



Strasbourg, 22.11.2016
SWD(2016) 357 final

COMMISSION STAFF WORKING DOCUMENT

IMPACT ASSESSMENT

Accompanying the document

**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) 723 final}
{SWD(2016) 358 final}

1. INTRODUCTION	4
2. POLICY CONTEXT, ECONOMIC CONTEXT, PROBLEM DEFINITION AND SUBSIDIARITY	5
2.1. Policy context	5
2.2. Economic context	9
2.3. Drivers and problems	13
2.3.1. Drivers	13
2.3.2. Problems	28
2.4. Risks	41
2.5. Baseline scenario	42
2.6. The EU's right to act, subsidiarity, necessity and proportionality	43
3. OBJECTIVES	47
4. HIGH-LEVEL OPTIONS	48
4.1. Description of high level options	48
Option 1: Maintaining the status quo (baseline scenario)	48
Option 2: Setting up a fully harmonised preventive restructuring procedure and a second chance framework	48
Option 3: Introducing an alternative, optional EU restructuring and second chance regime for cross-border cases	49
Option 4: Setting up a minimum harmonised legal framework in the area of restructuring and second chance for entrepreneurs	49
4.2. Analysis of high level options and discarded options	50
5. SUBSTANTIVE SUB- OPTIONS AND ANALYSIS OF THEIR IMPACT	55
5.1. Early restructuring possibility	57
5.3. Debtor in possession	64
5.4. Plan approval by a majority of creditors	67
5.5. New financing and interim financing, safe harbour provisions and third party releases	71
5.6. Reducing the formalities relating to court proceedings	75
5.7. Lowering and aligning discharge periods for natural persons	77
5.7.1. Entrepreneurs	77
5.7.2. Consumers	82
5.8. Measures to increase the effectiveness of restructuring, insolvency and second chance procedures	86

6. THE PREFERRED HIGH-LEVEL OPTION 4 89
**7. ANALYSIS OF OVERALL IMPACTS OF THE PREFERRED HIGH-LEVEL
OPTION 4 93**
8. MONITORING AND EVALUATION..... 103
9. ANNEXES..... 104

IMPACT ASSESSMENT REPORT

RESTRUCTURING AND SECOND CHANCE

1. INTRODUCTION

Insolvency rules in their widest sense cover a wide range of measures from early intervention before a company gets into serious difficulties, timely restructuring to ensure that viable business parts are preserved, giving a second chance to honest entrepreneurs and liquidation proceedings. A well-functioning insolvency framework covering all these measures is an essential element of a good business environment and it is a key condition for sustainable growth and jobs creation, which is a key priority of the European Commission. A reliable and predictable insolvency framework maximises the efficiency, predictability and effectiveness of insolvency proceedings, which ultimately results in an effective credit system and a favourable investment climate. Insolvency frameworks providing for transparent, predictable and cost-effective mechanisms for resolution of over-indebtedness should make it possible to save viable businesses in difficulties (by restructuring the existing company or by selling it as a "going concern") or make it easier to liquidate a company and its assets if the company does not have any prospect of survival. Efficient insolvency rules, thus, help increase the recovery rate of debts and avoid the build-up of non-performing loans in the financial system. At the same time, allowing honest entrepreneurs to benefit from a second chance after overcoming bankruptcy is crucial for ensuring a dynamic business environment and promoting innovation. Restructuring and second chance for individuals are therefore critical parts of an appropriate insolvency framework.

Good insolvency frameworks should define procedures for dealing with

- businesses in financial difficulties, but not yet insolvent (where the restructuring framework is most useful),
- companies that are very close to insolvency or already insolvent (where any means of recovery the value for creditors are most important),
- a possibility of a fresh start of economic activity for natural persons, in particular entrepreneurs (debt discharge).

The core of any insolvency law is the most efficient use of the resources used by a distressed company and allocation of potential costs. This primary economic efficiency objective is complemented by specific redistributive goals¹ which result from cultural and social value patterns of a given society and may vary between countries. Insolvency legislation therefore sets out conditions for initiating insolvency procedures, outlines creditors' and debtors' rights and obligations, describes the role of courts, as well as the steps and the timeframe to be followed once the procedure starts.

An effective insolvency regime should not only ensure a fair and timely distribution of assets among creditors through liquidation proceedings, but it should also allow viable debtors to restructure at an early stage and thus avoid insolvency and the related loss of value, jobs and

¹ For example, the need to ensure a high recovery for creditors comes into an apparent conflict with a society's interest in curbing poverty and social exclusion and bringing individuals back to a productive life.

know-how. In addition, in a cross-border context, each of the countries affected has an interest in regulating insolvency of an entrepreneur whose activities or assets are located on its territory². An effective restructuring and second chance framework should also provide for safeguards against possible moral hazard risks which are inherent but which should not impede the adoption of restructuring and second chance frameworks. This brings about problems which cannot be resolved solely by rules determining the applicable law and jurisdiction. These aspects have been partly addressed through the Regulation (EU) 2015/848 on insolvency proceedings³ (the Insolvency Regulation), which includes provisions on jurisdiction for opening insolvency proceedings, recognition and enforcement of judgments issued in such proceedings, as well as provisions regarding the law applicable to insolvency proceedings. However, even under such rules, in a number of situations, more than one law and jurisdiction will have a competence to handle the cross-border insolvency and the differences in these laws will hinder a successful resolution of such a case⁴.

2. POLICY CONTEXT, ECONOMIC CONTEXT, PROBLEM DEFINITION AND SUBSIDIARITY

2.1. Policy context

Efficient insolvency frameworks play a key role in economic policy since they can contribute in a tangible way to create jobs and sustainable growth by helping companies in difficulties, but still viable, to get back on their feet and quickly taking companies beyond rescue off the market. For this reason, the issue has attracted considerable interest at the level of the European Union for quite some time. In 2011, the European Parliament adopted a Resolution on insolvency proceedings⁵ which contained recommendations for harmonising specific aspects of substantive insolvency law, including restructurings, and company law. The recommendations regarding the harmonisation of specific aspects of insolvency and company law concerned certain aspects of the opening of insolvency, certain aspects of the filing of claims, aspects of avoidance actions, general aspects of the requirements for the qualification and work of liquidators, as well as aspects of restructuring plans. An accompanying study⁶ confirmed that there were 'certain areas of insolvency law where harmonisation is worthwhile and achievable', in particular as regards the efficiency of restructuring procedures. Also the Competitiveness Council conclusions of 2011 called on Member States to reduce the discharge period for entrepreneurs to 3 years.

² Ghio, E., Coping with Business Failure and Bankruptcy in the European Union. A Case Study on the Failure of Market Integration, 16 October 2015, p. 3.

³ OJ L 141, 5.6.2015, p. 19.

⁴ The "universality principle" for cross-border insolvencies implies that the court having jurisdiction to the insolvency proceedings encompasses all assets and creditors of the debtors' estate, and that the law applied by this court (the "*lex fori concursus*") applies to all questions emerging during the proceedings. However, a fully-fledged application of the universality principle proved not to be realistic in the EU. Therefore, even the recently adopted Insolvency Regulation still keeps wide ranging possibilities of opening secondary or other local proceedings in parallel to the main insolvency proceedings in other Member States, thus resulting in the parallel application of insolvency laws of different Member States to a single economic unit operating in several Member States.

⁵ Report with recommendations to the Commission on insolvency proceedings in the context of EU company law, 2011/2006(INI), 17 October 2011.

⁶ Harmonisation of Insolvency Law at EU level, Directorate General for Internal Policies of the European Parliament, PE 419.633.

Against this background and recognising the significant differences between national insolvency frameworks, the European Commission issued in December 2012 a Communication⁷ which highlighted a need for a step-by-step approach as regards certain areas where differences between domestic insolvency laws could hamper the functioning of an efficient internal market⁸. The subsequent first action under this approach was the modification of Regulation (EC) No 1346/2000⁹ accomplished by the adoption of the Insolvency Regulation. The Insolvency Regulation focuses on resolving the conflicts of jurisdiction and laws in cross-border insolvency proceedings, and ensures the recognition of insolvency-related judgments across the EU. It does not harmonise the substantive insolvency laws of the Member States.

As a next step, the Commission adopted in 2014 the Recommendation on restructuring and second chance (the Recommendation)¹⁰. The Recommendation focused on restructuring and second chance, since it was considered that in these two fields the action at EU level would bring most added-value¹¹. The Recommendation invited Member States to put in place (i) effective pre-insolvency procedures with the aim of helping viable debtors to restructure and thus avoid insolvency and (ii) second chance provisions for entrepreneurs enabling them to have a discharge in no more than three years after insolvency. In particular the Recommendation focused on:

- (i) availability of a preventive restructuring framework,
- (ii) facilitating negotiations of restructuring plans, including appointment of a mediator or a supervisor, stay of individual enforcement actions and suspension of insolvency proceedings,
- (iii) restructuring plans, including contents of restructuring plans, adoption of restructuring plans by creditors, court confirmation of the restructuring plan, rights of creditors, and effects of a restructuring plan,
- (iv) protection for new financing, and
- (v) second chance for entrepreneurs, including discharge periods.

Following its adoption, an evaluation of its implementation was conducted¹² and two data collection rounds were carried out after one year and after two years, respectively. Already on the occasion of these two reviews which were carried out in 2015 and 2016¹³, it was apparent that most Member States which were already lagging behind in this area were not making sufficient progress.

⁷ European Commission: "A new European approach to business failure and insolvency" COM(2012) 742, 12 December 2012.

⁸ Second chance for entrepreneurs, discharge periods, opening of insolvency and restructuring proceedings, filing of claims and their verification, promotion of restructuring plans.

⁹ OJ L 160, 30.6.2000, p. 1.

¹⁰ C(2014) 1500 final, 12 March 2014.

¹¹ Impact Assessment accompanying the Commission Recommendation on a New Approach to Business Failure and Insolvency, SWD(2014) 61 final, 12 March 2014.

¹² Evaluation of the implementation of the Commission Recommendation of 12.3.2014 on a new approach to business failure and insolvency, 30.9.2015, (available at: http://ec.europa.eu/justice/civil/commercial/insolvency/index_en.htm).

¹³ See Annex 8 of this Report.

These reviews also revealed that while the Recommendation has provided useful focus for those Member States undertaking reforms in the area of insolvency, it has not led to the desired impact in terms of consistent changes across all Member States, facilitating the rescue of businesses in financial difficulty and in giving a second chance to entrepreneurs. This was due to its partial implementation in a significant number of Member States, including those having launched certain reforms.

By way of example, it can be outlined that on restructuring, there are still several Member States where it is not possible to restructure a business before it is insolvent (DK, CZ, BG, HU, SK, LT). CY, SI and PL introduced new preventive restructuring procedures but they differ in certain points from the Recommendation (in SI commercial creditors for example cannot participate in preventive restructuring which is limited to financial creditors); while EL, ES, SL, RO and IT brought some limited improvements to their existing procedures¹⁴. On second chance, since the adoption of the Recommendation, several Member States (e.g. ES, RO, HU, HR) have introduced for the first time a debt discharge regime for natural persons. In EL, discharge for entrepreneurs was reduced to 3 years. However, in most Member States where reforms were recently introduced, the duration of the discharge period and the conditions for having access to discharge do not comply with the Recommendation: in general discharge periods are five year or more (ES, RO, HU) and sometimes there are impossible repayment obligations attached (in HU, 50% of debt needs to be repaid to benefit from discharge). In Romania, only consumers benefit from the discharge regime, but not the entrepreneurs. Other differences in the implementation of the Recommendation are described in more detail below in section 2.3.2. on problem drivers. Such differences in Member States frameworks translate into continuing legal uncertainty, additional costs for investors in assessing their risks, less developed capital markets and persisting barriers to the efficient restructuring of viable companies in the EU, including cross-border enterprise groups.

A comparative legal study on differences between insolvency and restructuring regimes in Member States concluded that "there appears to be the incomplete and inconsistent implementation of the Recommendation."¹⁵ Following the adoption of the Insolvency Regulation, the Commission reflected on ways forward to deal with the disparities between substantive insolvency laws¹⁶. Evidence from the public consultation on the Green Paper on the Capital Markets Union¹⁷, which included explicit questions on insolvency frameworks, as well as the Doing Business data of the World Bank¹⁸ on the global practices for resolving insolvency confirmed the critical importance of restructuring processes as workable alternatives to liquidation processes for viable businesses. In parallel, studies and reports on entrepreneurial activities¹⁹ concluded that entrepreneurs should not be stigmatised when honest business endeavours fail. On the one hand, individuals should not be deterred from entrepreneurial activity, resuming consumption or taking up gainful employment; on the other

¹⁴ IT improved the debtor in possession regime; EL made the stay period more effective, in line with the Recommendation; RO introduced additional minimum voting requirements for the approval of the reorganization plan; and by clarifying rules on voidable transactions; ES made resolving insolvency easier by introducing new rules for out-of-court restructuring, introducing provisions applicable to pre-packaged reorganizations.

¹⁵ Study on a new approach to business failure and insolvency, University of Leeds, January 2016, p. 223.

¹⁶ Action Plan on Building a Capital Markets Union, COM (2015) 468 final, p. 24 - 25.

¹⁷ COM (2015) 063 final.

¹⁸ International Finance Corporation, World Bank Group, 2013, http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2013/02/26/000333037_20130226123527/Rendered/PDF/752400BRI0SMAR0urable0Results0FIXED.pdf

¹⁹ Bankruptcy and second chance for honest entrepreneurs, Ecorys, Report for DG Enterprise and Industry, 31 October 2014.

hand, any rules providing for debt discharge should prevent abuse and incentivise careful debt management. In light of these assessments, it was apparent that non-binding measures at the European level would not be sufficient to bring about these changes.

The "Five Presidents' report" of 22 June 2015 on "Completing Europe's Economic and Monetary Union" listed the area of insolvency law among the most important bottlenecks preventing the integration of capital markets in the euro area and beyond²⁰. Convergence of insolvency and restructuring proceedings would facilitate greater legal certainty for cross-border investors and encourage the timely restructuring of viable companies in financial distress. The inefficiency and divergence of insolvency laws make it both harder for investors to assess credit risk in general and particularly as regards cross-border investments. More cross-border risk-sharing, deeper and more liquid capital markets and diversified sources of funding for EU businesses will deepen financial integration, lower costs and increase the EU's competitiveness. This in turn will contribute to job creation and sustainable growth.

The 2015 Capital Markets Union Action Plan²¹ therefore announced a legislative initiative on business insolvency, including early restructuring and second chance. This initiative is intended to address the most important barriers to the free flow of capital and build on national regimes that work well. In the public consultation of the Green Paper on the Capital Markets Union Action Plan which took place in summer 2015 the majority of stakeholders highlighted the need of further action going beyond the 2014 Recommendation on restructuring and second chance regarding on restructuring of companies, stay on individual creditor claims and definition of a common discharge period, efficiency and effectiveness of insolvency practitioners and the courts²².

At the same time, the Single Market Strategy stated that the Commission would support honest entrepreneurs and propose legislation to ensure that Member States provide a regulatory environment that is able to accommodate failure without dissuading entrepreneurs from trying new ideas again²³.

More specifically as regards the banking sector, the Communication Towards the Completion of Banking Union²⁴ published in November 2015 confirmed that (i) there is a need for greater convergence in insolvency law and restructuring proceedings across Member States, (ii) the inefficiency and divergence of insolvency laws make it harder to assess and manage credit risk, and that (iii) enhancing legal certainty and encouraging the timely restructuring of

²⁰ 'Completing Europe's Economic and Monetary Union', Report by Jean-Claude Juncker in close cooperation with Donald Tusk, Jeroen Dijsselbloem, Mario Draghi and Martin Schulz (so-called Five Presidents'), 22 June 2015, p. 10.

²¹ Action Plan on Building a Capital Markets Union, COM(2015) 468 final, p. 25.

²² COMMISSION STAFF WORKING DOCUMENT, Feedback Statement on the Green Paper "Building a Capital Markets Union", SWD (2015) 184 final, p. 59. And at p. 77: 'The European Commission has addressed a Recommendation to the Member States to encourage them to put in place minimum standards on early restructuring procedures and second chance for natural persons. The Recommendation has been partially taken up by some Member States, especially by those receiving insolvency recommendations in the context of the European Semester exercise addressing macro-economic imbalances. Even those Member States which have taken up the European Commission Insolvency Recommendation did so in a selective manner, meaning that differences remain'.

²³ Upgrading the Single Market: more opportunities for people and business, European Commission, COM (2015) 550 final, p. 6.

