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**NOTE  
On  
The impact of the current legal framework on collateral execution on  
banks and on consumers**

1. Current legal framework on and process of collateral execution
2. Impact on banks; study cases
3. Impact on consumers

**1. Current legal framework on and process of collateral execution**

The current legal framework on collateral execution is given by the provisions of Civil Procedure Code, Chapter 3, Art.560-580 “The enforcement on immovable property, ships and airplanes”.

According to the legal provisions, upon a debtor’s default, the chargeholder has an automatic right to obtain a court order, which will empower an execution officer (bailiff) to take possession of the charged assets. Realization can then take place through public auction, as a whole or in commercial units or part. Table 1 bellow presents the detailed process of enforcement. However, execution officers proved not to be as reliable and efficient as needed. Courts are also reported to be slow and not very experienced in handling enforcement cases, with a high risk of corruption issues.

**Table 1. Detailed Process of Enforcement and Related Issues**

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<b>Conditions to start enforcement</b>	In order for a charge to be valid, Albanian Law requires a written charge agreement which must be registered with the Registry of Securing Charges. Once registered, the agreement constitutes an immediately enforceable instrument, which can be enforced without further procedure.
<b>Method of enforcement Creditor ability to control / lead</b>	First, the charged asset is seized by the bailiff office and handed over to the charge holder. The chargeholder can then sell the charged asset as he chooses to do so.
<b>Steps to enforcement Simplicity</b>	The chargeholder must deliver a notice inviting the debtor to cure the default and warning that failure to do so within 10-day period will trigger enforcement. The charge agreement gives the right to have: - an enforcement order issued by court; and - an execution carried out immediately by the bailiff office. The procedure is simple and formal, without the court reviewing issues. The Bailiff office can then act immediately upon receipt of the enforcement order (without prior notice to the debtor). The charged asset is finally handed over to the chargeholder.
<b>Costs of enforcement</b>	The Bailiff office requires a non-refundable flat fee of 10% of the claim (not recoverable in practice).
<b>Time involved Problems encountered</b>	It seems that it is difficult for the debtor to delay or prevent the enforcement process. The courts are advised to postpone the enforcement procedure only in exceptional circumstances.
<b>Third party priority</b>	Claims to the proceeds of the sale of charged assets rank as follows: - Purchase money securing charges have priority over all other claims. - State budget obligations have super priority on all claims.
<b>Scope of collateral and secured debt</b>	It is possible to create charges over inventory. This type of charge would also include new acquired goods. However, the law is not clear as to what extent new/replaced assets are automatically included.
<b>Insolvency</b>	Insolvency has no impact on the method of enforcement and the priority of the secured claims.
<b>Immovable assets / Receivables</b>	<u>Immovable</u> : Charges require registration with the Immovable Property Registry. <b>Mortgages can be only enforced through a public auction sale conducted by the bailiff office.</b> Receivables: The same procedure as for movable assets applies.
<b>Practical experience to support findings</b>	Charge enforcement is not a common practice. The relevant legislation is still recent and secured transactions are still a new market instruments.
<b>Institutional framework</b>	Courts can be slow and not very experienced in handling enforcement cases.

According to the EBRD's (2006) assessment, the secured transactions legal framework (covering also mortgages), generally, is **appropriate** and **sound** but its effectiveness is hampered by the **slow enforcement system** and flaws in the administrative system. The enforcement system is characterized by relatively long and cumbersome procedures that result in a moderate recovery of the initial amount by the secured creditor. Compared to

other developing economies in Europe, Albania is considered to have an enforcement system less than median efficient and creditor-friendly (Annex I, chart 2). In the complex of issues related to the enforcement system, the process of enforcement of the immovables, with regard to simplicity and certainty for the charge over immovables, is one of the weakest points that should be tackled with special attention.

Annex 1 refers extensively of the results of the studies performed on the enforcement system in Albania.

EBRD underlines as core principle for formulating a mortgage law (see Annex 2) the prompt realization of the mortgaged property at market value and the low costs for taking, maintaining and enforcing a mortgage.

