (Table 6).

Table 6. Duties of Insolvency Administrators and Data Collection for Supervision

List of Duties of an Administrator	Data Collection and Compliance
• Prepare and send electronically an operational report every quarter to the	Directly verifiable by the Insolvency Control Service

	creditors and the Insolvency Control Service[132] (Insolvency Law, Section 85)	
•	Managing records and accounting of revenue and expenditure that accrue in the course of its official duties (Insolvency Law, Section 26.[1)]	The Insolvency Control Service can verify compliance indirectly, through the administrator reports.
•	Duty to keep creditors informed electronically on the course of the proceedings, specifically (i) the plan for the sale of the debtor's property; (ii) the non-existence of property in the debtor's establishment; (iii) the amount of its remuneration; (iv) the expenses of the insolvency proceedings; (v) the plan for settling the claims of creditors; (vi) the intention to renounce the claims, enter into a settlement or perform the cessation of the right to claim; (vii) the extension of the deadline for selling the non-pledged property; and (viii) other matters of significance during the course of the insolvency proceedings (Insolvency Law, Section 81)	The Insolvency Control Service can verify compliance indirectly, through the administrator reports.
•	Conduct without delay, following the proclamation of insolvency proceedings, a full inventory of the documents and property of the debtor and draw up the balance of the debtor (Insolvency Law, Section 65)	The Insolvency Control Service can verify compliance indirectly, through the administrator reports.
•	Ensure the evaluation of the property included in the plan for sale (Insolvency Law, Section 65)	The Insolvency Control Service can verify compliance indirectly, through the administrator reports.
•	Examine complaints about the course of insolvency proceedings and provide a reply to the submitter of the complaint within two weeks (Insolvency Law, Section 26)	There is no special section in the administrator reports on this issue. The Insolvency Control Service can only monitor compliance with this duty though direct checks.

[132] Starting from January 1, 2019, monthly reports will be generated automatically in the Electronic Insolvency Accounting System (based on amendments adopted on May 31st, 2018 to Section 85 of the Insolvency Law).

• Organize the accounting records of the debtor in accordance with the requirements of laws and regulations, including the submission to the State Revenue Service of a true copy of the annual financial statements and a sworn auditor's report (where required) only in the cases when the administrator has taken a decision to continue the economic activity of the debtor to full or restricted extent (Insolvency Law, Section 26)	There should be communication with the State Revenue Service for the verification of compliance with this duty.
• Organize at his or her place of practice or at a debtor's location the case file for an insolvency proceeding, in which he or she shall include all information and documents connected with the proceedings and prepare also a list of documents in the case file of these proceedings (Insolvency Law, Section 26)	The insolvency administrator reports include information on the most relevant aspects of the insolvency process, thus allowing indirect verification of compliance with this duty. The Insolvency Control Service can also verify compliance by performing direct checks.

vi) Other Uses of Data

118. The Latvian authorities should consider additional uses for the information on the insolvency system. The elaboration of statistical reports including the suggested additional information can have important uses beyond the performance of the insolvency system and the supervision conducted by the Insolvency Control Service.

119. Insolvency statistics provide useful information for economic analysis. The number of insolvency cases and the data on affected economic sectors and regions represent a valuable source of information for economic policy purposes. These data are relevant both in crisis and non-crisis scenarios.

120. In addition, insolvency statistics are relevant for financial regulation purposes. General data on the economic aspects of insolvency proceedings, as indicated above, can also be useful from the perspective of the financial supervisors, as it allows them to understand the challenges that financial creditors may be experiencing. The information on the duration of proceedings and the recovery rate of different classes of creditors is extremely helpful for the development and validation of loss provisioning models. Accurate data on the time to recover and overall satisfaction of claims is a key element for the pricing of non-performing loans and the development of a distressed debt market.

Recommendations:

- Increase the amount of data incorporated to the statistical reports, especially for Legal Protection Proceedings
- Increase the exchange of insolvency data among the systems of the Enterprise Register (Insolvency Register), Court Administration (Court Information System) and Insolvency Control Service.
- Make use of the existing and newly collected data to enhance the supervisory functions of the Insolvency Control Service
- Introduce revisions to the methodology for the insolvency statistics
- Revise the performance indicators for the insolvency system to incorporate only indicators that measure the efficiency of the courts and the Insolvency Control Service

IV. Conclusion and Next Steps

121. The Latvian authorities have made remarkable progress towards the goal of establishing an efficient and reliable insolvency system. The reforms of the legal framework have been accompanied by extraordinary efforts in the implementation and institutional framework.

122. There have been noticeable improvements in the regulation and supervision of insolvency administrators. The reforms of the legal framework have been accompanied by extraordinary efforts in the implementation and institutional framework. Certain aspects of the system, as explained in this report, can be modified to achieve a balanced model for the regulation of insolvency administrators (assessment of reputation; rules for the renewal of licenses; insurance; remuneration of insolvency administrators).