²⁴ 'Towards the completion of the Banking Union', European Commission, COM (2015) 587 final, 24 November 2015.

borrowers in financial distress is particularly relevant for the success of strategies to address the problem of non-performing loans in some Member States.

The ECOFIN Council Conclusions of July 2016 on a roadmap to complete the Banking Union underlined the importance of the work carried out by the Commission to propose a legislative proposal for minimum harmonisation in the field of insolvency law in the context of the Capital Markets Union (CMU), noting that this may also support efforts to reduce future levels of non-performing loans.²⁵

More recently, in its Communication on Capital Markets Union - Accelerating Reform the Commission reiterated that inefficiencies and differences in national insolvency frameworks generate legal uncertainty, obstacles to recovery of value by creditors, and barriers to the efficient restructuring of viable companies in the EU, including for cross-border groups.²⁶

2.2. Economic context

In recent years, an average of 200,000 firms went bankrupt each year in the EU, resulting in direct job losses totalling 5.1 million over three years²⁷. About one-quarter of these bankruptcies involved creditors and debtors in more than one EU Member State²⁸. However, the single market dimension of the problems is even larger than these figures suggest since many companies avoid expanding or investing cross-border in the first place, due to the non-convergence of insolvency frameworks and uncertainty about the effectiveness of the applicable rules, as described in section 2.1. The trends in the number of corporate insolvencies are provided below as provided below in the table show the increasing number of insolvencies starting with the peak of the economic crisis in 2009 and still remaining high.

Table 1: Trends in number of business bankruptcies and other forms of involuntary business cessations selected Member States 2007 to 2014²⁹ – 2009=100 % (the numbers in the table are given in 100%)³⁰.

Member State	2007	2008	2009	2010	2011	2012	2013	2014
AT	91.2	91.5	100.0	92.4	85.0	87.5	79.1	78.6
BE	81.5	90.0	100.0	101.6	108.5	112.4	124.6	114.0
BG			100.0	125.2	145.1	177.6	193.8	170.6
CY	88.7	84.9	100.0	107.5	114.5	83.6	118.9	102.5

²⁵ Council Conclusions of 17 June 2016 http://www.consilium.europa.eu/press-releases-pdf/2016/6/47244642837_en.pdf

²⁶ COM(2016) 601 final http://ec.europa.eu/finance/capital-markets-union/docs/20160913-cmu-accelerating-reform_en.pdf

²⁷ Impact Assessment accompanying the Commission Recommendation on a New Approach to Business Failure and Insolvency, SWD(2014) 61 final, 12 March 2014, p. 2.

²⁸ 27% of insolvencies in the UK are triggered by the insolvency of another company, the European Small Business Alliance response to the public consultation, 2013, SWD (2014) 61 final, p. 6.

²⁹ [Annual Report on European SMEs 2015/2016, SMEs as the engine of growth in 2016, SME Performance Review 2015/2016, March 2016, prepared for Directorate-General for Internal Market, Industry, Entrepreneurship and SMEs] [forthcoming], p. 53 – 54.

³⁰ 2009 was chosen as reference year because it was a peak year for a large number of Member States and for no Member States was it the lowest value year. Peak values by country are in red, the lowest values in green.

CZ	67.3	72.3	100.0	109.1	119.7	131.0	151.1	144.3
DK	42.0	65.0	100.0	113.2	95.8	95.6	87.4	70.6
EE	19.1	40.1	100.0	97.4	59.1	46.9	43.5	40.6
EL	144.5	101.1	100.0	100.0	125.4	116.9	110.4	93.0
ES	19.9	55.6	100.0	94.5	109.5	148.9	167.2	114.0
FI	68.8	79.8	100.0	87.5	90.0	90.4	95.6	91.2
FR	81.2	87.9	100.0	95.5	94.1	96.7	99.0	98.9
HU		84.7	100.0	104.4	83.0	68.7	93.1	149.1
IR	53.6	66.0	100.0	100.8	113.0	109.0	95.6	
IT	65.6	80.0	100.0	119.7	129.5	130.6	150.6	167.5
LT	32.9	51.9	100.0	88.8	69.0	76.0	84.2	91.4
LU	95.1	82.8	100.0	132.5	141.1	151.5	151.4	122.7
LV	0.0	56.4	100.0	121.9	41.2	40.0	36.5	42.9
NL			100.0	88.8	88.1	105.9	120.7	95.7
PT	68.5	92.5	100.0	107.2	124.4	175.3	158.1	105.3
SE	75.8	82.5	100.0	95.2	91.1	97.8	100.8	93.7
SK	61.2	90.9	100.0	124.6	135.9	130.4	142.8	148.6
UK	62.8	86.2	100.0	85.8	89.7	85.5	75.9	69.7

Sources: London Economics based on data from AT: Kreditschutzverband; BE: Statistics of the Belgium Federal Public Service Economy; BG: provided by official of Ministry of Economy; CY: Department of Registrar of Companies and Official Receiver; CZ: CRIF from Insolvency Register of Ministry of Justice; DK: Statistics Denmark; EE: Kreditiinfo SA; ES: OECD; Statistics Finland; FR: Insee; EL: OECD; HU: Hungarian Central Statistical Office; IR: Dpt of Jobs, Enterprise and Innovation; IT: Cerved; LT: Statistics Lithuania; LU: Statec; LV: Lursoft; NL: Statistics Netherlands; PT: COSEC SA; Swedish Agency for Growth Policy Analysis; SE: SK: Ministry of Justice Slovakia; UK: Insolvency Service

Today in Europe half of all businesses do not survive the first 5 years of their existence. In a number of Member States, the peak of bankruptcies was reached during the initial years of the crisis, i.e. in 2009 (Austria, Estonia, Finland, France, Lithuania, United Kingdom) or in 2010 (Denmark, Hungary, Latvia). In another group of Member States the peak was reached in 2012 (Luxembourg, Portugal) or in 2013 (Belgium, Bulgaria, Cyprus, Czech Republic, Luxembourg, Netherlands, Spain and Sweden)³¹. However, even if the number of bankruptcies can be expected to stabilise and re-converge to pre-crisis trends, the economic case for more efficient and convergent insolvency frameworks remains.

In case of liquidation, companies trading with the insolvent company may not receive anything at all if their debt was not secured; also secured creditors have to take into account the possibility of a substantial reduction in value of their claims³². In case of restructuring, on

³¹ [Annual Report on European SMEs 2015/2016, SMEs as the engine of growth in 2016, SME Performance Review 2015/2016, March 2016, prepared for Directorate-General for Internal Market, Industry, Entrepreneurship and SMEs] [forthcoming], p. 53 – 54.

³² The recovered value for secured creditors can be in certain countries as low as cca 16 % of the original value of the secured loan (<http://www.insolcentrum.cz/kompletni-databaze-insolvencnich-rizeni>).

the other hand, insolvency is avoided, contract debts are in general paid, and negotiations concern in most cases only the financial debt. Restructuring is in general beneficial for the creditors if the business is viable. Hence, restructuring instead of liquidation constitutes a gain for all stakeholders involved, provided that restructured companies are able to stick to their new repayment plan.

Regarding second chance, a distinction between entrepreneurs and consumers needs to be made, since the economic rationale for offering each of them a second chance is different in the two cases. Offering a second chance to entrepreneurs means that they have a chance to restart a business activity and there is evidence that those starting for a second time learn from their mistakes and their next businesses are more viable³³. For consumers, the rationale of providing them with a second chance is not only economic but also social. Consumers discharged of debts can start buying services and products and therefore contributing to the rise of GDP. But most importantly, consumers and their families could avoid being caught in a debt-trap for life, with all the precarious social consequences that this situation may cause to individuals and families.

In some Member States natural persons entrepreneurs (with unlimited liability) constitute more than 50% of all businesses, since the creation or management of limited liability companies has not been facilitated in those Member States³⁴. Therefore, a discharge, even for entrepreneurs or managers of single-member limited liability companies, could have a significant impact on the economy going beyond what is usually associated with local businesses. A number of such companies, registered as "sole traders", have cross-border activity which in other Member States is normally performed by their corporate equivalents.

Moreover, entrepreneurial debts are often intertwined with personal debts (e.g. using the same car both for business and private purposes). In addition, in order to start a limited liability company, credit institutions require a security on private houses as a prerequisite to a loan³⁵. This means that economic consequences of entrepreneurial debts, and a possible discharge of them, go beyond the economic activity of an entrepreneur.

The focus on restructuring of corporate entities and discharge of natural persons is complementary and allows dealing with the economic consequences of debts regardless of the legal form which created such debts. The debts of natural persons-entrepreneurs would be subject to discharge, whereas the debts of limited liability companies would be treated in restructuring or liquidation proceedings.

Enterprise mortality is closely linked to the problem of non-performing loans which is the most usual cause of liquidation of companies. The European Central Bank's 2015 comprehensive assessment identified a total of EUR 980 billion in non-performing exposures in the banking system³⁶. The table below compares the change in non-performing loans between 2004 and 2014 in the EU, the United States and Japan. It demonstrates that the Eurozone had the greatest difficulties in liquidating the large portfolios of non-performing loans. Whilst there are several reasons for this, it is clear that cumbersome and lengthy

³³ Bankruptcy and second chance for honest entrepreneurs, Ecorys, Report for DG Enterprise and Industry, 31 October 2014, p.14.

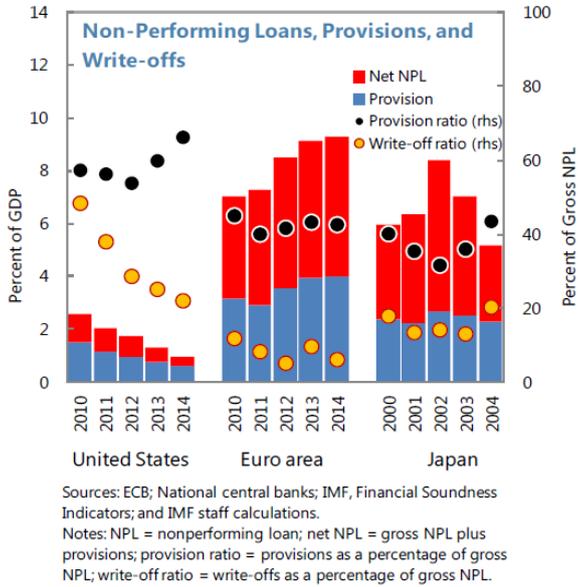
³⁴ Impact Assessment accompanying the proposal of the Directive of the European Parliament and of the Council on single-member private liability companies, SWD/2014/0124 final, p. 13-17 and 21.

³⁵ Ibid., p.37.

³⁶ European Central Bank, Statistics, 23 June 2016, <https://www.bankingsupervision.europa.eu/banking/statistics/html/index.en.html>

insolvency proceedings, as well as lack of modern restructuring and second chance frameworks contribute significantly to this problem³⁷.

Chart 1: Non-performing Loans, Provisions and Write-offs in the United States, Eurozone and Japan



Source: *Euro Area Policies, Selected Issues, IMF July 2015*³⁸

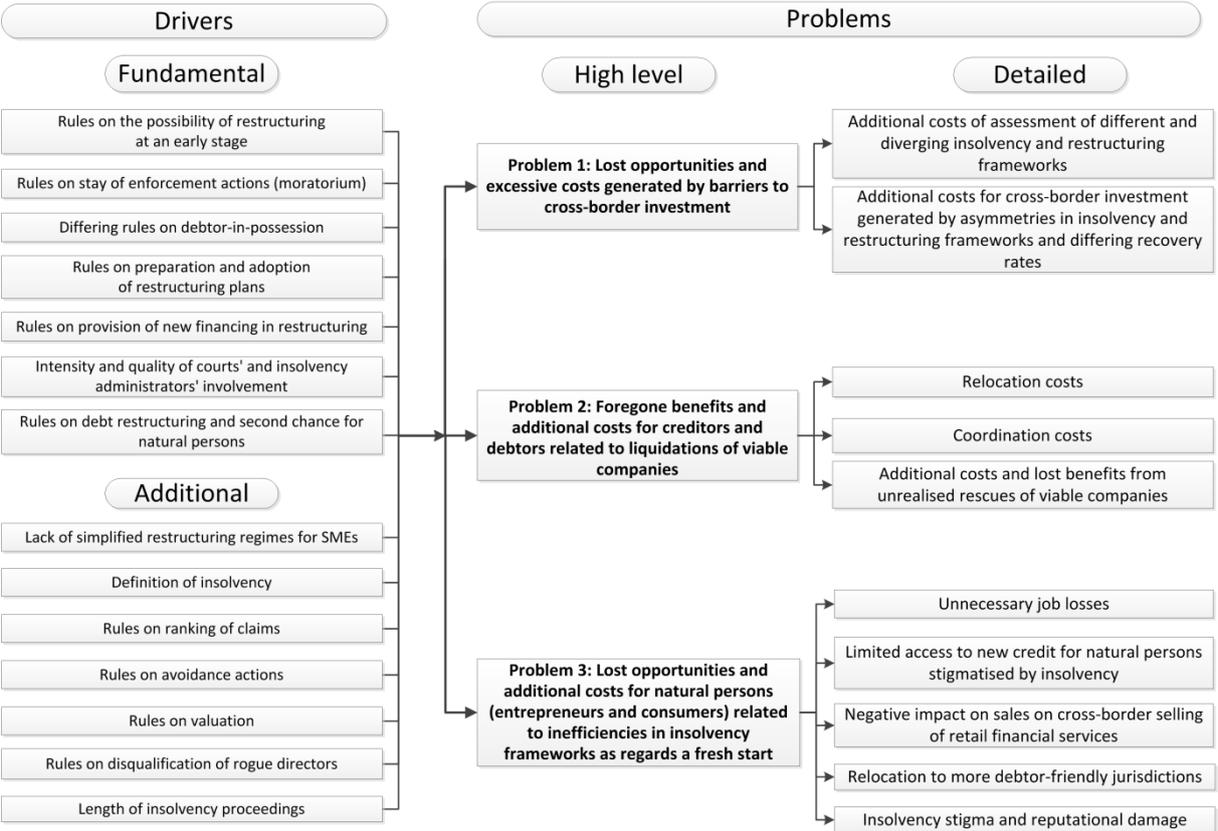
Member States with less efficient insolvency frameworks to deleverage non-performing loans are faced with the weight of existing company debt which deters investors, holds back consumption, and creates a situation of debt overhang³⁹. High levels of non-performing loans in banks' portfolios also undermine their lending capacity for banks and impacts job creation and growth. Studies and data from the International Monetary Fund⁴⁰ suggest that high indebtedness of EU companies and the problem of non-performing loans represent an investment barrier and prevent economic growth. As the graph above shows, in the EU the progress has been slower in resolving these impaired loans in comparison to the U.S. or Japan. As long as private debts remain at high levels, economic activity may struggle to pick up. The International Monetary Fund calculates that freeing-up capital disposed for non-performing loans could unlock new lending of between EUR 167–€522 billion, provided there is a corresponding demand for new loans⁴¹.

Efficient insolvency and restructuring laws can serve to avoid future build-up of non-performing loans since loans on which performance ceases could be enforced more

³⁷ Gros, D., The Transatlantic Growth Gap, Project Syndicate, 21 July 2014.
³⁸ IMF: Euro Area Policies – Selected Issues, IMF Country Report No. 15/205, July 2015, Euro Area Policies, IMF Country Report No. 15/2014, July 2015, p 58.
³⁹ Yan, L., Rosenberg, Ch., “Dealing with Private Debt Distress in the Wake of the European Financial Crisis: A Review of the Economics and Legal Toolbox, IMF Working Paper No. 13/44, Washington, D.C.: IMF, 2013.
⁴⁰ IMF: Euro Area Policies – Selected Issues, IMF Country Report No. 15/205, July 2015, Euro Area Policies, IMF Country Report No. 15/2014, July 2015, p. 61.
⁴¹ Potential economic gains from reforming insolvency law in Europe, AFME, Frontier economics, Weil, February 2016, p. 21.

efficiently. Improving legal settings of enforcement regimes will thus not resolve the issue of existing NPLs over which enforcement proceedings have already started. However, reinforcement of the judiciary setting could still help to speed up the remaining steps of the proceedings. High levels of NPLs have a direct consequence on the capacity of banks to support growth. According to the IMF Article IV review of the Euro area, “high levels of NPLs and debt have held back bank lending and investment, limiting the pass through of easier financial conditions.⁴²” In this way, reforms of insolvency laws can complement other ongoing reforms at the EU level in the banking sector and as regards capital markets.