## **2. Impact of the current foreclosure procedures on banks; study cases**

Despite the fact that there are no statistical data available on how many cases ended with the bidder paying the fixed price in an auction and became the new owner, bailiffs confirm that this number is extremely low<sup>1</sup>. It happens very seldom that after the second auction the creditor takes the immovable against the price designated for the second auction. In case the immovable has been appraised by the experts contracted by the Bailiff Offices at a value higher than the debt (even after it was reduced by 20% in the second auction), the creditor has to pay to the debtor the difference between the appraised value and amount of the debt . Due to the ceiling in the fixed assets to total assets ratio, banks have to sell the immovable in a short time and sometimes in unfavorable conditions.

In addition to the above mentioned the successful enactment of the foreclosure procedures is hindered also by:

- Undefined time periods for the bailiff to notify the debtor;
- Subjectivity in determining the value of the collateral for the first auction and redefining the value of the collateral for re-auction, in the case that the first auction has failed, as there are no commonly set standards for real estate property valuation;
- Long time periods and cumbersome auctions procedures. According to the 2008 Doing Business report an enforcement process has to go through 39 procedures and lasts 390 days.

### **Case Studies**

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## **3. Impact of the current foreclosure procedures on consumers**

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<sup>1</sup> EURALIUS, Proposal for Improvements of the Civil Procedure Code (EURALIUS Activity 8.5), Part I: Enforcement on immovable assets, 2006.

The non-execution of the foreclosure has negative ramifications in the domestic economy as well, influencing the consumers' access to loans. Due to the difficult process of recovering a debt, banks might be reluctant in approving some clients' applications. The financial consequences of the foreclosure procedure for collateralists are reflected in the price of banks' products and services and thus the "good" clients are bearing the costs produced by the "bad" clients.

By enhancing creditors' confidence that they can recover real value from mortgaged or charged assets, the availability of credit should increase and the terms (typically, the amount of the loan, the period for which it is granted, the loan to collateral ratio and the interest rate) on which it is available should improve.

### **Glossary**

**Enforcement** – the process of exercising the right to recover the secured debt out of the mortgaged property, including establishing the right to enforce, realising the mortgaged property and distribution of the proceeds from the realisation.

**Mortgage** – an ancillary right in immovable property entitling a creditor to recover his claim out of the mortgaged property. In legal terms it is important to make the distinction between the mortgage and the loan that it secures.

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World Bank, 2008, Doing Business Report 2008.

## The enforcement system in Albania

### Why contract enforcement matters

Enforcement is central to commercial exchange, and therefore to economic and industrial development. Good enforcement procedures enhance the predictability of exchange, and reduce uncertainty by restraining destructive opportunistic behaviour among contracting parties. This, in turn, reduces transaction costs and promotes exchange.

If good enforcement procedures are lacking, economic agents will seek to minimise the risk of non-compliance by resorting to alternative structures<sup>2</sup> which hampers exchange and affect the economic and industrial growth of a country. The reluctance of economic agents to deal with strangers in a low contract enforceability environment entails a significant cost.

### Security of transactions in Albania

Under the Albanian legal framework, security over immovable assets (mortgage) is governed by the Civil Procedure Code (art. 560-607). Charges over immovable property must be registered in the local registry for immovable property. Security over movable assets in Albania is governed by the 1999 Law on Securing Charges, which was fully implemented in 2001.

**Table 2: Doing Business in Albania, selected indicators.**

<b>Ease of...</b>	<b>Doing Business 2008 rank</b>	<b>Doing Business 2007 rank</b>
Doing Business	136	135
Registering Property	82	77
Getting Credit	48	45
Protecting Investors	165	165
Enforcing Contracts	74	76
Closing a Business	178	178

**Table 2/A: Doing business – contract enforcement detailed information.**

<b>Enforcing Contracts</b>	<b>Albania</b>	<b>Region</b>	<b>OECD</b>
Procedures (number)	39	35.9	31.3

<sup>2</sup> Alternative structures comprise spotmarket transactions or vertical integration, for a detailed review on the negative impact of these alternative structures see EBRD, Law in Transition, Contract Enforcement, Autumn 2001.