123. There is room for improvement in the efficiency of the insolvency system. The reforms of the legal framework have been accompanied by extraordinary efforts in the implementation and institutional framework. Certain areas of the insolvency system deserve special attention, especially Legal Protection Proceedings, which need technical changes to offer better opportunities for business rehabilitation. Assetless insolvency cases are absorbing much needed resources and can be tackled through reforms of tax legislation and the insolvency law. Finally, the sale of businesses as a going concern in liquidations represents an important goal to increase the efficiency of insolvency proceedings; and requires amendments in the law to support this type of transaction. Moving forward, the authorities have signaled their intention of assessing personal insolvency proceedings, which may be a necessary addition to the work done so far.

124. Data collection mechanisms and statistical reports are strong, but they can be reinforced. There are many positive points in the existing system: it produces abundant and reliable data, through an advanced technological infrastructure. With the suggested

improvements, the data collected by the authorities will crucially support the objectives of improving the efficiency of the insolvency system and of the supervision of insolvency administrators.

125. The revisions of the insolvency data collection and statistical system can inspire further work in other areas. Similar principles can be applied to the data on the insolvency of natural persons: an additional aspect on the insolvency of natural persons is the incorporation of different sets of data that are relevant for social and economic policy (age, gender, occupation, incidence of fraud, repeat personal insolvency cases). Another area of great economic significance is the enforcement of individual claims. Although this area falls outside the competence of the Insolvency Control Service, it would be extremely interesting to compare the time, costs and recovery rates of individual enforcement actions of secured and unsecured credit against the respective insolvency indicators. Accurate data on enforcement are also important for financial supervisors.

126. The Latvian authorities should continue building on the existing system and introducing incremental improvements. The reforms of the legal framework have been accompanied by extraordinary efforts in the implementation and institutional framework. The analytical work and the statistical studies place Latvia in a privileged position to implement the future requirements of the EU Directive on preventive restructuring frameworks[133]. The Latvian authorities should in fact look beyond the requirements of European law and continue introducing improvements in the insolvency system. Over time, the effects of the reforms and the implementation efforts will be apparent in the Latvian economy.

[133]See Proposal for a Directive of the European Parliament and of the Council on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures and amending Directive 2012/30/EU (COM/2016/0723 final - 2016/0359 (COD)). The Proposal follows the line initiated with the EC Recommendation of 2014 (2014/135/EU: Commission Recommendation of 12 March 2014 on a new approach to business failure and insolvency).

ANNEX 1: DESCRIPTION OF PROCEDURES

A) Legal Protection Proceedings

LLPs commence from the day of initiation of the proceeding by the court until the day a court decision to terminate the proceeding is rendered.[134] Along the process, there are several clear milestones and actual or potential data collection points. These can be summarized as follows:

- *Application.* An application for the initiation of the LPP must be submitted by the debtor to the court in accordance with the procedure set out in the Civil Procedure Law.[135] This is the first milestone in the process. The application is also a data collection point, as the debtor is required to provide certain information with its application. However, it would be preferable to retrieve information from more reliable sources in the process (the court or the supervisor).
- *Initiation by the Court.* An LPP commences from the day of its initiation by the court. The court is required to take a decision with respect to an LPP application no later than the day following its receipt. Initiation by the court has a number of important legal effects, including the stay of creditor actions (including secured creditor actions) and a prohibition of the initiation of insolvency proceedings.[136]
- *Appointment of a Supervisor*. For each specific LPP, a supervisor needs to be appointed. In principle, appointment of supervisors is done by the court at the suggestion of a majority of creditors in agreement with the debtor and the supervisor.[137] An application for the approval of the appointment of a candidate as a supervisor is to be lodged with the court by an authorized representative of the requisite majority of creditors.[138] In terms of time, the appointment of the supervisor is done by the court immediately after the plan is submitted by the debtor for court approval.[139]
- *Plan Formulation by Debtor.* Following the initiation of an LPP, the debtor is required to send immediately to all creditors a current list of creditors and their respective claims and submit for court approval a plan that is approved by creditors within a period of two months (extendable by one month) from the initiation of the proceeding by the court.[140] It is not clear whether the list of creditors and their respective claims that is submitted by the debtor at this point is entered in any register. The plan formulated by the debtor needs

[134] Insolvency Law, Section 3(2).
[135] Insolvency Law, Section 33.
[136] Insolvency Law, Section 37; Civil Procedure Law, Section 341.4.
[137] Insolvency Law, Section 35.
[138] Insolvency Law, Section 35.
[139] Civil Procedure Law, Section 341.5.