2.3. Drivers and problems



2.3.1. Drivers

This sub-section describes the main drivers which give rise to the problems explained in section 2.3.2. These drivers were raised by stakeholders in the performed public consultations, in particular in the public consultation on the Green Paper on the Action Plan of the Capital Markets Union⁴³. Overall, respondents indicated a number of specific issues within the area of insolvency which in their view should be harmonised at EU level, such as preventive restructuring proceedings, out-of-court and hybrid restructuring procedures, second chance for

⁴² IMF: Euro Area Policies – Selected Issues, IMF Country Report No. 15/205, July 2015, Euro Area Policies, IMF Country Report No. 15/2014, July 2015, p. 61.

⁴³ COMMISSION STAFF WORKING DOCUMENT, Feedback Statement on the Green Paper "Building a Capital Markets Union", SWD(2015) 184 final.

entrepreneurs, regulation of qualifications, tasks and rights of insolvency practitioners, liability of directors and shadow directors, introduction of a time cap on insolvency procedures, establishment of an EU register with information on insolvencies and a harmonised form for petition claims. Stakeholders suggestions also aimed at harmonisation of requirements for opening insolvency proceedings, including a common definition of default and avoidance actions, restructuring of companies, stay on individual creditor claims and definition of a common discharge period. Other frequently quoted proposals for action suggested harmonisation of ranking of creditors' claims and the issue of personal insolvency⁴⁴. Following the consultations with the group of insolvency experts, relevant stakeholders and Member States experts, all the issues raised were examined and most of them, although not all⁴⁵, have been made subject to a deeper analysis and regulatory action as described in the following sub-section A. to E. and in section 5 on substantive sub-options.

A. Preventive restructuring

A.1. Rules on the possibility of restructuring at an early stage

The later a business initiates restructuring proceedings, the higher the costs of restructuring and the lower the management powers and success rate. Therefore debtors in financial difficulties should have the possibility to restructure their debts before they are insolvent. That said, the risk of insolvency has to be apparent, for example, because the debtor is unlikely to be able to repay his debts as they fall due in the foreseeable future⁴⁶. However, the overall general statistics demonstrate that less formal procedures are not applied very often in the majority of Member States⁴⁷. The highest proportion of restructurings in relation to the overall number of insolvency proceedings in the EU appears to be in France with around 30 % of restructuring proceedings⁴⁸. For instance, in Spain, where restructuring proceedings have been recently introduced and which shows a situation common to most Member States, out of all the agreements reached in 2014, only 9.7% were made in an early composition agreement. Since 2010, a smaller number of agreements has been made (with exception of 2013) compared with 2006, 2007 and 2009 where the rates were 22.4%, 25.4% and 21.8 respectively. Most agreements are made as part of ordinary insolvency proceedings and this is the case even more in the last years which might suggest that the latest changes in the law did not succeed in promoting less formal proceedings, or that debtors are using alternatives, such as the homologation refinancing agreement. This is despite the fact that the median value of recovery rates in the early composition agreements in 2014 was 68.7% of the nominal present value of the debt, whereas in the ordinary composition agreement it was only 44.3%. Additionally, recovery rates in early composition agreements were in general higher always higher than in the ordinary composition agreement (see figure below).

⁴⁴ SWD(2015) 184 final, Answers to Question 29, p. 59.

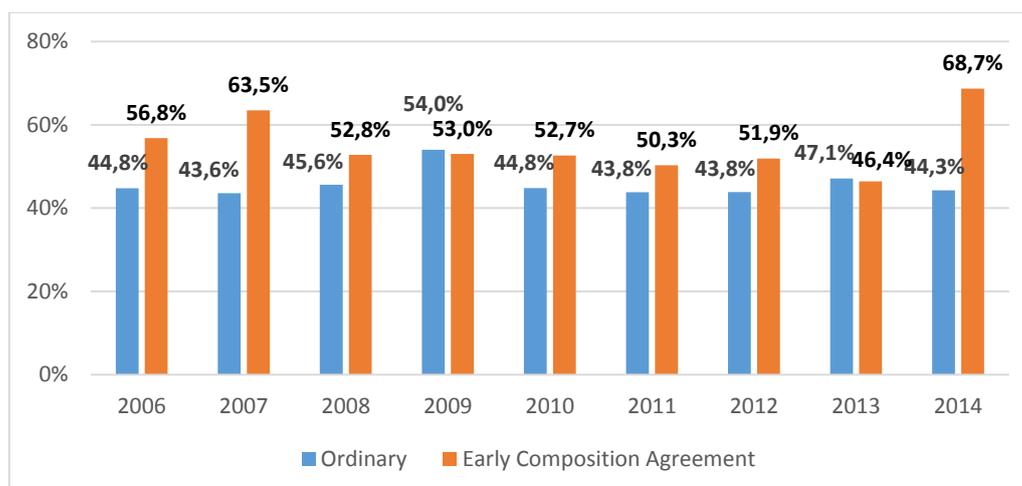
⁴⁵ For example, the insolvency expert group, stakeholders and Member States' expert did not consider as feasible or desirable to harmonise, at this stage, the definition of insolvency, requirements for opening insolvency procedures or ranking of claims in insolvency etc.

⁴⁶ According to the Insolvency Regulation a preventive restructuring procedure can be notified to the Commission only if it is available to the debtor once there is a 'likelihood of insolvency'.

⁴⁷ Existing statistics on the number of out of court preventive restructuring procedures and in court preventive restructuring procedures in EU Member States are only very partial statistics. Distinct figures for liquidated and restructured companies exist for some Member States only. Moreover, the restructuring and restructuring procedures are understood differently in different Member States.

⁴⁸ For instance, 62 586 judgments opening insolvency proceedings were registered for the overall 2014 in France, as follows: 42 874 liquidation proceedings, 18 092 reorganisation proceedings, 1 620 safeguard proceedings (Impact assessment study on policy options for a new initiative on minimum standards in insolvency and restructuring law, Final Report, VVA/JIIP/DTI/Grimaldi consortium, November 2016).

Chart 2: Comparison of median recovery rates in Spain between ordinary composition agreements and early composition agreements



Source: Own elaboration of VVA/ JIIP/ DTI/ Grimaldi consortium using the data provided by Colegio de Registradores de la Propiedad, Bienes Muebles y Mercantiles de España; * The recovery rates refer to the recovery expectations of the nominal present value for the normal creditors and under the supposition of full payment of what is agreed⁴⁹

A concern that such preventive procedures can be misused by debtors whose businesses are not viable, and should rather be liquidated than rescued, has led some Member States to impose high thresholds for entering these procedures. Furthermore, in some Member States debtors are under an obligation to file for formal insolvency procedures as soon as they are over-indebted (balance sheet test), which may dissuade directors to file for preventive restructuring due to risks of personal liability. SMEs, in particular, are reported to have great difficulties recognising their financial difficulties and the need to act quickly to contain the damage⁵⁰.

Table 3: Situation in Member States as regards access to restructuring frameworks

Access to restructuring	Member States
No access to any type of defined procedure to restructure debts with creditors before their companies are actually insolvent or are already late with payments	BG, HU, SK and HR
Possibility to restructure before being insolvent, but under very strict access conditions (e.g. an expert certificate must be filed or proof of a high majority of creditors already supporting the plan is required, imminent insolvency leading to late filing).	AT, DE, DK, IT and PT
Possibility to restructure at an early stage when there is a likelihood of insolvency in the future, without strict conditions being attached	BE, CZ, EE, FI, FR, EL, ES, LV, LT, LU, NL, PL, RO, SE, CY, IE and UK

An early possibility of restructuring and a low threshold for entering into negotiations of a restructuring plan favours the saving of viable businesses channelling them away from liquidation⁵¹. The risk of misuse exists but should be addressed by a proper assessment of the

⁴⁹ Impact assessment study on policy options for a new initiative on minimum standards in insolvency and restructuring law, Final Report, VVA/ JIIP/ DTI/ Grimaldi consortium, November 2016.

⁵⁰ SMEs also often lack resources to hire independent experts to help them with the drafting of restructuring plans which would help debtors making the necessary disclosures in order to submit credible restructuring plans to their creditors and to courts.

⁵¹ SMEs should be further encouraged to file early, for example by giving them access to early warning tools and by making available model restructuring plans.

viability of the business in the light of the restructuring plan, adopted by creditors, rather than by imposing strict entry conditions to access the procedures.

In the public consultation and during the 'Sounding Board' meetings, most of the stakeholders from business and the financial sector as well as practitioners in the field of restructuring underlined that many economically viable business that could have eventually avoid insolvency, end up in bankruptcy because they did not have the possibility to restructure effectively at an early stage. Business sector voiced that the death rate of companies can be reduced by the possibility of early restructuring for viable business in difficulties as it would shift the focus away of liquidation. Financial sector also stressed that since creditors' recovery rates are in general higher where the insolvency framework allows for early and efficient restructuring of viable firms and quick resolution of the non-viable ones, the introduction of efficient restructuring procedures in EU will allow creditors to recover more than in the case of liquidation of an insolvent debtor. Trade Unions' representatives warned against the moral hazard risk that business may use restructuring frameworks strategically to reduce their liabilities towards workers.

A2.Rules on stay of enforcement actions (moratorium)

A stay on enforcement actions by a court suspends the right of a creditor to enforce its claim against a debtor⁵². A properly defined "stay" of individual or collective enforcement actions is a crucial element of any useful restructuring procedure⁵³. Inadequate or overly restrictive stay provisions are likely to reduce the chances for a successful turnaround and damage the overall value of the business. The application of the stay, as one of the “fundamental debtor protections provided by the bankruptcy laws⁵⁴, impacts on the prospects of viability of the company and may give higher rewards to creditors who started enforcement early⁵⁵. This goal will be compromised, however, if creditors are able to seize assets that are essential to the carrying on of the company’s business⁵⁶. It is thus essential to strike the right balance between the different interests at stake.

Table 4: Situation in Member States as regards rules on stay of enforcement actions

Conditions of application of stay of enforcement actions	Member States
No possibility to obtain a stay of individual enforcement actions in preventive restructuring procedures	AT
Stay period limited in time, but extendable in more complex cases or upon evidence of progress in negotiations	CZ, FR, IT, LV, LT, NL, PT, SE, SI, CY, IE and UK
Stay period limited in time and non-extendable in more complex cases or upon evidence of progress in negotiations	DE, ES, EL, PL

⁵² In principle, each creditor has the right to seize the debtor’s assets according to a “first come first served” basis in order to satisfy its claim. Creditors, however, usually cannot coordinate themselves and, therefore, it is rational for them to collect their debts individually and to seize debtor’s assets as soon as financial distress becomes apparent.

⁵³ The UNCITRAL Legislative Guide on Insolvency reflects the view that to allow recovery procedures by creditors to operate without restraint could frustrate the overall socially desirable goal of restructuring and rescue. Since going-concern value may be a lot more than breakup value, restructuring proceedings are designed to keep a business alive so that this additional value can be captured.

⁵⁴ Study on a new approach to business failure and insolvency, University of Leeds, January 2016, p. 230.

⁵⁵ For example, an ineffective stay could allow customers and suppliers to walk away (or demand punitive amendments) at a time when their continued commitment is most crucial to the company’s rescue.

⁵⁶ The stay is also an intrinsic feature of Chapter 11 of the U.S. Bankruptcy Code.

Stay may be lifted by the court before the expiry of the stay period if the objectives of the stay can no longer be achieved or evidence of abuse	BE, DE, EL, SE, CY, IE
Stay for an indefinite period until the restructuring plan is adopted or rejected	BE, EE, FI, LU, RO and DK

Most often the stay also means that formal insolvency procedures cannot be opened against the debtor. In some Member States certain actions cannot be "stayed" (e.g. in BE, DK and SE in respect of specific secured transactions; in EE in respect of employment claims).

During negotiations of a restructuring plan, the debtor should be able to apply to a court for a suspension of individual enforcement actions ("stay"), otherwise the success of the restructuring process is in jeopardy. The "stay" could be requested against any type of creditor. The stay would not be effective if, at the same time, the debtor's duty to file for insolvency were not suspended for the period of the stay or if creditors were allowed to enforce their rights through a collective action (i.e. opening insolvency proceedings) during this time⁵⁷.

During the consultation process, the business sector and experts in the field of restructuring have pointed out that the absence of a 'breathing space' (stay on individual or collective enforcement actions) is likely to reduce the prospects of a successful restructuring. They were of the view that businesses in financial difficulties should have the possibility of a necessary amount of time to define a restructuring plan and avoid precipitate creditor action. In addition, the financial sector stressed that a stay of a proportionate and appropriate timeframe, along with the possibility for a creditor to lift it under conditions, can contribute to the efficiency of negotiations by striking a balance between the debtor's and creditors' interests.

A3. Rules on debtor-in-possession

The debtor-in-possession is a mechanism ensuring that the management of the debtor will not be displaced in favour of an outside insolvency administrator. The use of this mechanism encourages timely use of the restructuring option⁵⁸. However, the debtor-in-possession is not available in all jurisdictions and not under the same conditions. The choice between debtor-in-possession and management displacement is not an 'all-or-nothing' one and there are in fact a plurality of possible approaches on this issue⁵⁹. Evidence from the World Bank Doing Business Index suggests that average recovery rates for creditors in economies where insolvency administrators have a key role in deciding on the viability of the business are more than 10% higher than in economies where that determination is done by other means⁶⁰.

⁵⁷ Also, the company would not be able to carry out its business if essential suppliers, during the stay period, were to terminate contracts early.

⁵⁸ Study on a new approach to business failure and insolvency, University of Leeds, January 2016, p. 228.

⁵⁹ These approaches are discussed in detail in the InsolEurope study done for the European Commission, 'Study on a new approach to business failure and insolvency – Comparative legal analysis of the Member States' relevant provisions and practice's, p. 24-26.

⁶⁰ Doing Business Project Encourages Economies to Reform Insolvency Frameworks, World Bank, January 2013, http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2013/02/26/000333037_20130226123527/Rendered/PDF/752400BRI0SMAR0urable0Results0FIXED.pdf

Table 5: Situation in Member States as regards debtor-in-possession rules

Application of debtor-in-possession rules	Member States
Debtor may lose certain powers of control over the business during preventive restructuring procedures	FR, CY and NL
Debtor left in possession, but an insolvency practitioner or administrator is also appointed to supervise the debtor	AT, CZ, EE, FI, DE, LV, LT, LU, PL, RO, SK, SI, SE, UK, IE and HR
Supervision of the debtor by the court	BE
No obligation for a court to appoint insolvency practitioner or administrator (or out-of-court appointment possibility)	EL, IT, PT and ES
Supervision of insolvency practitioner or administrator is not required in a simplified restructuring procedure.	FI

While the principle of a debtor in possession is not controversial as such, the role and level of involvement of insolvency practitioners must strike a balance between the need to ensure the success of proceedings, including the necessary confidence, and cost and effective access to such procedures, in particular for SMEs.

Most of the stakeholders consulted were of the view that the productive capacity of a company is undermined if the debtors do not have the possibility to keep control over the day-to-day operations of their business. In the public consultation, the business sector particularly mentioned that debtor-in-possession arrangements can promote operational efficiencies and realise significant cost savings. During the dedicated stakeholders' meetings, some business organisations also voiced that many SMEs are hindered from accessing restructuring, because of the costs and difficulties that the appointment of a supervisor/administrator entails. On the other hand, it was supported by the business and financial sector that the appointment of a practitioner sometimes is proved necessary, for example, in complex cases or where it is the only way to achieve full transparency for creditors and reduce the risk of abuse,

A4. Rules on the preparation and adoption of restructuring plans

A company's ability to make use of a legal proceeding for the adoption of a restructuring plan is integral to any insolvency system aiming to avoid business failure where possible. The speed and rules of adoption of a restructuring plan are of crucial importance for a cross-border investor. Both secured and unsecured creditors need to know what the so-called cram down rules⁶¹ are, if any, in the country where the investment is made and what it means for their own prospects of recovery. If the creditor is a shareholder, he needs to know the rights of shareholders in the adoption of the restructuring plan itself and the rate of recovery.

⁶¹ The term 'cramdown' can be understood in two senses. In one sense, it simply means that if the necessary majority within a class approve a plan then the plan becomes binding on the other class members. But it can also be used in the sense of cramming down a dissenting class in its entirety, i.e., forcing a majority of the class to accept a scheme against their wishes (so-called cross-class or inter-class cram down (Study on a new approach to business failure and insolvency, University of Leeds, January 2016, p. 245).