Duration (days)	390	443	443.3
Filing and service	30		
Trial and judgment	180		
Enforcement of judgment	180		
Cost (% of claim)*	31.8	22.7	17.7
Attorney cost (% of claim)	21.6		
Court cost (% of claim)	1		
Enforcement Cost (% of claim)	9.2		

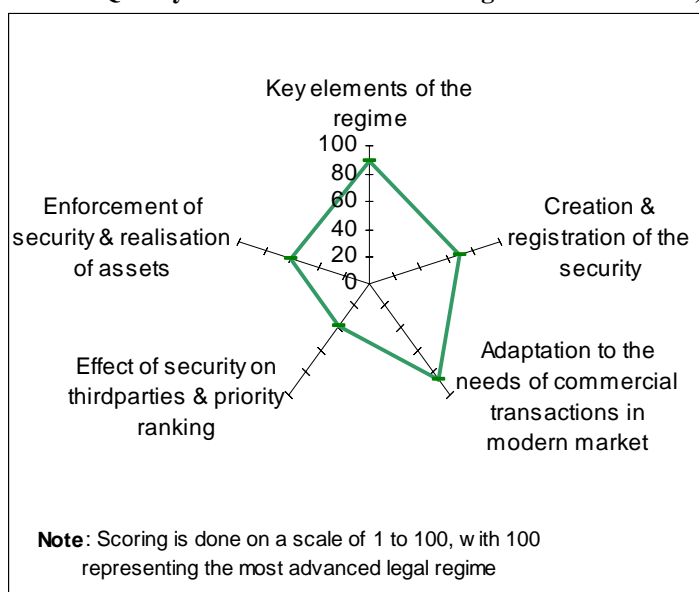
\* Claim assumed to be equivalent to 200% of income per capita.

**Note:** The ease or difficulty of enforcing commercial contracts is measured below. This is determined by following the evolution of a payment dispute and tracking the time, cost, and number of procedures involved from the moment a plaintiff files the lawsuit until actual payment.

Source: World Bank.

Chart 1 depicts the results of the EBRD Regional Survey of Secured Transactions Legislation 2004 providing a glimpse on quality and major shortcomings and achievements of the legal framework on secured transactions.

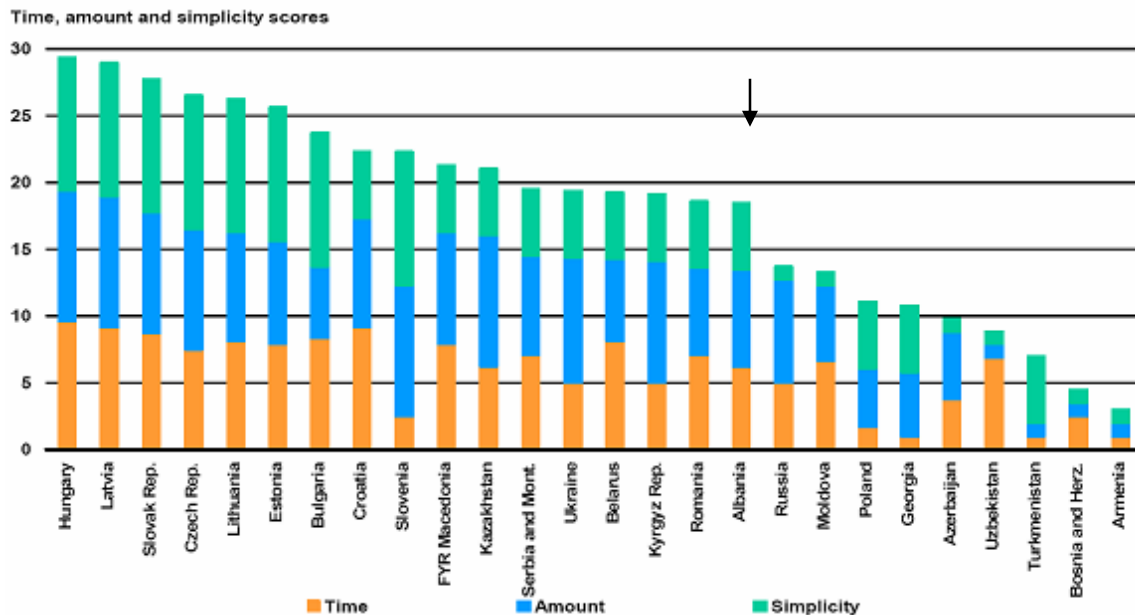
**Chart 1. Quality of secured transactions legislation – Albania, 2004**



Source: EBRD 2006.