[140] Insolvency Law, Section 40.

to include certain components: an overview of all payment obligations of the debtor, a forecast of the projected revenues, expenses and cash flows of the debtor during the period of the proceeding and its underlying assumptions, the debt restructuring tools used in the plan (e.g. rescheduling of debts, recapitalization), the timeframe for the implementation of the plan, information on the supervisor of the proceeding, a list of the pledged property needed for the plan and compensation for the affected secured creditors, and the objections of dissenting creditors to the plan (along with any relevant auditor opinion)[141] as well as an explanation of how the plan would afford them at least the equivalent of what they would receive under an insolvency proceeding along with any relevant opinion by an auditor.[142] The plan shall also include the measures by which the obligations of the debtor against secured creditors shall be honored.[143]

- *Creditor Consent to the Plan.* A debtor is required to provide the plan to all creditors and invite them to vote on the plan within the period that it specifies. Creditors' consent needs to be submitted in writing and signed by the respective creditors. A creditor that has not provided a written response during the designated timeframe is considered to have not consented to the plan. It would appear that such responses need to be addressed to the debtor. Presumably, the debtor needs to provide proof of creditor consent of the plan when submitting it for court approval in accordance with Section 40(1).[144] A creditor may submit written objections to the plan within five days after the receipt thereof.[145]
- *Supervisor's Opinion on Plan.* Prior to the approval of a plan (or the amendment thereof) by the court, the supervisor of an LPP shall prepare an opinion regarding the plan within a period determined by the court but that is left unspecified in the Insolvency Law. Such opinion shall be provided to the debtor simultaneously with its submission to the court. Besides opining on whether the plan would achieve the stated objectives of the LPP under the Insolvency Law, the opinion of the supervisor may also identify a creditor claim as invalid *prima facie*. Where this is the case, such opinion will be handed over to the debtor who shall notify the concerned creditor. Creditors have the right to apply to the court to defend the validity of their claims by submitting evidence not later than three days prior to the examination date of the application by the court.[146] The same right of creditors applies where a sworn auditor recognizes a claim as invalid *prima facie.* There does not seem to be data available on such objections by creditors (i.e. if any are presented and if yes how often).
- *Court Approval of the Plan.* An LPP is to be implemented if, in addition to creditor consent, the court approves the plan and adjudicates that the LPP shall be implemented. A plan is considered to be in effect from the date of court approval and is binding on

[141] Insolvency Law, Section 43.1 (providing for the provision of an auditor opinion in cases where the debtor fails to take into account objections by dissenting creditors to the plan or to the validity of a creditor's claim).
[142] Insolvency Law, Section 40(4) and (6).
[143] Insolvency Law, Section 41.
[144] Insolvency Law, Section 42(3)-(5).
[145] Insolvency Law, Section 42.
[146] Insolvency Law, Sections 43 and 47.

dissenting creditors. The Insolvency Law does not specify the timeframe within the court is required to approve or reject a plan or within which it needs to rule on evidence submitted by creditors on the validity of their claims (see preceding bullet). The law is also unclear regarding the type of judicial decision, the information it must include, or the available appeals.

- *Timeframe for Implementation of an Approved Plan.* The period for the implementation of the proceeding is two years from the day the court adjudication regarding the implementation of the LPP enters into effect. This period is extendable by two years subject to the approval of the majority of creditors as specified in the Insolvency Law.[147] During the implementation of a proceeding, the debtor is required to notify the supervisor of the proceeding at least once a month of the implementation of the plan and to provide any information regarding the implementation upon request.[148]
- *Termination.* An LPP is terminated by the court if the plan is not approved by the requisite creditor majority or contravenes the provisions of the Insolvency Law.[149] A Legal Protection Proceeding shall be converted into an insolvency proceeding if the debtor has not implemented the plan for more than 30 days and has not submitted amendments to the plan to the court.[150]
- *Publicity.* The Insolvency Law specifies certain information that is to be entered in the Insolvency Register on LPPs; namely (i) the debtor's name; (ii) the debtor's registration number; (iii) the debtor's legal address; (iv) the date when the matter was initiated, and the name of the court; (v) the date when the court adjudication was rendered regarding the implementation of LPPs and the plan of measures of the LPPs was approved, and the name of the court; (vi) the given name, surname, address of place of practice in Latvia, phone number and electronic mail address of the person supervising an LPP, as well as an identification number allocated by the responsible authority which administers the Insolvency Register; (vii) the methods specified in the plan of measures of the LPPs; (viii) the time period for the implementation of LPPs; (ix) the date when the court approved amendments to the plan of measures of the LPPs and the name of the court; (x) the date of termination of LPPs, the name of the court, and the grounds; and the date of the making of the entry.[151] The requisite information does not include a description of the business of the debtor or give any indication of the amount of claims, the value of the assets, or the commitments under the plan.
- *Data available on the Website of the Insolvency Control Service.* The Insolvency law enumerates several data items that are to be published by the Insolvency Control Service regarding an LPP and the supervisor handling it. The data items to be published are the following: (i) given name, surname and contact information of a person supervising LPPs as well as information about the education and qualification of such person; (ii)