Table 6: Situation in Member States regarding the preparation and adoption of restructuring plans

Preparation and adoption of restructuring plans	Member States
No possibility of binding dissenting creditors by majority voting	AT and LT
Possibility of binding dissenting creditors allowed, but certain categories of creditors are exempted (e.g. public creditors, workers, secured creditors, commercial creditors)	CZ, EE, EL, ES, HR, IT, LV, LU, NL, PL, PT, SI and the UK
Creditors are not treated in separate classes for the purposes of voting on a restructuring plan and the restructuring plan is adopted if not opposed by a majority of creditors	DK
Simple majority in value for a “cram-down” of liabilities in the course of a voluntary business arrangement	CY
Possibility of binding dissenting creditors, but all creditors must be involved, even those whose rights are not affected	BE, DE and RO
Possibility that only certain categories of creditors which are affected by the plan are involved (e.g. financial creditors)	FI, FR and SI

The rules on adoption of restructuring plans should reflect the different interests of creditors (e.g. secured and unsecured) and shareholders and their likely recovery in the event of insolvency. For example, creditors or classes of creditors and shareholders who can no longer profit should not have a decisive say in the adoption of such plans. By giving a bigger say to creditors and shareholders who are "in the money", that is those who can still financially contribute to the rescue of the business, restructuring plans would have bigger chances of success in the long term and help debtors avoid relapsing into financial difficulties soon after a first restructuring.

SoLocal, the French online marketing group (former YellowPages in France), has 4.400 workers and €1.164 billion euros in debt. On 19 October 2016, the shareholders rejected the group’s debt restructuring during a general meeting. The company’s “Conquer 2018” proposal, which aimed at reducing the group’s debt to €400 million and featured a capital increase, required the support of two-thirds of shareholders, even after the required majority of creditors approved the financial restructuring. After the shareholders' vote, creditors have the right to demand immediate payment on SoLocal’s debt as it wouldn’t comply with its September and June leverage covenants. The company future enters a phase of serious uncertainty.

During the consultation process, business sector and practitioners in restructuring said that restructuring cannot be effective and successful if there are no clear rules on the adoption of the plan and on the need for the plan to balance among the different interests. Specifically, they were of the view that restructuring can have bigger chances to success if the plan is fair and reasonable and leave no creditor worse off than they would be in the most likely alternative scenario, i.e. liquidation. Financial institutions also underlined that uncertainty and higher financing costs can only be avoided by ensuring adequate safeguards for secured creditors in cram-down mechanisms. Trade Unions' representatives underlined the importance of preserving the workers' rights to information and consultation, which are conferred by EU law, in particular where restructuring involves a transfer of parts of the business.

A5. Rules on provision of new financing in restructuring

If new financing is necessary for the success of restructuring, the protection of the parties providing this funding is of vital importance for the rescued company⁶². In the absence of debtor-in-possession financing arrangements, under which a company under court-supervised protection can receive additional financing, a distressed company has to rely on existing creditors to meet its interim funding requirements whilst a restructuring plan is devised. The process with a large number of financial institutions having differing strategies and involved in complicated cross-border proceedings often leads to conflicting objectives⁶³. Weak protection of parties providing new sources of financing diminishes the prospects of viability of the company and also of recovery rates⁶⁴.

Table 7: Situation in Member States as regards provision of new financing in restructuring

Conditions of provision of new financing in restructuring		Member States
No special protection provided in relation to parties who provide new financing ⁶⁵		CZ, EE, DE, HU, LT, LU, MT, NL, SK, UK
New financing involving a connected person and provided within 6 months prior to the filing of bankruptcy proceedings can be set aside		PL
New financing cannot be challenged provided that	the lender supplied funds and it was in relation to a settlement that had been approved by the court	FR
	the new financing was provided pursuant to a <i>bona fide</i> attempt to rehabilitate the insolvent and restructuring provisions were adhered to	BG
	the new financing occurred during the execution of a restructuring plan	EL
	the bankruptcy judge approves the reorganisation arrangement	RO
	certain specified conditions have occurred ⁶⁶	ES
	the arrangement envisaged favourable treatment being bestowed on the financing ⁶⁷	LV
	the action was designed to fulfil obligations under the restructuring scheme approved by the court ⁶⁸	SI
Any transaction involving new financing and entered into pursuant to an effort to restructure is deemed not to have an intention of harming creditors		DE

Putting in place incentives for new financing is an essential element in ensuring a sustainable restructuring. Protection from avoidance actions⁶⁹ in subsequent insolvency proceedings is

⁶² Potential economic gains from reforming insolvency law in Europe, AFME, Frontier economics, Weil, February 2016, p. 18 and 19.

⁶³ Idem.

⁶⁴ Idem.

⁶⁵ Avoidance rules that are generally applicable will apply to new financing, but it will mean that any security that is granted in exchange for new financing, and in order to support restructuring, will usually be safe from attack.

⁶⁶ For example, the scheme is recorded in a public document.

⁶⁷ Latvian Insolvency Law, s 40(5).

⁶⁸ Slovenian Insolvency Act (ZFPPIPP) (Slovenia), Arts. 44 and 273.

therefore an essential element of restructuring plans. It seems necessary to extend such protection also to interim financing, i.e. financing necessary to ensure the continuation of the debtor's business during negotiations (before the plan is adopted), in particular in respect of creditors who are stayed. Several Member States fall short of ensuring this basic protection. A super-priority status for new financing exists in some Member States, however while being very effective in protecting new financing it is more controversial as it is sometimes considered to come into conflict with the principle of legal certainty and protection of property rights for existing creditors.

During the public consultation and the 'Sounding Board' meetings, protection of new financing was deemed by most of the stakeholders as a necessary incentive for restructuring. The business sector underlined that if viable companies, in need of working capital, are left without the possibility to finance their day to day operations, they will be driven to liquidation, to the detriment of the real economy. In addition, business sector and financial institutions stressed that potentially interested creditors should be encouraged; when creditors decide to inject liquidity in a distressed company, they should be given a sufficient degree of predictability on the recovery of their claims.

A6. Intensity and quality of courts' and insolvency administrators' involvement

Preventive restructuring frameworks allow debtors and creditors to negotiate informally before insolvency starts. However a number of jurisdictions allow only for restructuring through formal insolvency: within these jurisdictions there are differences in the opening of the insolvency procedure that may generate problems in cross border situations⁷⁰.

In most Member States, insolvency proceedings are administered by a judicial authority, through commercial courts, courts of general jurisdiction or through specialised insolvency courts. Sometimes judges have specialised knowledge and responsibility for insolvency matters, while in other cases insolvency matters are just one of a number of wider judicial responsibilities of the courts.

During the 'Sounding Board' meetings, most of the stakeholders, including the business and financial sector as well as practitioners in the field of restructuring agreed that rigidity, cost and time of the procedures can be reduced if there is less court involvement. The experts consulted were also of the view that court involvement should be required when there is a

⁶⁹ Provisions concerning avoidance actions exist so as to enable the general body of creditors to be protected from an unfair reduction in the value of the insolvent's estate which can be the consequence of the debtor giving an advantage to one party prior to the opening of insolvency proceedings by those avoidance actions (Study on a new approach to business failure and insolvency, University of Leeds, January 2016, p. 138).

⁷⁰ For instance, some EU Member States apply liquidity tests (the ability to pay debts as and when they fall due) others balance sheet tests (the surplus of assets over liabilities). Under Polish law, the balance sheet test only applies to certain categories of entities including companies and partnerships. Under Spanish and French laws, only the liquidity test applies. Under Italian law the liquidity test applies subject to some additional criteria. In Germany over indebtedness and imminent illiquidity can be a reason to file for bankruptcy. The majority of Member States adopt the general cessation of payments test and the balance sheet test in different combinations to establish a commencement standard. Other requirements may be added, such as for example, that the cessation of payments must reflect a difficult financial situation that is not temporary. In Germany and Austria, the debtor must also be overindebted. Under Danish law, the debtor is insolvent when the debtor is unable to pay its creditors on the due date and the situation is not temporary. A similar test is adopted in Estonia (Impact assessment study on policy options for a new initiative on minimum standards in insolvency and restructuring law, Final Report, VVA/ JIIP/ DTI/Grimaldi consortium, November 2016).

need to protect the interests of third parties and avoid abuse. Furthermore, in the public consultation, business and financial sector stressed that confidence in the operation of courts and efficiency of the restructuring procedures can be enhanced by improving the efficiency of insolvency practitioners as well as encouraging specialisation of judges.

The laws of Member States have different rules on insolvency practitioners themselves, namely their qualifications, eligibility for their appointment, licensing, regulation, supervision, professional ethics and conduct. The questions related to insolvency practitioners concern any type of mediators or supervisors engaged in the insolvency process. Depending on the extent of involvement of courts and/or insolvency practitioners one could distinguish:

- *Pure out-of-court agreements*: private contractual arrangements that require all creditors' consensus;
- *Hybrid informal agreements*: mechanisms which combine the benefits of judicial control and out-of-court easiness at low cost can rely on decisions by a majority of creditors.

The lowest degree of involvement of courts or insolvency administrators or practitioners is in out-of court proceedings, whereas the highest in formal insolvency proceedings. The degree of involvement has an impact on costs. However, in Member States where no insolvency practitioner is involved in restructuring procedures, the debtor is less likely to make use of the procedure and to do so quickly and effectively⁷¹.

The high quality of insolvency practitioners and judges matters for the time of the proceedings. Specialised insolvency practitioners and judges can contribute greatly towards reducing the length of procedures and bring other benefits⁷². Since cross-border restructurings and insolvencies presuppose a high level of cooperation between insolvency administrators and judges, it is even more crucial that they have a proper training and resources and that they adhere by common ethical standards.

Table 8: Situation in Member States as regards intensity of courts' and insolvency administrators' involvement

	Member States
Hybrid proceedings combine out-of-court and formal procedures	UK, EL, PT, ES, FR and AT
Formal insolvency proceedings needed with full involvement of the court/insolvency practitioners	BG, HU, DK, CZ, SK, SI, HR, LT

Providing for hybrid proceedings and the enforceability of private agreements would increase the effectiveness of insolvency frameworks, especially as regards preserving value for debtors and creditors. It would provide more options to companies, instead of always having to go for more costly involvement of courts or insolvency administrators. The efficiency could further increase if judges or insolvency administrators had a high level of specialisation in insolvency

⁷¹ Study on a new approach to business failure and insolvency, University of Leeds, January 2016, p. 329.
⁷² In 2013-2014, the insolvency profession rescued approximately 6 700 businesses through formal insolvency procedures, saving around 230 000 jobs, while another 3 700 businesses continued operating after informal advice, employing around 310 000 people after informal advice, employing around 310 000 people after receiving advice (Why Insolvency Matters – the insolvency profession value to the UK Economy, Association of Business Recovery Professionals, 2015).

and restructuring. According to the 2016 public consultation, the degree of specialisation of insolvency administrators and of judges co-relates with increased recovery rates for creditors.

B. Insolvency (liquidation) procedures

Other drivers concern in particular rules related to formal insolvency (liquidation) proceedings such as: conditions for filing for insolvency (definition of insolvency), ranking of claims, the wider issue of avoidance actions, the length of formal insolvency proceedings, directors' responsibilities relating to insolvency. In the public consultation, although many stakeholders identified them as areas, which would merit some form of action at the EU level, they also acknowledged feasibility concerns due to the existing divergence of national rules, national specificities and implications on other areas of law. Moreover, most of the Member States expressed strong concerns with regard to those areas.

B1. Definition of insolvency

In the performed public consultation, the banking sector voiced that different definitions of insolvency result in different moments when insolvency is declared, therefore there is no clarity for creditors about the time span for the restructuring and when the opening of an insolvency proceedings is inevitable. In addition, some business organisations agreed that a **common definition of insolvency**, although difficult to achieve, would be very useful. However, the Expert Group on Insolvency⁷³ expressed the view that a definition would not be necessary in order to access early restructuring proceedings and that harmonising this aspect might have unintended consequences for other areas of national law, such as company law, employment law etc.. Certain experts were of the opinion that focus should be put on the triggering criteria, especially for early restructuring proceedings⁷⁴. Against the background of the discussions with Member States' experts it appeared that there is opposition to a harmonisation of the definition of insolvency but also that this is less relevant for the purposes of restructuring than the critical guidance on when the debtor can access early restructuring, on the terms of such restructuring and on the impact on the debtors' duty to file for formal insolvency proceedings. So while it may be important to define concepts, a definition of insolvency did not appear to be indispensable to ensure the efficiency of preventive insolvency procedures while for formal insolvency procedures, although helpful, a definition would not be at this moment in time a priority.

B2. Order of priority of claims

The laws of Member States differ significantly as regards the **priority of claims** in insolvency. This has an impact on how insolvency proceedings are run and how debts are recovered. In the public consultation, some stakeholders supported that differences in the areas of ranking of claims affect to a large or to a considerable extent the operation of the internal market. Moreover, others supported that a general harmonisation in this area would increase recovery rates for creditors. However, the banking sector voiced that although this issue is important when doing business on a cross border basis, it is not necessarily the essential driver of the decision to invest or not. Moreover, business organisations expressed scepticism on the feasibility of EU action in this area given how it is deeply rooted in national legal traditions, which carries the risk of unintended consequences in case of intervention. In

⁷³ For more details on the work of this expert group, see Annex 2.

⁷⁴ Other experts were of the opinion that if general and objective criteria may be relevant at EU level (see the eventual interplay with Recital 17 of the recast Insolvency Regulation), details should be left to Member States.

addition, during the dedicated meetings with the Member States, most of them, if not all, were opposed to a general harmonisation of ranking of claims because of national specificities and implications on other areas of law. Discussions in the Commission Expert Group revealed that this area is sensitive given that Member States have taken different approaches as regards preference for workers and state creditors (tax, social security etc.). This goes at the core of national discretion and competing values are at stake. Nevertheless to incentivise companies to restructure at an early stage, tax and state aid rules should not be more burdensome in early restructuring than in insolvency procedures.

B3. Avoidance actions

The laws of Member States also differ on possibilities for **avoiding contracts detrimental to companies and creditors**. Differences concern conditions under which a detrimental act can be avoided (avoidance actions) and the period within which such acts can be challenged. In the public consultation, a part of the respondents stressed that divergence on avoidance actions affect to some extent the operation of the internal market and that harmonisation of avoidance actions (in particular of suspect periods) would contribute to increasing recovery rates for creditors. They stressed that investors, companies and entrepreneurs would be more willing to invest or do business outside their Member States if they were provided with the assurance that certain types of transactions, entered into within a certain period of time, are prescribed throughout the EU. Particularly, the banking sector acknowledged that rules on avoidance actions are essential to decide whether to deal with a debtor in financial trouble and insolvency practitioners' organisations voiced that different standards in avoidance actions create legal uncertainty and it gives rise to substantial legal costs in insolvency proceedings. However, discussions in the Commission Expert group revealed that while avoidance actions could in principle be harmonised across the board, it would be disproportionate to do so at this stage. Therefore, it was proposed to create a limited rule on avoidance actions, namely a harmonized safe harbour from avoidance actions for non-related party transaction related to restructuring negotiations.

B4. Liquidation of assets

In some Member States the rules on the **actual liquidations of assets** result in prolonging the proceedings. In the performed public consultation, when asked what are the key issues for the excessive length of insolvency proceedings, most of the respondents mentioned delays in the liquidation of the debtor's assets, activities related to the supervision of the debtors and litigation concerning the debtors' right and obligations. A smaller part of respondents considered lack of digitisation as a key issue for the excessive length of proceedings. Particularly, the banking sector explained that the foreseeable length of enforcement and insolvency proceedings are usually taken into consideration for investment decisions. Business organisations mentioned that measures to shorten the length of the proceedings would have a positive impact in recovery rates. . However, while some stakeholders were of the view that a target maximum duration for insolvency proceedings would be useful, a larger part were of the opinion that it would not be appropriate. Particularly, practitioners' organisations expressed that the variety of proceedings is much too large for that and there are too many risks entailed.

When asked what incentives could be put in place to reduce the length of insolvency proceedings, the respondents mentioned: electronic means of communication; specialisation of courts; supporting the courts' resources; less court involvement/supervisory role only; clear requirements for entering to insolvency proceedings; ensuring that the thresholds are triggered

early enough for restructuring; deadlines/time-limits for court proceedings; publicly accessible information as a (general) prevention; remuneration of insolvency practitioners.