As shown by the chart, the legal framework is generally clear, comprehensive, and provides the right flexibility to accommodate relatively sophisticated transactions. Users report positive experiences associated with the perfection of a charge at the Central Registry. A drawback lies with the priority of secured creditors as priority may be lost to some employee, social security and state claims. However, **the weakest point of the regime is found in enforcement.**

**Chart 2. Effectiveness of the Charge Enforcement Process – Albania 2003**



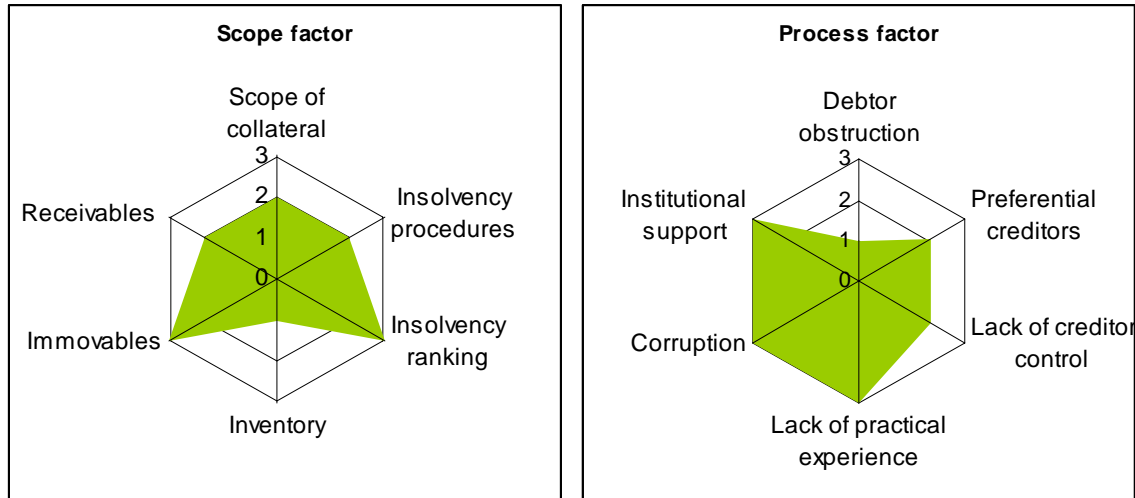
**Note:** The chart shows how much a secured creditor can expect to recover (amount), how quickly (time), and how simply (simplicity). The higher the bar, the more efficient and creditor-friendly the system is.  
Source: EBRD 2006.

The amount indicator reflects the likely return on the realization of the assets minus the enforcement costs (since the costs will be recovered out of the sale price and will therefore diminish what the secured creditor will recover from the collateral). The amount has been adjusted on a scale of 0-10 where 10 equals the maximum possible return. The time indicator reflects the estimated length of the process necessary for successful enforcement, from the commencement of the enforcement procedure to the collection of the proceeds of sale. The time has been adjusted on a scale of 0-10 where 0 equals the longest estimated time (24 months) and 10 the shortest (one month). The simplicity indicator summarizes a range of factors, including the number of procedural steps to be taken, the number of places to visit or persons to contact, the availability of information, clarity of the law and regulations, uniformity of practice, the adoption of necessary implementing regulations and the ease of ascertaining the existence of competing claims. To simplify the scoring, countries were given a 10 where the enforcement process was considered overall clear and with only a minor level of complexity; 5 where there was a significant likelihood of complexity or uncertainty which might prejudice the enforcement process; and 1 where there was a major level of complexity or uncertainty which could deter creditors from commencing enforcement.

These results, based only on the predicted return, timing and simplicity in a single situation, are not comprehensive. The efficiency of the enforcement process may be influenced by many other factors, or “qualifiers”, that add nuance to the ‘raw’ results on amount, time and simplicity. Twelve qualifiers were taken into account here. Six of these qualifiers account for difficulties which can be encountered in the process of enforcement, especially by involved parties or institutions being able to affect this

process. While, the rest of qualifiers relate to the scope of enforcement. Such factors include insolvency procedures and ranking of creditors under insolvency (a more detailed information on the qualifiers is presented in Annex I).