[147] Insolvency Law, Section 48.
[148] Insolvency Law, Section 49(4) and (5).
[149] Insolvency Law, Section 51(1).
[150] Insolvency Law, Section 51(2).
[151] Insolvency Law, Section 36.

information regarding violations of persons supervising LPPs in the performance of their duties as set forth in regulatory enactments in the field of insolvency and in the exercise of their rights, if such violations have been established by a decision of the court, the Insolvency Control Service or the disciplinary matters commission, which may no longer be appealed; (iii) information regarding the number of LPPs being supervised by persons supervising LPPs; (iv) information regarding LPPs supervised by a person supervising LPPs and terminated by proclaiming insolvency proceedings of a legal person; (v) information regarding LPPs supervised by a person supervising LPPs and terminated due to the performance of the plan of measures of LPPs; and (vi) information as to how long the person has been practicing as a supervisor of LPPs.[152]

B) Insolvency Proceedings

The first step in an insolvency process is the application for insolvency. Along the process, there are several milestones and actual or potential data collection points which can be illustrated as follows:

- *Application.* An application for the commencement of insolvency proceedings of a legal person may be submitted by a creditor, an employee or the debtor himself in accordance with the procedures set out in the Civil Procedure Law, after the payment of the required deposit which is to be used for covering the costs of the proceedings (in cases where debtor has no property or where the value of the property is lower than the deposit amount).[153] The application is the first data collection point, as the applicant is presumably required to submit certain information with its application. However, in the Latvian system, the primary source of information is the administrator's report, which is more comprehensive and rigorous than any application submitted by the debtor or a creditor.
- *Commencement.* The period between the submission of an application for the commencement of insolvency proceedings and their proclamation by the court varies depending on whether the application is initiated by the debtor or creditor(s). In case of an application by the debtor, the court is required to examine the application within seven days from it submission. In case of a creditor application, the court is required to examine the application within 15 days from it submission.[154]
- *Appointment of Administrator.* The Insolvency Law provides for the appointment of an administrator and assigns it various functions and duties. In terms of timing, the administrator is appointed at the time of commencement of insolvency proceedings by

[152] Insolvency Law, Section 12(2).
[153] Insolvency Law, Sections 60 and 62.
[154] Civil Procedure Law, Section 363.11.

the court (i.e. in seven or 15 days from the submission of an application for initiation of insolvency proceedings). Following the proclamation of insolvency and its appointment by the court, the administrator is required to perform certain duties "without delay".[155]

- *Effects of Proclamation of Insolvency*. The proclamation of insolvency proceedings by the court has a number of important legal consequences for the debtor, including the transfer of the debtor's management to the administrator within a period of no less than three days and no more than 10 days from the date of proclamation of the insolvency proceedings.[156] In this regard, the representative of the debtor is required to prepare a list of the property and documents of the debtor that are to be handed over.[157] This list is a potential data collection point.
- *Submission of Creditor Claims.* Within one month from the day when the entry has been made in the register regarding the proclamation of the insolvency proceedings, creditors are required to submit their claims to the administrator. [158]
- *Inspection and Recognition of Creditor Claims.* The administrator is required to decide on the recognition of creditors' claims within seven days from the receipt of each claim (15 days for claims submitted after the deadline.[159][160] Both creditors and the debtor's representatives are entitled to submit complaints to the court regarding the administrator's decision on the recognition of any creditor claim. A creditor is entitled to appeal the decision of the administrator on the non- or partial recognition of its claim to the court within two weeks from the day of receipt of the decision or within three weeks from the expiration of the deadline for submission of claims if the complaint relates to another creditor's claim (or within one month from the decision if the creditor's claim was submitted earlier than the deadline for the submission of claims. Complaints may be submitted to the court handling the respective proceedings.[161] The review of complaints submitted to the court must be initiated within 30 days following the receipt of the explanation or the expiry of the deadline for its submission.[162]
- *Register of Creditors' Claims.* The administrator is responsible for organizing a Register of Creditors' Claims, which shall include the following information (i) creditor's details (name, registration number and contact details); (ii) whether the claim is recognized; (iii)

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[155] See Insolvency Law, Section 65; Civil Procedure Law, Section 363.15

[156] Insolvency Law, Section 63.

[157] Insolvency Law, Section 70(2).

[158] Insolvency Law, Section 73.

[159] In case there are any shortcomings in a submitted claim, the administrator is required to send a request to the concerned creditor to address them within 10 days (as of the date the request is sent). If the shortcomings are not rectified by the creditor within the specified period, the administrator shall take a decision regarding the recognition of the claim within 10 days from the expiration of the deadline granted to the creditor. See Insolvency Law, Section 74.

[160] Insolvency Law, Section 75.