B5. Directors and shareholders

In a company, **directors** exercise corporate powers which are generally balanced with duties of care prohibiting wrongful trading. Some Member States have certain obligations in place for directors in the period before insolvency occurs and impose liability for any harm caused by continuing to operate when it was either clear or should have been foreseen that insolvency could not be avoided. The rationale for such provisions is to create appropriate incentives for early action through the use of voluntary restructuring negotiations. It may also encourage directors to obtain competent professional advice when financial difficulties occur and thus avoid insolvency. **Shareholders** may obstruct a restructuring procedure which would return the company to viability. Allowing shareholders to oppose restructuring would likely reduce the number of successful restructurings.

In the public consultation, the majority of stakeholders⁷⁵ were of the view that directors of companies should be incentivised to take appropriate preventive measures if companies are in distress but not yet insolvent. Financial institutions voiced that it is necessary that directors should have a duty to act diligently in order to protect creditors and stakeholders. However, during the dedicated meetings with the Member States, although they acknowledged the need to incentivise directors for early restructuring, most of them were reluctant to mandatory detailed provisions on directors' duties, due to the implications on company law.

On shareholders, many stakeholders from the business and financial sector said that the existing differences between the laws of the Member States regarding measures to clarify the position of shareholders of companies in insolvency or close to insolvency affect the functioning of the Internal Market either to a considerable extent or to some extent. Financial institutions and investor associations (EBF, AFME,) said that the shareholders' rights within creditors' committee might need to be limited in certain circumstances, i.e. when they prevent the plan from being adopted although this plan is likely to ensure the continuation of the company's activity and the recovery of the debts.

Overall, these other drivers while being relevant relate only indirectly to restructuring and second chance and are strongly dependent on the existing national legal frameworks and the social, economic and political choices made in other areas of law. They will be looked at more closely in this impact assessment report but only in connection with the aspects which are related to preventive restructuring and second chance. The assessment in the preferred option touches upon some specific aspects relevant for these additional drivers, such as the availability of early restructurings, definition of conditions for new financing and their priority, cram down requirements or reduction court formalities which would impact positively on the costs, length and recovery rates of both preventive restructuring and formal insolvency procedures.

C. Second chance

Discharge from debt is instrumental for those who wish to learn from their mistakes and have a fresh start. The need of discharge for natural persons is amplified by the fact that people starting business bring in their project also personal assets and credits taken in their personal

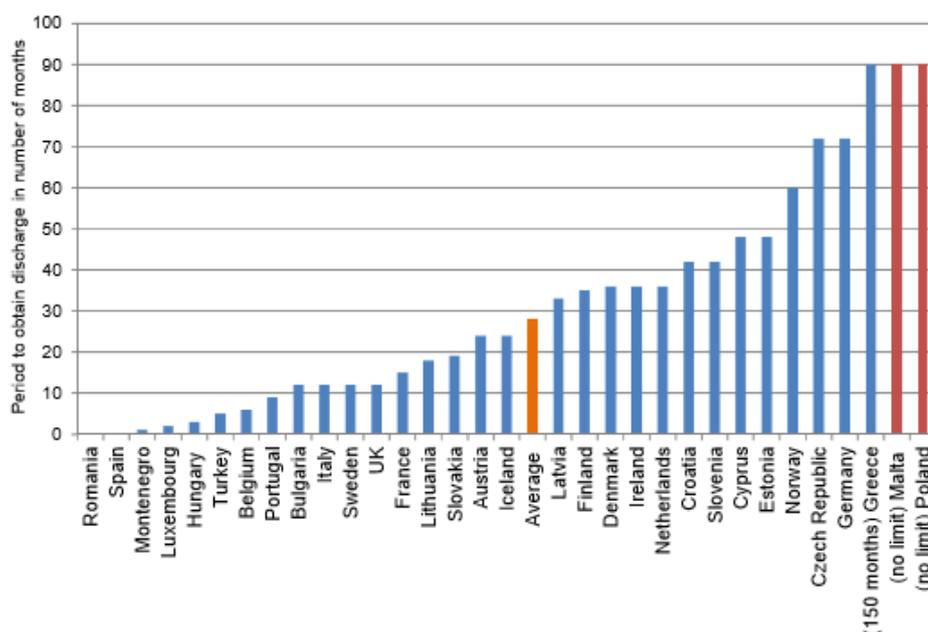
⁷⁵ Among those, UEAPME, EACTP, BusinessEurope, German Bar Association.

capacity or help from the members of family⁷⁶. Where debt settlement procedures are not available the entrepreneur will normally still have access to bankruptcy procedures available to corporate debtors⁷⁷. At the same time, almost all Member States offer a debt settlement procedure to consumers⁷⁸.

Table 9: Situation in the Member States debt restructuring for natural persons including discharge and second chance

	Member States
Full discharge of entrepreneurs as part of bankruptcy is available	BE, CZ, CY, EE, FR, EL, IE, LU, RO, SI, UK
Bankruptcy does not give right to discharge	AT, BG, HU, NL, SE
Opportunity of discharge for entrepreneurs after a debt settlement following the expiry of discharge period of differing length	AT, CY, CZ, DK, EE, FI, DE, EL, HU, IE, LT, LV, NL, PT, SK, SI, ES, UK
Discharge without further conditions after one year	UK, IE
Discharge within 3 years is available in bankruptcy proceedings	CY, IE, FR, UK
Discharge within 3 years is available in debt settlement	AT, CY, NL and SK
No debt settlement procedures for entrepreneurs	BG, FR, LU, MT, PL, RO

Chart 3: Period of time to obtain full discharge



Source: Ecorys, *Bankruptcy and Second Chance for Honest Entrepreneurs*, 2014

⁷⁶ As to natural persons without business activity, over-indebtedness is most often caused by external circumstances, such as the unemployment of disease. (The over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact, Civic Consulting for the European Commission, 2014, p. 32, http://ec.europa.eu/consumers/financial_services/reference_studies_documents/docs/part_1_synthesis_of_findings_en.pdf)

⁷⁷ Study on a new approach to business failure and insolvency, University of Leeds, January 2016, p. 329.

⁷⁸ With the exception of Bulgaria where, however, proposal for establishing consumer debt settlement procedure is in the legislative pipeline. In the UK, for instance,

Discharge from business debts (and personal debts of business people) under reasonable conditions and received after a period which is not excessively long gives a second chance to restart business. The impossibility of repayment and too difficult conditions of discharge cause both entrepreneurs and consumers to fall in a debt trap. In consequence, these natural persons do not contribute to economic growth (reduced consumption, withdrawal from labour market, lower potential for entrepreneurship) and instead of returning to economically productive life they may have to rely on social services support.

In the performed public consultation, the majority of the respondents were of the view that the absence of adequate second chance provisions hampers economic and entrepreneurial activities and that therefore a full discharge of debts, possibly subject to certain conditions, should be offered to both entrepreneurs and consumers provided that they are 'honest' debtors. Many stakeholders' organisations, including practitioners in the field of restructuring, stressed the increasing number of sole entrepreneurs and the difficulties of distinguishing between debts arising from professional and private life; they were of the view that consolidation of the procedures is appropriate for an effective discharge. Businesses and entrepreneurs stressed that a second chance approach would increase trade, strengthen the real economy and be a driver for growth, since it would encourage entrepreneurship and stimulate consumer spending. However, they supported adequate safeguards in order to prevent moral hazard. The banking sector said that a responsible entrepreneurship model should be promoted in a way that a full discharge of debt is given to honest entrepreneurs only after the repayment of certain amount of debt. They were even more critical of consumer insolvency, saying that this policy area should not be pursued at this moment in time.

D. General effectiveness of procedures

A modernised insolvency framework could not achieve the objectives set if the quality and efficiency of actors involved is not improved. This conclusion came up consistently in the public consultation, during the expert group discussions and the dedicated meetings with the stakeholders, academics and practitioners. This no doubt translates into excessive length of procedures in some Member States and/or high costs of procedures. Although an ideal length of insolvency procedures has not yet been established, investors are reluctant to invest where procedures risk taking too long. In the EU, there are 10 Member States where the average time to resolve insolvency is more than two years⁷⁹ (in 8 of these MS the average length is 3 years or more).

The effectiveness of all procedures is dependent on the speed with which the **courts** can take decision, on the quality of the assistance or supervision performed by **insolvency practitioners** and by the level of **digitalisation** of procedures. These aspects are relevant across all insolvency spectrum, be it preventive restructuring, liquidation of second chance, a view which came across consistently during the consultations.

Specialised insolvency practitioners and judges can contribute greatly towards reducing the length of procedures and bring other benefits. In the public consultation and the 'Sounding Board' meetings, businesses, financial sector, insolvency practitioners and academics stressed that enhancing the efficiency of insolvency practitioners as well as encouraging specialisation of judges is of key importance in order to increase confidence in the operation of the system and improve the efficiency of the procedures.

⁷⁹ 2016 Justice Scoreboard, p. 11, available at http://ec.europa.eu/justice/effective-justice/files/justice_scoreboard_2016_en.pdf.

E. Additional drivers

One additional important indirect driver is the lack of special arrangements for restructuring SMEs. SMEs often do not have the resources to undergo an early health check by a professional and therefore the number of early restructurings in this sector is relatively small. As a result, SMEs are disproportionately driven to liquidation rather than restructuring. Liquidation of SMEs can be value destructive in a disproportionate manner since a majority of countries do not have a simplified procedure for SMEs; a simplified liquidation procedure could speed up the process and lower the costs of liquidation, resulting in higher returns to creditors and a speedier second chance for directors or entrepreneurs.⁸⁰ Means to encourage SMEs to address their financial difficulties early include: early warning tools, including specialised low-cost advice; templates for restructuring plans; hybrid procedures or out-of-court work-outs with creditors.

Special small business rescue procedures do not exist in many Member States, including countries with mature, sophisticated economies such as Germany, Austria, Netherlands and the Scandinavian countries (Denmark, Sweden, Finland the comparator, Norway)⁸¹. Therefore, the creation of an EU-wide fast track procedure for SMEs would not seem in line with the approaches taken in most Member States. Instead, SMEs problems could be addressed throughout the whole framework focussing on specific points where access can be improved and made less costly and where SMEs can be encouraged to seek early advice on how to address their financial difficulties.

2.3.2. Problems

The differences and inefficiencies in national laws cause the following key problems:

- Lost opportunities and excessive costs generated by barriers to cross-border investment (Problem 1),
- Foregone benefits and additional costs for creditors and debtors related to liquidations of viable companies (Problem 2),
- Lost opportunities and additional costs for natural persons (entrepreneurs and consumers) related to inefficiencies in insolvency frameworks as regards a fresh start (Problem 3).

Problem 1: Lost opportunities and excessive costs generated by barriers to cross-border investment

The suboptimal cross-border investment in the EU is caused by many factors. Inefficiencies in insolvency frameworks are an important element which has an influence on the level of cross-border investment⁸². Cross-border investment is hampered in the following ways:

- (i) difficulty to assess cross-border investment risks due to divergences in insolvency frameworks (and uncertainties as regards the outcomes), including the rules on

⁸⁰ Study on a new approach to business failure and insolvency, University of Leeds, January 2016, p. 281 and foll.

⁸¹ Ibid, p. 211.

⁸² Economic Analysis accompanying the Action Plan on Building a Capital Markets Union, SWD(2015) 183 final, 30 September 2015, p. 72 and. foll.

restructuring and second chance. This means that at least to a certain extent cross-border investment is not taking place, since it is too difficult or it is too costly to quantify the risk;

- (ii) significant differences in recovery rates cross-border due to divergences in insolvency frameworks, including the rules on restructuring and second chance. This means that at least to a certain extent cross-border investment is not taking place, since the recovery rates for foreign investors are unsatisfactory.

When taking a decision about funding a project in another country of the EU, a prudent creditor or investor will seek information about the prospect of recovering his dues in case of failure. In order to evaluate the risk of any investment, the investor needs to be able to quantify both the expected risk of failure (probability of default) and the expected loss incurred if that failure happens (loss given default). In its risk assessment the prudent investor/creditor will look at the insolvency framework as a whole (prevention, recovery of value and discharge). Not only will he analyse major parameters of the formal insolvency proceedings (security of claims, distribution of value and time to resolution), but he will also want to know whether a debtor can restructure a business and whether it can do it with or without the agreement of its creditors. In order to make a cross-border investment, it is essential to know whether restructuring can be "imposed" on some classes of stakeholders. Also, it is critical to know whether an entrepreneur could be discharged of debts (at which moment and after which period)⁸³.

Large asymmetries between Member States in the way restructuring proceedings and debt discharge are regulated generate additional costs for cross-border investors compared to those who invest in the EU only in one Member State⁸⁴. The costs increase exponentially in case the investor would like to invest in more than one Member State. In particular, such costs could be prohibitive if the investment were to take place simultaneously in a number of Member States or would be done by an SME which does not have in-house legal department and would need to pay for the costs of foreign legal advice⁸⁵.

Moreover, the investor in the EU may be obliged to pay not only for the assessment of multiple differing restructuring frameworks of individual Member States, but also for the assessment of the costs resulting from the coordination of the multiple applicable national restructuring frameworks. The more the insolvency frameworks, including restructuring and second chance, will differ, the more expensive the assessment of the coordination between their concurrent applications will be. Ultimately, this leads to additional costs of creation of corporate structures which will not be designed economically in the most efficient way but with the aim of circumventing the concurrent application of multiple insolvency and restructuring frameworks or at least those with low recovery rates or those under which restructuring is difficult. Certain transactions in EU Member States are under certain

⁸³ A good example of taking all the elements into account are the U.S. Investment Climate Statements (published very year) which provide 'country-specific information and assessments prepared by U.S. embassies and diplomatic missions abroad on investment laws and practices in those countries [...].The statements cover a breadth of topics that can help U.S. investors make informed investment decisions'. They include information on all elements of insolvency frameworks (i.e. on formal insolvency proceedings, second chance for individuals, preventive restructuring).

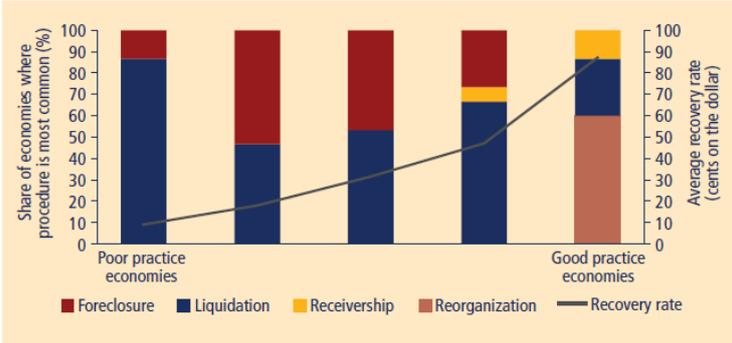
⁸⁴ OECD, 2014 Economic Review for the European Union, p. 50.

⁸⁵ Unlocking Funding for European Investment and Growth, AFME, 2013, www.afme.eu/unlocking-funding-for-European-investment-and-growth, p. 100.

circumstances structured using complex structures with special purpose vehicles⁸⁶ to reduce the potential impact of insolvency if it occurs⁸⁷.

According to the World Bank, the highest recovery rates for creditors are recorded in economies where restructuring is the most common insolvency proceeding⁸⁸. For instance, 45 percent of OECD economies use restructuring as the most common way to save viable firms and have an average recovery rate of 83 cents on the dollar, as opposed to 57 cents on the dollar in liquidation⁸⁹. This difference contributes to the creation of additional costs in the assessment of the risk under the foreign system.

Chart 4: Higher recovery rates are more likely in economies where restructuring is the most common insolvency proceeding,



Source: World Bank

A recent report shows that balanced and effective insolvency frameworks have a beneficial effect on the costs of borrowing via changes to credit ratings. It also proves that recovery rates remain a significant factor affecting the cost of borrowing, even when other institutional variables, beyond insolvency-related factors, are shown to have explanatory power⁹⁰.