**Chart 3. Qualifying Factors in the enforcement Process – Albania (2003).**



Note: “Process” factors measure the impact that specific obstacles would have on the enforcement proceedings. “Scope” factors give an indication of how effective enforcement would be when conducted on various types of collateral and in the context of debtor insolvency. Scale: 3 (problematic area) to 1 (not problematic), the fuller the colored area, the more serious the problems are.

Source: EBRD 2006

The Process Factors qualifiers account for difficulties which can be encountered in the process of enforcement, especially by involved parties or institutions being able to affect this process. While some of these process-related factors may be reflected in the raw scoring (e.g., a high likelihood of debtor obstruction would have influenced the assessment of the time of the enforcement process), it is useful to assess them separately to gain a better understanding of the practical situation in a given country.

The Scope Factors include insolvency procedures and ranking of creditors under insolvency. The relevance of insolvency is self-evident. A creditor’s assessment of his security will change if, on examination, it appears that the relatively good enforcement that might be expected would be radically curtailed should the debtor be declared insolvent. Limitations on the kinds of assets that can be pledged, and variations in the legal procedures relating to different classes of assets.

Process Factors	Scope Factors
<p><b>Debtor obstruction:</b> possibility for the debtor to prevent, slow down or otherwise obstruct the enforcement proceedings to the detriment of the chargeholder. Legitimate exercise of right of defense or appeal is not included.</p>	<p><b>Insolvency procedure:</b> the impact of the debtor's insolvency on the enforcement process.</p>



<p><b>Preferential creditors:</b> impact of claims of other creditors (other than prior-ranking secured claims) on the satisfaction of the secured creditor's claim.</p>	<p><b>Insolvency ranking:</b> the priority of the secured creditor's claim upon insolvency of the debtor.</p>
<p><b>Creditor control:</b> ability of the creditor to control or influence the conduct of the enforcement procedure.</p>	<p><b>Receivables:</b> an assessment of the simplicity and certainty of the enforcement process for a charge over receivables.</p>
<p><b>Institutions:</b> reliability of the courts and other institutions necessary to support the enforcement process.</p>	<p><b>Immovables:</b> an assessment of the simplicity and certainty of the enforcement process for a charge over immovables.</p>
<p><b>Practical experience:</b> the general level of practical experience with the enforcement process in the country in question.</p>	<p><b>Inventory:</b> an assessment of the simplicity and certainty of the enforcement process for a charge over inventory.</p>
<p><b>Corruption:</b> the impact of corruption within the court system on the enforcement process.*</p>	<p><b>Scope of collateral:</b> the possibility to enforce against replacement and subsequently acquired assets included in the general description of the collateral.</p>

### **EBRD Core Principles for a Mortgage Law**

The principles are drawn on the assumption that the role of a mortgage law is economic. It is not needed as part of the essential legal infrastructure of a country: its only use is to provide the legal framework which enables a market for mortgage credit to operate. The principles do not seek to impose any particular solution on a country – there may be many ways of arriving at a particular result – but they do seek to indicate the result that should be achieved. As with any set of general principles of this nature they must be read within the context of the law and practice of any particular country and they do not aim to be absolute; exceptions inevitably have to be made.

#### **1. A mortgage should reduce the risk of giving credit, leading to an increased availability of credit on improved terms.**

The first principle is overriding: If the legal framework for mortgage does not lead to a reduction in the risk of giving credit and an increased availability of credit on improved terms, then there is no point in the law providing for mortgage at all. This goes to the basic assumption made by EBRD on all its work on mortgage law reform. Every element of the legal framework should be analyzed against this basic principle.

#### **2. The law should enable the quick, cheap and simple creation of a proprietary security right without depriving the person giving the mortgage of the use of his property.**

The second core principle relates specifically to creation. It is more prosaic than the first but it permeates many aspects of the law on mortgage. The trio of simplicity, speed and inexpensiveness is fundamental and ties in directly with the concept of legal efficiency: formal requirements should be kept simple and the costs low. Every cost, irrespective of who bears it, that is involved in the creation of mortgage detracts from the benefits that mortgage provides. Any delays or complexities translate into cost.

#### **3. If the secured debt is not paid the mortgage creditor should be able to have the mortgaged property realized and to have the proceeds applied towards satisfaction of his claim prior to other creditors.**

This principle is also at the core of the mortgage's economic purpose. The exact nature of the proprietary right that arises when security is granted has to be defined in the context of the relevant laws, but if it is to be effective it must link to the creditor's claim the remedy of recovering from the property given as security.