[161] Insolvency Law, Section 80.

[162] Civil Procedure Law, Sections 250.75-76.

the grounds for the claim; (iv) the time the claim arose; (v) the type of the claim; (vi) the amount; and (vii) the number of votes of the creditor at the creditors' meetings. Although the administrator is required to group creditors' claims into secured and unsecured (see Insolvency Law, Section 77), the data required to be included in the Register of Creditors' Claims does not include any data on the value of the collateral of secured creditors even though this is the point of the process at which secured creditors' claims should be split into secured and unsecured portions (to the extent the value of the claims exceed that of the collateral in place).[163]

- *Administrator's Duty to Keep Creditors Informed.* The administrator is required to notify creditors regarding (i) the plan for the sale of the debtor's property; (ii) the non-existence of property in the debtor's establishment; (iii) the amount of its remuneration; (iv) the expenses of the insolvency proceedings; (v) the plan for settling the claims of creditors; (vi) the intention to renounce the claims, enter into a settlement or perform the cessation of the right to claim; (vii) the extension of the deadline for selling the non-pledged property; and (viii) other matters of significance during the course of the insolvency proceedings. The administrator is to provide the foregoing information to creditors electronically.[164] This represents another data collection point.
- *Administrator's Operational Report.* Following the proclamation of the insolvency proceedings of a debtor, the administrator is required to prepare and send its operational report electronically to the creditors and the Insolvency Control Service each quarter. The form of the administrator's operational report and the procedures for completing it are determined by the Cabinet.[165]
- *Transition to LPP.* A creditor, the debtor's representative or the administrator may submit an application for the termination of insolvency proceedings and the proclamation of the LPP, in which case it shall be applicable in conformity with the regulations of the extrajudicial LPP.[166]
- *Sale of Property in Insolvency Proceedings.* Within two months after the day of the proclamation of insolvency proceedings, the administrator is required to draw up a plan for the sale of the debtor's property or a report regarding the non-existence of the debtor's property and submit it to the debtor and creditors. The administrator is to commence the sale in accordance with the plan no sooner than two weeks after sending the plan to the creditors but no later than a week after the plan is considered finalized.[167] All of the debtor's property is required to be sold within six months after the proclamation of the insolvency proceedings (extendable for up to six months subject to creditors' consent).[168]
- *Information to be Included in the Sale Plan.* The following information is to be included in the plan for the sale of the debtor's property (i) a list of non-pledged property of the

[163] Insolvency Law, Section 79.
[164] Insolvency Law, Section 81.
[165] Insolvency Law, Section 84.
[166] Insolvency Law, Section 107.
[167] Insolvency Law, Section 113.
[168] Insolvency Law, Section 111.

debtor; (ii) an evaluation of non-pledged property of the debtor; (iii) the estimated amount of funds which are planned to be acquired by selling the non-pledged property of a debtor, including the amount of funds to be acquired with or without auction and also the amount to be obtained in case of the sale of the debtor's property as a whole (with or without auction); (iv) the method of sale of the non-pledged property of a debtor; (v) a list of the pledged property of the debtor; (vi) an evaluation of the pledged property; (vii) the method of sale of the non-pledged property of a debtor; (viii) the amount of funds planned to be acquired by selling the pledged property of a debtor; (ix) information regarding the cession of claims; (x) the source of financing for the insolvency proceedings; (xi) the planned costs of the insolvency proceedings (the remuneration of the administrator and expenses of the proceedings; (xii) the deadline for the sale of the debtor's property; and (xiii) information regarding the intent to recourse against the debtor's board of directors.[169]