In the performed public consultation, stakeholders in banking and investment acknowledged that differences in insolvency frameworks between Member States can become a deterrent to cross-border corporate investment, since the difficulties of establishing the value of distressed debt, may increase the cost at which investors are willing to invest or even it could discourage investors from establishing their business activities in other Member States. Moreover, they voiced that creditors who decide to inject liquidity in a distressed company should be given a sufficient degree of predictability on the recovery of their claims. They agreed that a system that enables the rescue of viable companies, outside or within insolvency proceedings, is essential to mitigate the problem of non-performing loans. Moreover, insolvency practitioners supported that divergence and inefficiency in insolvency frameworks can create barriers to corporate lending and investment, including cross-border investment. They stated that

⁸⁶ Registered in Luxembourg, for instance.
⁸⁷ Feedback Statement on the Green Paper "Building a Capital Markets Union" (Question 29), SWD(2015) 184 final, 30.9.2015, p. 59 and foll.
⁸⁸ Resolving Insolvency, World Bank, <http://www.doingbusiness.org/reports/globalreports/~media/GIAWB/Doing%20Business/Documents/Annual-Reports/English/DB14-Chapters/DB14-Resolving-insolvency.pdf>
⁸⁹ Doing Business Project Encourages Economies to Reform Insolvency Frameworks, World Bank, January 2013.
⁹⁰ Potential economic gains from reforming insolvency law in Europe, AFME, Frontier economics, Weil, February 2016, p. 40.

uncertainty or difficulties over realising value from distressed debt may be particularly pronounced in the case of cross-border lending and investments and this may increase the cost at which investors and creditors are willing to invest in or lend to cross-border borrowers.

Also in the public consultation on the Green Paper on the Action Plan of the Capital Markets Union large number of market participants and investors noted that the diversity of regimes across the EU negatively impacts confidence in cross-border investment. Central banks and regulators of capital markets supported a comprehensive reform of insolvency frameworks to remove obstacles to cross-border investment in the EU posed by differing national insolvency regimes. Also from the point of view of commercial banks, pension funds and other financial intermediaries, in this consultation the widespread divergence in Member States' insolvency regimes constitute a key deterrent to cross-border investment. Banks further argued that a targeted harmonisation of certain aspects of the differing national insolvency regimes would be a positive contribution to the Capital Markets Union. Member State governments and Finance Ministries adopted a more cautious approach suggesting the performance of a step-by-step approximation. Likewise, business associations showed more divided positions both on the impact of differing national insolvency regimes and on the form of possible actions to tackle those differences. Representatives of the SMEs would appreciate improvements in the efficiency and effectiveness of insolvency practitioners and the courts. Labour unions called for a wide ranging harmonisation of national insolvency frameworks. Other respondents, such as research institutes, considered that a better insolvency framework allows for a better re-allocation of capital and more growth, and that a targeted harmonisation of certain aspects of national insolvency frameworks would bring an added value in a Capital Markets Union⁹¹.

Problem 2: Foregone benefits and additional costs for creditors and debtors related to liquidations of viable companies

A successful restructuring of a financially distressed, but economically viable enterprise is conditioned by a number of pre-requirements, in particular the resolution of the problem of the “race to grab” debtors' assets⁹² (the need for a stay of enforcement actions at least for the period of preparation of the restructuring plan) and the “hold-out” problem⁹³ of individual creditors (the need for a qualified majority, not unanimity, for the adoption of the restructuring plan) and some additional requirements⁹⁴. Moreover, cross-border groups of

⁹¹ SWD(2015) 184 final, Answers to Question 29, p. 59 - 60.

⁹² Usually, creditors cannot coordinate themselves and, therefore, often collect their debts individually, seizing the debtor's assets as soon as financial distress becomes apparent (race to grab). This “race to grab” leads to inefficient outcomes for the creditors as a group, especially if the going concern value of debtors' assets is higher. (Mucciarelli, F. M., Optimal allocation of law-making power over bankruptcy law in “federal” and “quasi-federal” legal systems: is there a case for harmonizing or unifying bankruptcy law in the E.U.? September 2011, LAW & ECONOMICS RESEARCH PAPER SERIES WORKING PAPER NO.11-28, p. 9).

⁹³ Individual creditors may reject restructuring plans, which would keep the going concern value of the firm and would be value-enhancing for the creditors as group, simply because they hope to be paid in full if the plan succeeds and all other creditors adhered to it (Mucciarelli, F. M., Optimal allocation of law-making power over bankruptcy law in “federal” and “quasi-federal” legal systems: is there a case for harmonizing or unifying bankruptcy law in the E.U.? September 2011, LAW & ECONOMICS RESEARCH PAPER SERIES WORKING PAPER NO.11-28, p. 10).

⁹⁴ In addition, in a number of Member States successful restructurings face the problem of overly restrictive conditions preventing an early entry of distressed companies to restructuring proceedings which leads to the relocation of companies to Member States where access to restructuring is easier, unavailability of early warning mechanisms allowing a timely identification of companies which could be candidates for restructuring, lack of assessment tools enabling to distinguish viable businesses which should be rescued and non-viable businesses which should be liquidated, lack of protection of new

companies have to deal with additional coordination costs of multiple national restructuring proceedings.

In the performed public consultation, business sector and practitioners voiced that unnecessary liquidation of viable businesses can increase costs for all stakeholders and result in a loss of productive capacity.

The absence of an easily accessible and well-functioning restructuring framework generates three types of costs: relocation costs, coordination costs and lost benefits from financially distressed companies which due to the difficult access or low-quality of restructuring frameworks have to be liquidated instead of being rescued.

a) Relocation costs

Relocation costs represent costs for companies that could not use a good restructuring framework in a Member State where they were located and were obliged to relocate to other Member States for the purpose of restructuring and avoiding insolvency. Relocation costs also include the costs for creditors to inform themselves about the laws of the "new" Member State (the one to which the distressed company moved).

Great discrepancies between the restructuring regimes in Member States create incentives for relocation. Relocation triggered by differences in restructuring regimes might lead to the application of a different insolvency regime than originally expected by creditors. Debtors who want to free themselves of long-standing re-payment obligations at home gain from relocating to another Member State with less stigmatising regimes. This may adversely affect minority creditors even though the restructuring itself could be beneficial to the body of creditors and the company as a whole. At the same time, creditors at home risk to be adversely affected if debtors relocate too soon, particularly if they are taken by surprise and have to incur legal and administrative expenses trying to enforce their claim in another Member State.

In the case of SMEs, relocation is usually not an option because of the anticipated legal complexity. Luxembourg has been mentioned as one of the countries where relocation to other European Member States happens more frequently. Consulted stakeholders stated that it is quite common among Luxemburgish companies to move to the UK due to its more favourable pre-pack insolvency regime (better adapted procedures and higher chances of business survival), under which companies can be restructured. Such relocation is 'common' merely among large companies, being way too costly for SMEs and individual entrepreneurs⁹⁵. Total relocation costs for both debtors and creditors amount to an estimated € 9 million per year in Europe. Of course, this figure is a rough estimate which does not account for all types of cases (e.g. a large multinational bank declaring insolvency abroad after relocation)⁹⁶.

financing provided to distressed enterprises which will ensure successful restructuring and high costs of restructuring resulting from the involvement of courts or insolvency administrators.

⁹⁵ Impact assessment study on policy options for a new initiative on minimum standards in insolvency and restructuring law, Final Report, VVA/ JIIP/ DTI/ Grimaldi consortium, November 2016.

⁹⁶ Idem, p. 47.

Table 10: Estimation of relocation costs incurred by debtors in the EU

Number of relocating businesses in the EU	Relocation costs/business			Total relocation costs for debtors
	Travel	Moving	Renting	
0.5% x Total number of formal insolvencies (=559)	€100	€250	€8742	€5,082,428

Source: Calculations of VVA/ JIIP/ DTI/ Grimaldi consortium based on respondents' answers⁹⁷

The forum shopping⁹⁸ phenomenon has been used in the EU in situations where debtors and creditors have sought to utilise more friendly non-insolvency based restructuring procedures existing in other Member States than insolvency based restructuring schemes available in Member States where they had their centre of main interest (COMI). In particular, there has been a recent trend for non-English companies to restructure under the English law scheme of arrangement⁹⁹. In some circumstances, the ability to institute proceedings in a different and more favourable jurisdiction may be helpful to a company in distress, but this is not available to all companies (particularly medium or smaller companies), and may often be more costly and inefficient than proceedings in the debtor's own jurisdiction¹⁰⁰. The costs for the creditor may discourage enforcing of claims and lead to small or inexistent recovery. Additional costs will arise for creditors after the relocation, i.e. costs of legal advice and the costs related to a shift in centre of main interests (COMI)¹⁰¹; this may be a barrier for creditors to properly manage their interests in recovering the debt, especially when it is relatively low.

Some high profile examples of relocation have been noted in the impact assessment on the revision of the existing Insolvency Regulation¹⁰². In a recent series of cases the three German companies **Deutsche Nickel**, **Schefenacker** and **Hans Brochier** took steps in order to be able to make use of the English law on schemes of arrangement. The costs associated with these moves can be very high. For example, "Schefenacker, with debts of €400m, paid its advisers €40m" in order to "move to the UK in 2007 to speed up a complicated restructuring."¹⁰³ Another high-profile case involves **Hellas Telecommunications**, which led to a reported loss of € 1.3 billion for its unsecured creditors¹⁰⁴.

However, as these examples only cover large companies, they may not be representative of the total amount of relocations, nor of the average economic impact. It seems likely that many more relocations happen 'behind the scenes' and involve smaller enterprises¹⁰⁵. The fact that a

⁹⁷ Idem, p. 46.

⁹⁸ See Glossary in Annex 5.

⁹⁹ English courts have been willing to approve such schemes of arrangement where sufficient connection with the English courts was established.

¹⁰⁰ Potential economic gains from reforming insolvency law in Europe, AFME, Frontier economics, Weil, February 2016, p. 13.

¹⁰¹ The Centre of Main Interests (COMI): represents the place where main insolvency proceedings commenced under the Insolvency Regulation must be opened.

¹⁰² Impact Assessment accompanying the document Revision of Regulation (EC) No 1346/2000 on insolvency proceedings, SWD(2012) 416 final, 12 December 2012,

¹⁰³ 'European bankruptcies', Financial Times, London, 5 October 2009) <http://www.ft.com/cms/s/3/305fa1de-b113-11deb06b-00144feabdc0.html> (accessed 25/07/2015).

¹⁰⁴ See for more examples: Laufer, B., An economic analysis of the German bankruptcy code in the context of the European reform movement, Paris 2012, p. 33.

¹⁰⁵ Legal practitioners confirm that COMI-shifts are usually a serious option for restructuring – in particular in non-UK jurisdictions, See, for instance,

debtor opts for another jurisdiction could be related to the court efficiency or certain features of the chosen jurisdiction's preventive procedure (e.g. the possibility to bind dissenting creditors to a restructuring plan¹⁰⁶ which helps save a business from bankruptcy and liquidation)¹⁰⁷.

b) Coordination costs

Coordination costs represent additional costs for groups of companies, which have subsidiaries in other Member States, or lost benefits from an unrealised restructuring of a viable cross-border group which due to the differences in restructuring rules of affected Member States had to be liquidated instead. The difference in costs between purely domestic and cross-border insolvency proceedings could not, in most cases, be quantified, although cross-border insolvency proceedings were acknowledged as costlier. This increase was assumed to be 10%, based on the results of the consultation carried out¹⁰⁸. The average difference in length between cross-border and domestic proceedings (as indicated by the stakeholders who provided a quantitative estimate) is 55%. Much longer proceedings for cross-border insolvencies than for purely domestic insolvencies is one of the key drivers for costlier proceedings for both debtors and creditors¹⁰⁹.

In other words, a financially distressed, but viable group of companies located in one Member State will have much higher chances of being rescued than a group in the same situation which operates in two or more Member States because the latter will have to overcome the differences of multiple national restructuring procedures. In case of a cross-border group of companies in financial distress, if in one Member State restructuring takes place in formal proceedings and in others in informal (or is not available at all), this may even lead to a collapse of the whole restructuring. If there is no consolidated proceeding for a group of companies with domestic and foreign subsidiaries, there is a need to involve lawyers, administrators and trustees in all the different countries where there are subsidiaries¹¹⁰. In

<http://www.thisismoney.co.uk/money/markets/article-2052296/Bankruptcy-tourism-crackdown-shuts-61-companies.html#ixzz24QOWRIP9>

¹⁰⁶ Webb, L., Butter, M.: 'Insolvency Proceedings: Shopping for the best forum' (2009) (available at: www.practicallaw.com).

¹⁰⁷ Another example of less formalised proceedings are so-called pre-packaged proceedings (abbreviated as pre-packs). In Europe, the practice of pre-packs has been largely confined to the UK, France, the Netherlands and, to a certain extent, Greece, Ireland and Slovenia. Moreover, pre-packs have tended to take the form of pre-packaged asset sales rather than pre-packaged restructurings. In many other EU countries, pre-packs, while not strictly speaking prohibited, are rarely, if at all, encountered in practice. The lesson however, from the experience in the UK and Netherlands, as well as also the US, where the practice originated, is that pre-packs are potentially a valuable tool for preserving going concern value and maximising returns from the debtor's estate (Study on a new approach to business failure and insolvency, University of Leeds, January 2016, p. 204).

¹⁰⁸ Insolvency practitioners, public authorities and creditors' and debtors' associations consulted as part of this study provided different figures on the difference between domestic proceeding costs and cross-border proceeding costs. Some assumed domestic and cross-border proceedings to be equally expensive for creditors and debtors, while other reported an increase in proceeding costs of between 10 and 50% for cross-border proceedings compared with domestic proceedings. One outlying data points indicates a 10-time increase for cross-border proceedings costs compared with domestic proceeding costs. (Impact assessment study on policy options for a new initiative on minimum standards in insolvency and restructuring law, Final Report, VVA/ JIIP/ DTI/ Grimaldi consortium, November 2016).

¹⁰⁹ Impact assessment study on policy options for a new initiative on minimum standards in insolvency and restructuring law, Final Report, VVA/ JIIP/ DTI/ Grimaldi consortium, November 2016.

¹¹⁰ For creditors, coordination costs relate mainly to legal fees for foreign lawyers. Those costs can prove extremely high, up to double the costs that would have been incurred under a purely domestic proceeding according to one insolvency practitioner in Austria. In practice, the amount of coordination

particular, higher costs arise when there is a need for coordinating formal procedures in some Member States and less formalised procedures in other Member States. These differences in restructuring frameworks will make the cross-border restructuring much more expensive than a purely national restructuring. Often they will prevent any restructuring from happening, and force an otherwise viable group of companies into liquidation. For the reasons listed above, no restructuring plan involving the continuation of the business of groups of companies has ever been accepted in more than two jurisdictions¹¹¹. Even when a group of companies is represented by a mother company and one subsidiary in another Member State (for example an SME which has acquired one of its foreign suppliers), a common restructuring plan may be hard to be adopted.

According to the April 2011 report of the Reflection Group on the Future of EU Company Law, the international group of companies has become *the* prevailing form of European large-sized enterprises, in which business activity is typically organised and conducted through a multinational network of subsidiaries. About 20% of large enterprises (ca. 8,500) have foreign subsidiaries or joint ventures¹¹². There are more than one million SMEs in Europe which have subsidiaries or joint ventures abroad¹¹³.

Where the rules for the content and adoption of an early restructuring plan are complex and cumbersome and the conditions vary from Member States to Member States, the restructuring of the whole group of companies in financial distress is hardly an option for the management board. Although ad hoc solutions have been found in practice (mainly through the relocation of the firm to a Member States with an efficient preventive regimes, such as UK), where the legal uncertainty and costs for all parties involved is an obstacle to the functioning of the Single Market.

In the insolvency of the PIN Group, a mail delivery service provider¹¹⁴ the Luxembourg holding company moved its COMI to Germany where the vast majority of its subsidiaries were located, in order to enable a proper restructuring process for all members of the group in the same jurisdiction. Despite the vicinity of the insolvency petition the court held that the COMI shift was not abusive as it merely tried to coordinate the insolvency proceedings over the whole holding group. Therefore, it was regarded as being in the interest of the creditors as it tried to maximize the debtor's net assets. The restructuring of the group was successfully carried out¹¹⁵.

The additional coordination costs of cross-border restructuring, where such restructuring will not be impossible, can lead ultimately to extra costs for debtor. Creditors are likely to

costs depends on whether it is primary and secondary proceedings. An interviewee from a Belgian bank indicated that coordination costs account for about 10% of the total proceeding costs. Coordination costs are mainly driven by the need to hire expertise and legal representation abroad and it can therefore be assumed that coordination costs are proportionate to the number of insolvency regimes involved, with a 10% increase for every additional jurisdiction (Impact assessment study on policy options for a new initiative on minimum standards in insolvency and restructuring law, Final Report, VVA/ JIIP/ DTI/ Grimaldi consortium, November 2016).