The mortgage creditor should maintain a prior claim on the proceeds of realization of the property (subject to the right of any pre-existing, prior-ranking creditor).

#### **4. Enforcement procedures should enable prompt realization at market value of the mortgaged property.**

What gives a mortgage its value, and therefore enables borrower and lender alike to derive benefit from it, is the confidence that it can be used, if necessary, to repay the

creditor's claim. The greater the doubts of the creditor as to his ability to enforce or the conditions under which he would do so, the less will be the influence of the mortgage when he decides whether to lend and on what terms. When a creditor comes to enforce he needs to be able to realize the property rapidly. Delays in realization are likely to be a source of uncertainty and cost. The property should be realized at the same value as on any other sale in the market. Any surplus proceeds beyond those needed for satisfying the secured claim returns to the mortgagor, and there is no justification for penalizing him by a realization at below market value.

**5. The mortgage should continue to be effective and enforceable after the bankruptcy or insolvency of the person who has given it.**

The position against which the creditor most wants protection is the bankruptcy or insolvency of the debtor. Any reduction of rights or dilution of priority upon bankruptcy or insolvency will reduce the value of security. The validity of the mortgage should not be affected by insolvency (with the exception of fraudulent or preferential transactions or those carried out in the suspect period, but the same rules should apply as for other pre-insolvency transactions). Any rules permitting a moratorium or reorganization of the debtor's assets should aim to strike a fair balance between the interests of the mortgage creditor and other parties.

**6. The costs of taking, maintaining and enforcing a mortgage should be low.**

The mortgage creditor will usually ensure that all costs connected with the mortgage are passed on to the debtor. High costs of creation of mortgage (mortgage agreement, registration and so on) will increase the cost of borrowing and thus diminish the efficiency of the secured credit market. Enforcement costs will reduce the proceeds on realization and will influence a mortgage lender's assessment of the value of his security. Simple and fast procedures for creating and enforcing mortgage will help to reduce costs.

**7. Mortgage should be available (a) over all types of immovable assets (b) to secure all types of debts and (c) between all types of person.**

This principle covers a multitude of issues that may arise from legal tradition, the way the law is applied and the needs of commercial reality. A mortgage should be available over all types of immovable assets. There is little justification to allow mortgage over some properties and not over others. Similarly a mortgage should be capable of securing all types of debts, present and future, specifically or generally defined, that can be expressed as a money amount. Any physical or legal person (whether in the public or private sector) who is permitted by law to transfer property should be able to grant security over it to any other person.

**8. There should be an effective means of publicising the existence of a mortgage.**

Publicity is needed to ensure that any person can be alerted to the existence of the mortgage. When taking a mortgage the creditor will want to discover whether any pre-existing mortgages have a prior claim. And once his mortgage is created he will want to be sure that anyone subsequently claiming a right in the property is made aware of his claim. Without a reliable system for publicity a creditor is unlikely to have sufficient certainty in his rights in the mortgaged property.

**9. The law should establish rules governing competing rights of persons holding mortgages and other persons claiming rights in the mortgaged property.**

Certainty in his rights over the mortgaged property is key to the mortgage creditor. He needs to know what rights of other persons may take precedence over his right of mortgage, for example, other mortgages, tax liens, rights of occupation or rights of spouses, in order to be able to assess and value his security. The political or social justification for any right of a third party which dilutes or compromises the ability of the mortgage creditor to recover his claim out of the mortgaged property should be balanced against the loss of credit opportunity which may result.

**10. As far as possible the parties should be able to adapt a mortgage to the needs of their particular transaction.**

The law is there to facilitate the operation of the mortgage market and to ensure that necessary protections are in place to prevent the debtor, other creditors or third parties being unfairly prejudiced by the existence of the mortgage. Parties should be allowed wide contractual flexibility. There are few cases which justify the law, or the institutions that implement it, creating rules or barriers which limit the manner in which parties can structure their transaction principally at directing the manner in which parties to secured credit should structure their transaction.

*EBRD, Focus on Secured Transaction, Ten Years of Secured Transaction Reforms*