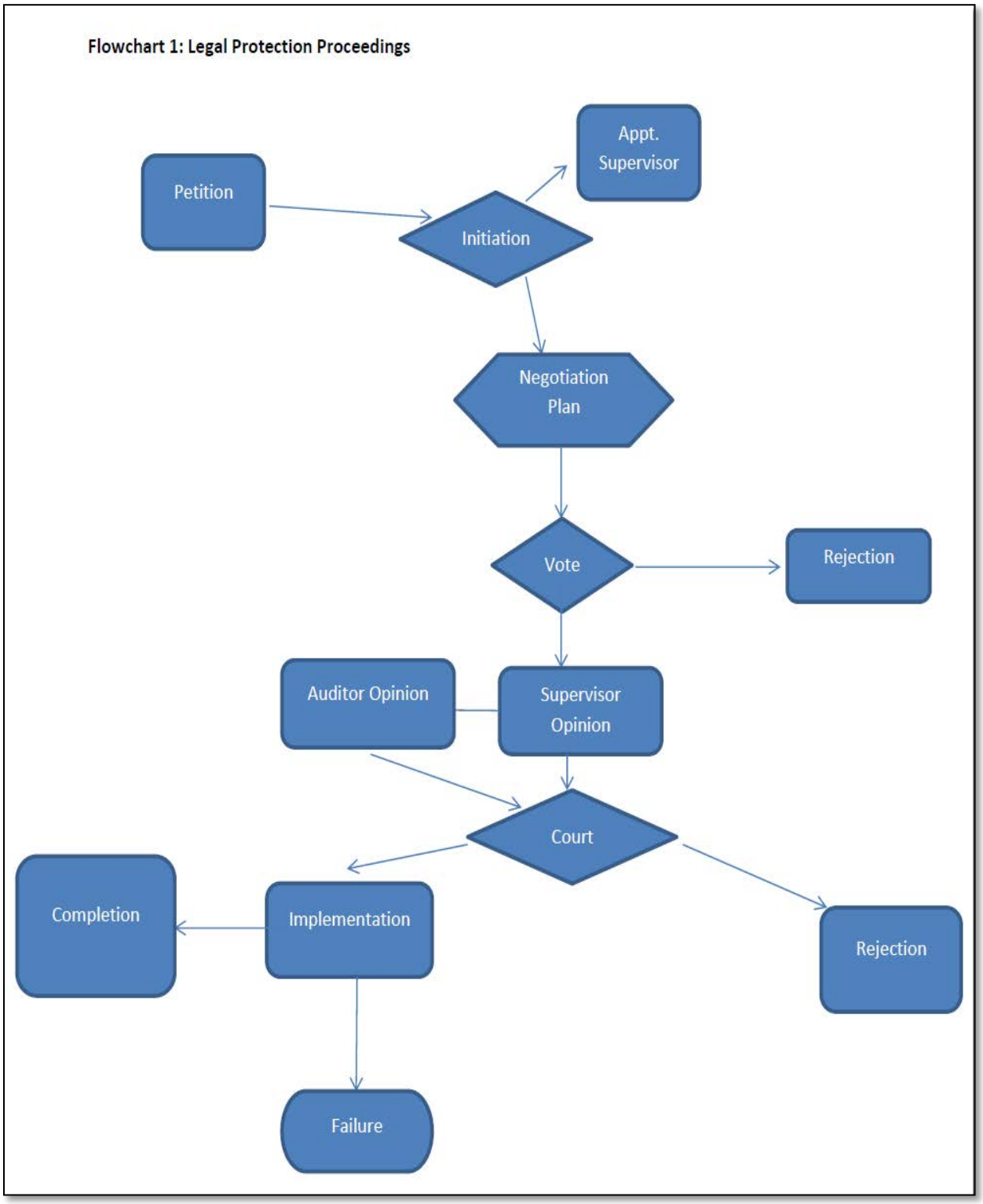
- *Administrator's Report on the Non-existence of a Debtor's Property*. In cases in which the administrator establishes that the debtor has no property or its value is lower than the deposit amount, the administrator is required to draw up a report indicating (i) the debtor's financial status; (ii) an evaluation of the possibility of recovering the debtor's property; (iii) the costs of the planned insolvency proceedings; (iv) a proposal to ensure the financing for the insolvency proceedings; (v) a proposal for the further continuation or termination of the insolvency proceedings; and (vi) information regarding the intention to seek recourse against the debtor's board of directors. The administrator shall send such report to all creditors within two months after the day of the proclamation of the insolvency proceedings.[170]
- *Settling the Claims of Creditors in Insolvency Proceedings.* Within 15 days after the implementation of the sale plan, the administrator is required to draw up a list of the costs of the insolvency proceedings and a plan for settling the claims of creditors and provide such list to creditors. The settling of claims shall begin in accordance with such list if no objections are received from creditors within 15 days. The administrator shall notify creditors of the settlement of claims within 15 days from completion.[171]
- *Termination of Insolvency Proceedings.* If no objections are received from creditors within 15 days from their notification of the completion of the settlement of their claims, the administrator is required to submit an application to court for the termination of the insolvency proceedings within 10 days. The administrator is also required to submit a request for termination of the proceeding to the court in cases a proposal for termination was made in a no-asset case after 15 days have lapsed from the date the administrator's report on the non-existence of the debtor's property is sent to creditors.[172] Within five days after receipt of the court decision to terminate the proceedings, the administrator

[169] Insolvency Law, Section 113.
[170] Insolvency Law, Section 112.
[171] Insolvency Law, Section 117.
[172] Insolvency Law, Section 119.