¹¹¹ Robert van Galen, Stephan Madaus, *Corporate Rescue*, 2013, p. 52.

¹¹² 2007 Eurobarometer survey.

¹¹³ Internationalisation of European SMEs, EIM, report for DG Enterprise and Industry.

¹¹⁴ Local District Court Cologne, Resolution of February 19, 2008 (73 IE 1/08), [2008] *Zeitschrift für Wirtschaftsrecht* 423

Schlaefter, G., 'The International Insolvency Institute: International Insolvency Studies' (2010) Forum Shopping under the Regime of the European Insolvency Regulation (available at: http://www.iiiglobal.org/images/pdfs/georg_schlaefter.pdf) 24

compensate the legal uncertainty due to the differing restructuring rules by raising their interest rates on loans, mortgages and other forms of credit or on reducing the amount they lend.

c) Additional costs and lost benefits from unsuccessful rescues of viable companies

Viable companies in financial distress should have the chance to be rescued instead of being directly liquidated¹¹⁶. If this were the case, a number of financially distressed, but viable companies could be saved and a number of other companies in the EU internal market would not become insolvent due to liquidation of other companies (knock-on effect). This could be achieved if all Member States had the necessary elements of a restructuring framework with an optimal economic potential. This could therefore lead to an efficiency gain in each Member State.

What is the foregone benefit of too formalised procedures? An example from the UK

1) Hypothetically, if the UK restructuring framework did not include the less formal tools such as the "Company Voluntary Arrangement" (CVA), firms would need to use formal procedures such as "Administration" in order to restructure. Assuming that 27% of firms use the CVA procedure successfully, that all firms using it are small¹¹⁷ and that 839 firms were using it in 2012¹¹⁸ it allows for the conclusion that if they used instead the Administration procedure (assuming that they could afford it), this would create for them **additional cost of up to 62.2 million**¹¹⁹.

2) The average return for unsecured creditors in the administration procedure is 4%¹²⁰. Average return for unsecured creditors in rescue cases under CVA is 37%¹²¹. The CVA rescue rate is 27%, so the number of firms rescued in 2012 would be 226¹²². Assuming the average unsecured debt of £506,781, if those firms were dealt with in the administration procedure the return would be 20,000 (compared with 187 500 under CVA). Consequently, the **foregone value would amount to £167,500 per case, or £37.8 m in total**.

In conclusion, the (hypothetical) financial cost of no alternative to the formal restructuring procedure in the UK would be around **£37.8 – 62.2 m**. In reality this cost would be significantly higher if the cases of restructuring via another UK's less formal procedure (Schemes of Arrangements) were included¹²³. Scaling up the quantifiable part of the cost to the group of countries which have only formal restructuring procedures (BE, DE, FR, FI, SE, LV) the total cost of not having a hybrid alternative could be (with all due caveats) estimated to be in the order of magnitude of **€135-223 m**¹²⁴.

¹¹⁶ Upgrading the Single Market: more opportunities for people and business, European Commission, COM (2015) 550 final, p. 6.

¹¹⁷ Preliminary Report to the Insolvency Service into Outcomes in Company Voluntary Arrangements, prof. A.Walters, dr S.Frisby, Outcomes from the sample of CVAs commencing in 2006 <http://www.insolvencydirect.bis.gov.uk/insolvencyprofessionandlegislation/research/corpdocs/CVA-Report.pdf>

¹¹⁸ Data provided by The Insolvency Service, UK

¹¹⁹ $(27\% * 839 * £300000) - (27\% * 839 * £25000) = £62.2 \text{ m}$

¹²⁰ Companies House data, based on 500 records

¹²¹ This concerns rescue cases. In wind down cases the average recovery is 17%.

¹²² The CVA seems to be also used as informal wind-down device with the average return of 17% in wind down cases. This benefit was not included.

¹²³ According to anecdotal evidence, the schemes of arrangement are becoming increasingly popular, see for example an article at <http://www.thelawyer.com/the-rise-and-rise-of-schemes-of-arrangement/124768.article>

¹²⁴ 14.7% (the share of UK in EU GDP) was scaled up to 44% (the share of Member States from Group 3 in EU GDP) (44%). Data on GDP shares is for 2012 as reported by the IMF.

Table 11: The costs of a formal rescue procedure (administration) compared to the less formal procedure (company voluntary arrangement or CVA) in the UK¹²⁵.

	per Administration (formal procedure) (£ 000's)	per CVA (less formal procedure) (£ 000's)
Small company	5 – 300	5 - 25
Medium company	45 – 500	10 - 200
Large company	2000 – 4000	500 - 1500

Assessment of additional costs due to cross-border dimension

Table 12: Total costs at EU level for domestic and cross-border insolvency proceedings: SMEs (incl. entrepreneurs)

	Domestic proceedings		Cross-border proceedings	
	Number of formal insolvencies/year	Total proceeding costs (€/year)	Number of formal insolvencies/year	Total proceeding costs (€/year)
UK+CZ+LU +FR+BE+LV	76,327	319,436,885	2,907	24,080,618
EU28 (method 1)	145,703	609,783,071	6,071	50,289,651
EU28 (method 2)	277,553	1,161,589,814	10,767	89,190,235
EU28 (middle estimate)	211,628	885,686,443	8,419	69,740,187

Source: Calculations of VVA/ JIIP/ DTI/ Grimaldi consortium based on respondents' answers¹²⁶

Table 13: Total costs at EU level for domestic and cross-border insolvency proceedings: large companies

	Domestic proceedings		Cross-border proceedings	
	Number of formal insolvencies/year	Total proceeding costs (€/year)	Number of formal insolvencies/year	Total proceeding costs (€/year)
UK+CZ+LU +FR+BE+LV	95	2,931,011	5	224,617
EU28 (method 1)	291	8,969,861	15	687,402
EU28 (method 2)	322	9,934,585	17	763,698
EU28 (middle estimate)	307	9,471,793	16	718,774

Source: Calculations of VVA/ JIIP/ DTI/ Grimaldi consortium based on respondents' answers¹²⁷

¹²⁵ Impact Assessment on encouraging company rescue - consultation, UK (Informal figures sourced from the insolvency profession), http://www.detini.gov.uk/encouraging_company_rescue_-_impact_assessment.pdf

¹²⁶ Impact assessment study on policy options for a new initiative on minimum standards in insolvency and restructuring law, Final Report, VVA/ JIIP/ DTI/Grimaldi consortium, November 2016.

First, it is important to note that these figures do not represent the additional costs of the cross-border dimension of insolvency proceedings, but the total costs incurred by all cross-border insolvency proceedings in the EU. Second, while the two methods used yield very different results (since the total number of formal insolvency proceedings per year in the EU has been estimated as 152,000 with the first method and 289,000 with the second method) the reality is believed ‘reality’ to lie in between, around 220,000 total insolvency proceedings per year in the EU, close to the European Commission figure of 200,000 firms going bankrupt each year in the EU. With 220,000 insolvency proceedings every year, total proceedings costs in the EU would amount to €895 million for domestic proceedings, and €70 million for cross-border proceedings¹²⁸. The **additional** cost of the cross-border dimension of insolvency procedures is estimated as follows:

Table 14: Difference between domestic and cross-border insolvency proceedings costs - SMEs

	Domestic proceedings	Cross-border proceedings	Difference (cross-border vs. Domestic) (€/insolvency)
	Average proceeding costs (€/insolvency)	Average proceeding costs (€/insolvency)	
EU28	4,185	8,284	+4,099 An addition of 98% compared with purely domestic proceedings

Source: own calculations based on respondents’ answers¹²⁹

Table 15: Difference between domestic and cross-border insolvency proceedings costs - Large companies

	Domestic proceedings	Cross-border proceedings	Difference (cross-border vs. domestic) (€/insolvency)
	Average proceeding costs (€/insolvency)	Average proceeding costs (€/insolvency)	
EU28	30,853	44,923	+14,070 An addition of 45% compared with domestic proceedings

Source: Calculations of VVA/ JIIP/ DTI/ Grimaldi consortium based on respondents’ answers¹³⁰

¹²⁷ Ibid.

¹²⁸ Proceedings cost have been estimated at national (for a sample of 6 Member States) and EU level . Two different methods were used to compute total proceedings costs at EU level: (i) Method 1 – Method 1 relies on the assumption that the number of formal insolvencies (both SMEs and large companies) per year in the EU is equal to 0.7% of all active businesses. In addition, formal domestic insolvency proceedings of SMEs (resp. large companies) are estimated to account for 96% (resp. 95%) of all formal insolvency proceedings. The number of active SMEs (incl. entrepreneurs) and large companies in the EU used in these calculations is 21,681,933 and 43,719, respectively . (ii) Method 2 - Method 2 relies on the assumption that the number of formal insolvencies is proportionate to the number of businesses, with UK, CZ, LU, FR, BE and LU altogether reporting 76,327 SME insolvency proceedings (resp. 95 large company insolvency proceedings) and accounting for around 27.5% (resp. 29.5%) of all SMEs (resp. large companies) active in the EU.

¹²⁹ Impact assessment study on policy options for a new initiative on minimum standards in insolvency and restructuring law, Final Report, VVA/ JIIP/ DTI/Grimaldi consortium, November 2016.

¹³⁰ Ibid.

If viable companies become insolvent, rather than restructured at an early stage, this has consequences for the whole chain of trading partners of these companies (knock-on effect). In the performed consultation, organisations of small business stressed that in some cases, since, start-ups have a smaller client - base as well as a smaller financial buffer than “older” companies, the insolvency of a client might have a larger impact on start-ups. One in six corporate insolvencies are the result of knock on effects from other insolvencies. Moreover, the 2016 Eurobarometer on insolvency showed that 17% of companies (SMEs) have foreign debtors. For those who have foreign debtors for many (50%) foreign debt constitutes more than 6% of turnover. It is higher for bigger and also for newer companies. It is true that companies less frequently enforce foreign claims, but it may be the effect of giving up certain foreign claims since they are more difficult and more costly to enforce¹³¹.

Government intervention is necessary to mitigate this network externality from business failures and reduce the impacts on employment and productivity. European companies have large networks of cooperation: on average, export constitutes 17,6% of supply provided by those companies. Thus there is a substantial risk that insolvency of a client will impact its supplier. Large companies, although only representing 0.2% of European companies, provide 30% of jobs in the EU and produce 41% of gross added value. According to the April 2011 report of the Reflection Group on the Future of EU Company Law, the international group of companies has become *the* prevailing form of European large-sized enterprises, in which business activity is typically organised and conducted through a multinational network of subsidiaries. About 20% of large enterprises (ca. 8,500) have foreign subsidiaries or joint ventures¹³². There are also more than one million SMEs in Europe which have subsidiaries or joint ventures abroad¹³³.

Problem 3: Lost opportunities and additional costs for natural persons (entrepreneurs and consumers) related to inefficiencies in insolvency frameworks as regards a fresh start

Failure and over-indebtedness are situations that affect natural persons, whether entrepreneurs or consumers. Business failure is an unavoidable risk inherent to any enterprises, especially young ones. In Europe, every year, more than 200,000 companies go bankrupt¹³⁴. Since the financial crisis, due to lowering incomes and increasing unemployment, over-indebtedness has impacted more than 10% of European citizens (recent data show that 11.4% of consumers are permanently in arrears¹³⁵).

Different discharge regimes may lead natural persons to relocate to more debtor-friendly jurisdictions. This involves costs for the debtor who needs to seek information, legal advice and relocate their centre of main interest¹³⁶. Likewise, creditors would also bear costs following the relocation as they would have to adjust to the change of their debtors or even have to give up the recovery of these debts. For smaller value loans, which are typically

¹³¹ Flash Eurobarometer, Report Insolvency, no. 442, 2016.

¹³² 2007 Eurobarometer survey.

¹³³ Internationalisation of European SMEs, EIM, report for DG Enterprise and Industry.

¹³⁴ Commission Staff Working Document, Impact Assessment accompanying Commission Recommendation on a New Approach to Business Failure and Insolvency, SWD(2014) 61 final, 12.3.2014, p. 2.

¹³⁵ Study on over-indebtedness of European households, http://ec.europa.eu/consumers/financial_services/reference_studies_documents/docs/part_1_synthesis_of_findings_en.pdf

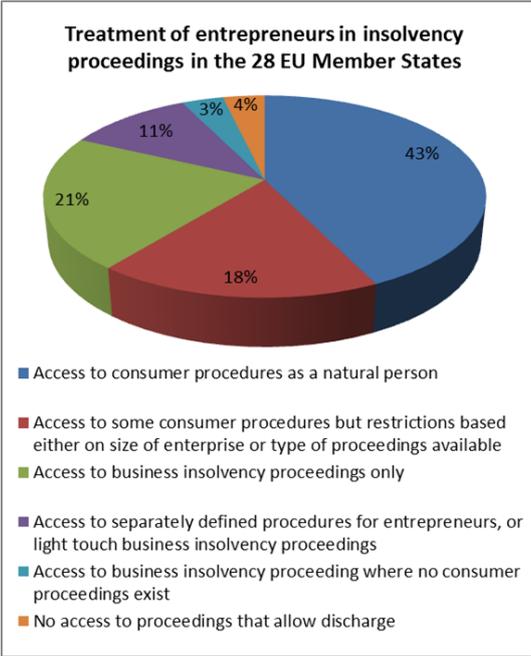
¹³⁶ Not everyone could benefit from this possibility, in particular, vulnerable people and younger businesses would be excluded.

granted to natural persons, the cost of recovery may discourage the enforcement of claims or lead to very low recovery. This would impact in particular creditors that have many debtors with smaller value loans.

Additional costs for natural persons may stem from the stigma of insolvency and the related "reputational damage" of insolvency. Entrepreneurs are likely to find it more difficult, hence more costly to find new trading partners for their new business or simply to continue the existing (restructured) business. For a natural person, finding a new job, for instance, after winding up a business, or new apartment to rent will also tend to be more difficult and the whole transaction more costly.

Personal and business debts of individual entrepreneurs are often intertwined: entrepreneurs take personal loans to start and run their business, for example because they guarantee their business loan by personal assets, such as car or a family; or natural persons use consumer credit to buy assets which they use also for professional activities. Since any debt, including the one contracted by the natural person, whether entrepreneur or consumer, can become unpaid, almost all Member States have systems that allow for discharge of natural persons from debts which they can no longer service. The chart gives a broad view of how entrepreneurs are treated in insolvency proceedings in EU Member States.

Chart 5: Treatment of entrepreneurs in insolvency proceedings in the 28 EU Member States



In several MS there is one single regime for discharging personal debt whether the debtor is a consumer or whether he is an entrepreneur (e.g. Finland, UK). These regimes are more efficient in affording second chance since all personal debts are consolidated into one procedure. In other MS, there are different regimes for entrepreneurs and consumers (e.g. France, Romania).

Debt discharge frameworks in Member States still substantially, in particular in terms of the conditions of access, repayment schedules and periods (one to eight years in depending on the

legal regulations in individual Member States¹³⁷), restrictions on performing certain activities and asset disposals etc.

A lost benefit consists in a reduced economic activity of individuals resulting from a limited access to new credit for natural persons stigmatised by insolvency. While in some cases refusing a credit is justified, possibly even in the interest of the borrower (e.g. for persons unable to manage their budget) this should not be applied systematically to all persons who have had payment difficulties. A further lost benefit of excessively long discharge periods for natural persons resides in the continuing poverty and financial exclusion of bankrupt individuals. Poverty has negative impacts on public spending, and the state of health and security in a country¹³⁸. As to financial exclusion¹³⁹, it is also detrimental to the providers of financial services who lose a part of their potential customers.

The lack of harmonised rules on consumer insolvency impacts negatively on cross-border selling of retail financial services¹⁴⁰. Legal uncertainty for creditors in the case of default of a natural person was identified as a barrier to cross-border lending, by several reports such as the report of 2009 on the functioning of the Directive on Distance Marketing of Financial Services¹⁴¹ and the study on the consumer credit market in Europe¹⁴². Cross-border lending to households, which is now at the level of approximately 5% of the total of household lending, could be substantially increased. At the same time, the overall costs of credit could decrease if natural persons had an easier access to loans offered in other Member States¹⁴³.

The Recommendation invited Member States to implement the discharge principles developed for entrepreneurs also to consumers. Many Member States have in recent years adopted or reformed (ES, RO, HU, HR, LU, CY, SI) national laws on consumer insolvency recognising the importance of enabling consumers' discharge of their debts and obtain a second chance. The discharge periods for over-indebted consumers remain very long in AT, BE, CZ, EE, EL, ES, LT, PT, SI, SE, RO (5 years or more). In addition, in DE, SK, HU and CY discharge after 3 years is conditional upon repayment of a certain percentage of the debt (e.g. 35% in DE, 50% in HU).