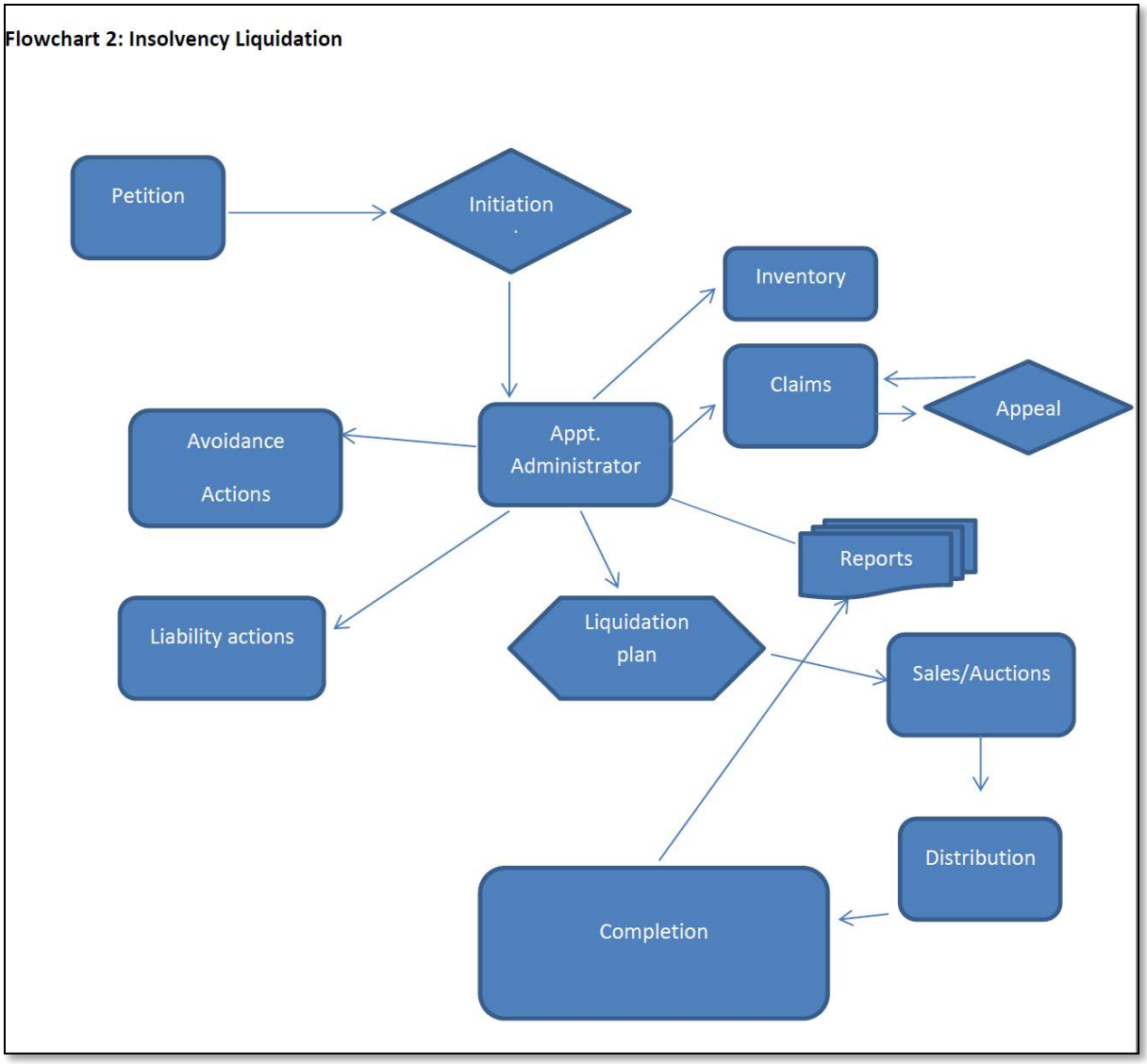
shall submit to the Register of Enterprises an application requesting the deletion of the debtor from the relevant register.[173]

[173] Insolvency Law, Section 120.

ANNEX 2: FLOWCHARTS OF INSOLVENCY PROCEEDINGS



Flowchart 2: Insolvency Liquidation



APPENDIX I: LIST OF AUTHORITIES AND STAKEHOLDERS MET BY THE MISSION

A) LATVIAN AUTHORITIES

Ministry of Justice of Latvia

Laila Medin
Deputy State Secretary on sectoral policy of the Ministry of Justice

Olga Zeile
Director of Department of Sectorial Policy

Liene Ozola
Lawyer of Department of Sectoral Policy of the Ministry of Justice

Edgars Stafeckis
Minister`s Office - Advisor

Court Administration

Anna Skrjabina
Court Administration
European Social Fund Project Leader

Lauma Legzdina
European Social Fund Project Coordinator

Dainis Slišāns
European Social Fund Project Coordinator

Dace Kazāka
European Social Fund Project Coordinator

Jānis Dreimanis
Operational risk manager

Insolvency Control Service

Inese Šteina
Head of Insolvency Control Service

Baiba Banga
Deputy Head

Alla Ličkovska
Director of the Legal Department of the Insolvency Control Service

Agnese Gabuža
Head of the First Supervision Department

Agnese Bugaja
Head of the Second Supervision Department

Karīna Paturska
Legal Consultant of the Legal Department

Ministry of Economics

Kristaps Soms
Head of Department of Business Competitiveness

Agnese Šķēle
Department of Business Competitiveness, Deputy Head of Enterprise Environment Division

Financial and Capital Market Commission

Kaspars Ločmelis

Latvijas Banka/the central bank of Latvia

Andrejs Kurbatskis
Senior Economist

Anna Kasjanova
Chief Economist

Register of Enterprises of the Republic of Latvia

Dzintra Švarca
Legal Consultant of the Legal Department

Larisa Ņesterenkova
Senior Expert of the Development Department

Irēna Rode
National notary

Judiciary

Irina Bogdanova
Judge of Bauska district court

Iveta Krēvica
President and judge of Riga City Vidzeme District Court

Daiga Vilsone
President of Riga Regional Court

Gvido Ungurs
Judge of Riga Regional Court

Ilona Zelmene
Judge of Riga City Pārdaugava Court

B) PRIVATE SECTOR STAKEHOLDERS

Financial Sector

Ivars Dimants
Member of the Association of Latvian Commercial Banks
Head of the Legal Division of Swedbank

Veronika Sajadova
Area managing lawyer (politics of law)
Legal department of Swedbank AS

Ulvis Jankavs
Senior Insolvency Executive
Insolvency Management Department - JSC "SEB banka"

Andželika Vanaga – Stūre

Dženeta Krūmiņliepa
Head of the recovery group -LUMINOR Bank

Renārs Viksna
Head of SCM Department
Manager of the restructuring and insolvency process

Igo Brahmanis
Head of Recovery Department CITADELE Bank

Entrepreneurs

Inese Olafsone
Adviser on National Economy - Employers' Confederation of Latvia

Jānis Atslens
Expert of the Policy Department
Latvian Chamber of Commerce and Industry

Foreign Investors Council in Latvia

Helmuts Jauja
Member of Insolvency working Group, representative of the Foreign Investors Council in Latvia

Ilze Znotiņa
Foreign Investor Council in Latvia,
Deloitte Legal, Associate Partner

Ulvis Jankavs
The leader of the Economic and Financial crime issues work group (SEB)

Linda Helmane
Project Director

Trade Unions and Other Associations

Free Trade Union Confederation of Latvia

Egils Baldzēns
Head of Free Trade Union Confederation of Latvia

Kaspars Rācenājs

Latvian Borrowers' Association.

Jānis Āboliņš
Chairman of the Board

Legal Professionals

Jānis Loze
Loze & Partners Law Office
Managing Partner, Attorney at Law

Edvīns Draba
Associate, lawyer, Sorainen law firm

Viktorija Jarkina
Counsel, sworn advocate, Sorainen law firm

Latvian Collegium of Sworn Advocates

Raimonds Groza
Attorney-at-law

Andris Rukmanis
Attorney-at-law

Saulvedis Vārpiņš
Sworn Advocate
Head of Saulvedis Varpins Sworn Advocate`s office

Olavs Cers
zvērināts advokāts, Head of the lawyer's section of insolvency law

Evita Ostrovska
Deputy Head of the lawyer's section of insolvency law

Haralds Velmers
Member of the lawyer's section of insolvency law

Sanda Kraukle
Ivars Rudziks
Sanda Ziedone

Attorneys-at-law bureau Rasa un Ešenvalds

Armands Rasa

Attorneys-at-law bureau Eversheds Sutherland Bitāns

Raimonds Groza
Attorney at Law, Certified insolvency process administrator,
Latvian Collegium of Sworn Advocates (insolvency law advocate section)

Attorneys-at-law bureau Voroncovs

Andrejs Voroncovs
Managing Partner, Attorney-at-Law, Certified insolvency administrator

Attorneys-at-law bureau Vilgerts
Gints Vilgerts
Partner

Valdis Kronis
Attorneys-at-law bureau GLIMSTEDT

Insolvency Administrators

Kaspars Novicāns
Insolvency process administrator
Sworn advocate's office "NOVIUS"

Haralds Velmers
Insolvency process administrator of join-stock company Liepajas metalurgs

Jānis Ešenvalds
Rasa un Ešenvalds Sworn Advocate`s office
Sworn Advocate and Insolvency process administrator

Insolvency Association

Jānis Kumsārs
Insolvency administrator and member of the Insolvency Association board and council of the association

Kaspars Novicāns
Board Member and Insolvency Administrator
Leading partner, sworn advocate at law firm Novius

Ieva Broka
Board Member and Insolvency Administrator

Other professionals

DB Partners (investment management firm):

Olafs Švanks
Finance expert

CREFO birojs JSC

Inga Veide
Member of the board

Inga Lēnerte
Legal advisory and support
Member of the supervisory board

Inga Kačevska
Attorney at Law

Credit Information Bureau

Jānis Timermanis
Chairman of the board