2.4. Risks

A. Moral hazard

A prevailing concern in deciding how to design an insolvency system is the risk of moral hazard. Many insolvency systems take a harsh stance in favour of liquidation because it provides for safeguards against such risks, in the form of full court involvement, a general and automatic moratorium, an insolvency practitioner acting in the interests of creditors taking over the business, with powers to avoid transactions etc. Member States may equally opt for

¹³⁷ Study on a new approach to business failure and insolvency, University of Leeds, January 2016, p. 382 and following.

¹³⁸ Those negative impacts are indicated in the study on over-indebtedness of European households

¹³⁹ According to the data from EU-SILC 12% of European citizens were living in households without a bank account (Research note 3/2010 Financial exclusion in the EU New evidence from the EU-SILC special module).

¹⁴⁰ Replies to the Green Paper of Retail Financial Services, http://ec.europa.eu/finance/consultations/2015/retail-financial-services/index_en.htm#results

¹⁴¹ http://ec.europa.eu/consumers/archive/rights/docs/final_rep_financial_services_2009.pdf

¹⁴² http://ec.europa.eu/consumers/archive/rights/docs/consumer_credit_market_study_en.pdf

¹⁴³ As reported in the Study on the functioning of consumer credit market in Europe, p.78, APR on consumer credits goes from 5% in Finland to 35% in Estonia.

long discharge periods or very strict conditions of access to discharge as a means of fending off potential risks of moral hazard.

However, experience from those Member States which have well-functioning restructuring and second chance frameworks shows that it is possible to achieve more restructurings, save more companies and jobs, help more entrepreneurs to re-enter the productive economy without creating further moral hazard risks. Any action in this area should provide therefore for appropriate safeguards against such risks. These risks will be considered in more detail in relation to specific options in the impacts sections below.

B. Employees' rights in early restructuring procedures

A number of Directives (Directives 98/59/EC¹⁴⁴, 2001/23/EC¹⁴⁵, 2002/14/EC¹⁴⁶, 2008/94/EC¹⁴⁷ and 2009/38/EC¹⁴⁸) guarantee the right to information and consultation before restructuring and/or collective redundancies. Directive 2001/23/EC aims at safeguarding workers' rights in case of transfers of part of the undertaking. Early restructuring procedures should not curtail such rights which provide important safeguards to employees.

Furthermore, Directive 2008/94 imposes an obligation on Member States to put in place guarantee institutions to guarantee the payment of employees' outstanding claims resulting from contracts of employment or employment relationships in the event of the employer's formal insolvency proceedings in relation to the employer. Member States have the possibility to extend the coverage of such guarantee institutions also to other types of procedures, but they are not obliged to do so. Where such claims are not guaranteed under national law, an early restructuring procedure which gives the debtor the benefit of a temporary stay of enforcement actions would risk negatively affecting employees' claims and protection. Special arrangements should therefore be put in place to ensure that employees receive appropriate protection in preventive procedures, equivalent to what they would receive in liquidation procedures.

2.5. Baseline scenario

The 2008 financial crisis and the following global economic downturn adversely affected businesses around the world, resulting in financial difficulties for many firms. Hence, the need for efficient and speedy restructuring regimes covering in particular several countries. Disparities in restructuring laws will not be resolved or determined by market forces due to an intensive regulation of Member States of insolvency and restructuring proceedings¹⁴⁹. Stakeholders will approach each restructuring with their own agenda and strategy, often

¹⁴⁴ Council Directive 98/59/EC of 20 July 1998 on the approximation of the laws of the Member States relating to collective redundancies, OJ L 225, 12.08.1998, p. 16.

¹⁴⁵ Council Directive 2001/23/EC of 12 March 2001 on the approximation of the laws of the Member States relating to the safeguarding of employees' rights in the event of transfers of undertakings, businesses or parts of undertakings or businesses, OJ L 82, 22.03.2001, p. 16.

¹⁴⁶ Directive 2002/14/EC of the European Parliament and of the Council of 11 March 2002 establishing a general framework for informing and consulting employees in the European Community, OJ L 80, 23.3.2002, p. 29.

¹⁴⁷ Directive 2008/94/EC of the European Parliament and of the Council of 22 October 2008 on the protection of employees in the event of the insolvency of their employer, OJ L 283, 28.10.2008, p. 36.

¹⁴⁸ Directive 2009/38/EC of the European Parliament and of the Council of 6 May 2009 on the establishment of a European Works council or a procedure in Community-scale undertakings and community-scale groups of undertakings for the purpose of informing and consulting employees, OJ L 122, 16.5.2009, p.28.

¹⁴⁹ Ringe, W-G.: Forum Shopping under the EU Insolvency Regulation, EBOR 9 (2008), p. 602.

looking for positions of control and influence to gain leverage, and not seeking common ground and consensus. In addition, policymakers in various local jurisdictions will use political considerations or historical and cultural practices as justification for avoiding reforms of their insolvency and restructuring frameworks.

Many Member States have reformed or are in the process of reforming national insolvency laws. However, fashioning *ad hoc* restructuring frameworks around national or market driven influences results in greater transaction risks and higher costs of capital. When Member States introduce changes, they will only take into account the national perspective. As a result, the heterogeneity of existing rules will continue to inhibit cross-border investment and the divergent and inadequate insolvency regimes will continue to limit the potential of the private sector to attract investment. The absence of a consistent and predictable EU-wide restructuring framework would thus continue to create a considerable layer of uncertainty, increase costs and, to some extent, alter the economic rationale of capital markets transactions.

Given the substantial divergences between national restructuring and second chance frameworks in the EU, it is highly unlikely that Member States individually would be able to ensure the overall coherence of their legislation with other Member States' insolvency legislations. Several Member States took or have taken action independently and have recently enacted or started preparatory work to adopt new rules aiming at improving the preventive restructuring framework and second chance, such as Cyprus, Croatia, Poland, Portugal. Reforms are being discussed in other Member States (Luxembourg, Italy) but there is yet no concrete timeline. However, these national rules differ widely in content and, as a result, they provide an uneven level of transparency and protection for investors. Although this does not mean that investors do not invest cross-border, it does mean that the current regulatory framework inhibits them to play a more optimal role within the internal market. It is to be expected that other Member States will follow this trend if the EU does not act. Besides, given the heterogeneity of the restructuring market, it would be difficult for it to overcome the existing legal complexity and fragmentation.

2.6. The EU's right to act, subsidiarity, necessity and proportionality

The Union's right to act in this field is set out in Article 114 of the Treaty on the Functioning of the European Union (TFEU). Its first paragraph empowers the European Parliament and the Council to adopt measures for the approximation of the provisions laid down by law, regulation or administrative action in Member States which have as their object the establishment and functioning of the internal market. Article 114 TFEU allows the EU to take measures, not only to eliminate current obstacles to the establishment and functioning of the internal market but also to address barriers that dissuade economic operators from taking full advantage of the benefits of that market (in particular investing in other Member States). On that basis, the European Union has a right to act to improve the conditions for creditors, debtors, investors and other stakeholders in the context of restructuring viable businesses in financial difficulty. Should an instrument address also consumer insolvency, according to Article 114 (3) TFEU, a high level of protection must be taken as a basis.

The case law of the Court of Justice of the European Union shows that if a measure addresses real obstacles to free movement or distortions of competition, present or future, it can be

based on Article 114 despite the fact that it may touch on important social aspects¹⁵⁰. It has been used in fields as diverse as environment, health, consumers, worker protection, telecommunication networks (roaming), circulation of personal data, advertising and promotion of tobacco products, the establishment of the European Network and Information Security Agency. It allows taking measures both with regard to existing and future obstacles, among others to prevent the emergence of divergent development of national laws. Future obstacles/distortions of competition must be real, not only address an abstract risk.

The increasing cross-border nature of investment suggests the need for coordinated action by Member States hosting business entities (companies and entrepreneurs). As the Eurobarometer on insolvency has showed, 17% of companies (SMEs) have foreign debtors. but that many cross-border claims remain un-enforced. This entails additional costs of doing business cross-border in particular for SMEs.

When lending to or investing in business entities in other Member States, creditors are confronted with different mandatory rules resulting from the lack of harmonised tools available to businesses in financial difficulty. The problems described above, creating costs and foregone benefits, obstruct fundamental freedoms (in particular free movement of capital) and thus have a direct effect on the functioning of the internal market.

However, investment in businesses does not mean only lending but can also take the form of ownership (the investor is not a creditor, but a shareholder of a company). Foreign investors do establish and run local business entities in other Member States, which themselves do not have cross-border activities. The barriers to cross-border investments have, therefore, a direct effect on the functioning of the internal market. These additional costs for investors may only be eliminated, if there is a general convergence of regulatory frameworks in Member States covering both cross-border and domestic cases (while an artificial distinction in the scope of restructurings on the basis of their expected or actual cross-border nature would just reinforce legal fragmentation). A convergent EU framework on insolvency would thus remove barriers also for foreign investors from outside the EU: looking at one set of restructuring and insolvency indicators valid for two or more of the EU Member States where an investment is foreseen would reduce the additional costs associated with assessing risks of investing in EU Member States. The additional costs grow exponentially where the foreign investor looks at several Member States in order to establish where to invest (e.g. where to set up a plant or a distribution point from where the whole EU can be covered). Building up the CMU is an EU priority also as regards making the EU a more interesting place for foreign investors from outside the EU.

The internal market problems are not limited to purely cross-border scenario. Even purely national insolvencies may have an impact on the functioning of the internal market through the so-called domino effect. Companies operating cross-border (about 25% of bankruptcies in EU involve creditors and debtors in more than one EU Member State¹⁵¹) have in their supply chain suppliers some of which may be purely domestic businesses. When a supplier

¹⁵⁰ Article 81 on judicial (cross-border) cooperation in civil matters is not an appropriate legal basis for measures of harmonisation of domestic procedures, which is the case here. There are already several precedents for measures of harmonisation of court procedures adopted on the basis of Art. 114, e.g. the Injunctions Directive or the Directive on the enforcement of IP rights. Procedural measures adopted on the basis of Art. 81 have so far created an exhaustive, 29th regime, not a harmonisation (e.g. European order for payment procedure, European small claims procedure).

¹⁵¹ Commission Staff Working Document, Impact Assessment accompanying Commission Recommendation on a New Approach to Business Failure and Insolvency, SWD(2014) 61 final, 12.3.2014, p. 2.

experiences financial difficulties and cannot be saved, this may have negative impacts which may trigger the insolvency of the cross-border company. Good restructuring frameworks are necessary in order to avoid a domino effect of insolvencies. According to the Flash Eurobarometer survey carried out in June 2016 among small and medium sized enterprises in 28 European countries, on average, 17% of those companies had debt claims against foreign debtors over 2015 fiscal year. However, in some countries this situation was much more frequent: 49% in Luxembourg, 45% in Slovenia, 31% in Austria. Half of the companies with foreign debt claims say foreign debt claims represented at least 6% in their 2015 turnover. Frequency of outstanding foreign debt claims as compared to domestic claims and also relative difficulty to recover them depended on the general economic situation in a given country. In the countries with internal economic difficulties recovery of domestic claims was perceived as more difficult, while in some countries not experiencing those difficulties (UK, Germany, Finland, Sweden) recovery of foreign debt was similarly or more difficult as recovery of domestic debts¹⁵². As 17% of small and medium sized companies have foreign debts, and in half of them they make a substantial proportion of their turnover, the probability neither of the fact of cross-border insolvencies nor of their importance for creditor companies cannot be neglected¹⁵³. In the UK alone, 27% of insolvencies are triggered by the insolvency of another company¹⁵⁴. In the light of the domino effects of insolvency, it is necessary to act not only in purely cross-border insolvency scenarios, but also in domestic insolvency cases. The possibility of an insolvency regime limited to cross-border insolvency or restructuring proceedings must therefore be discarded since such a limited solution would not solve the internal market problem.

In addition, a crystal-clear distinction between domestic and cross-border cases is particularly difficult in the context of insolvency. First, in most cases it is impossible to anticipate in advance (at the opening of proceedings), if the case will have a cross-border element in course of the proceedings. The cross-border nature of a restructuring proceedings (in the context of the Insolvency Regulation) depends of various different circumstances and factors which simply may not be anticipated by the debtor or by the court in advance, at the opening of the proceedings or beginning of the negotiations, even having carried out the highest diligence. If a debtor has a creditor abroad or some assets of the estate of the debtor are situated in another State, this alone qualifies the insolvency proceeding as having cross-border elements. These factors generating the cross-border element may, however, appear also in course of the proceedings, once negotiations are already on-going. For example this is the case where a domestic creditor changes domicile during the proceedings concerning the debtor or where during preventive restructuring assets are sold to a buyer in another Member State and later insolvency proceedings are opened and the insolvency practitioner aims at avoiding those transactions. These circumstances alone transform the domestic nature of the case to a cross-border situation.

As regards second chance, a distinction needs to be made between natural persons entrepreneurs and consumers. Different discharge periods may lead bankrupt entrepreneurs to exercise their free movement rights and relocate to a more debtor friendly jurisdiction (such movements were observed for instance from Germany to UK and France). This movement however raises two types of internal market problems: first, creditors and investors, whether at home or abroad, will face uncertainty as to what legal regime might ultimately apply to their claims against the debtor and whether in practice they will have no claim after 1 (UK), 3

¹⁵² Flash Eurobarometer, Report Insolvency, no. 442, 2016, para 1.

¹⁵³ Flash Eurobarometer, Report Insolvency, no. 442, 2016, para 2.

¹⁵⁴ The European Small Business Alliance response to the public consultation of 2013, see Annex

years (UK, FR, NL, FI) or 7 years (CZ). Second, the costs of obtaining a discharge for the entrepreneur who wants to benefit from a second chance sooner rather than later are considerably higher if he has to relocate to another jurisdiction (there is now a presumption in the reformed Insolvency Regulation that a debtor must be established in another MS for at least 6 months in order to be able to open discharge procedures in that state). This problem is not solved by the fact that entrepreneurs can set up a limited liability company to protect themselves: the concept of entrepreneurs includes also professionals, craftsmen, traders which may not opt for such a possibility (these may be lawyers, artists, midwives, cleaners etc.). These categories of persons will incur personal liability for their work-related activities.

Contrary to entrepreneurs, who constantly search for any sources of investment (often cross-border), consumers tend to be provided, at this stage, by local financing (loans from local banks). Therefore, it is not self-evident that the problem of consumers' over-indebtedness, which is real, should not be tackled first at national level. At this moment, there are attempts to attract cross-border lending to consumers, but this market has not been developed so far. Therefore, principle sources of debt for consumers are most often based on loans provided by local creditors.

A well-functioning EU internal market requires a coherent restructuring and second chance framework, capable of addressing the cross-border dimension of firms, as interaction between companies located in different Member States has become increasingly common. EU action will therefore add value by facilitating cross-border investing in the EU, ensuring that viable businesses in financial difficulty, wherever they are located in the internal market, will benefit from more choice of accessible tools aiming at preventing their insolvency; at the same time, entrepreneurs will profit from the possibility of using reasonable discharge periods in their Member States. This could not realistically be achieved by the Member States acting alone. Despite ongoing efforts to improve European insolvency and restructuring procedures, important differences persist across Member States. World Bank indicators¹⁵⁵ suggest that resolving insolvency can take between less than one year in Ireland, Belgium and Finland and more than three years in Bulgaria, Romania, Greece and the Slovak Republic. The recovery rate varies between 30% in Croatia and Romania and 90% in Belgium and Finland.

In addition, ensuring that cross-border creditors and investors involved in such a restructuring process have at their disposal appropriate safeguards will have positive economic effects. The proposed rules will create legal certainty for creditors and investors which want to lend in other Member States. At least, they would in many cases receive the necessary information to take informed decisions.

The proposal is designed to respect the principle of proportionality. The means it uses will be tailored to achieve the objective of ensuring the proper functioning of the internal market. The future EU instrument should set common objectives and general rules, while leaving freedom to Member States to define how to achieve those objectives. All policy options will therefore be assessed with regard to their compliance with the proportionality principle. Options that would not be in line with this principle will be discarded.

¹⁵⁵ COMMISSION STAFF WORKING DOCUMENT, Economic Analysis accompanying Action Plan on Building a Capital Markets Union, SWD(2015) 183 final, p. 75.

3. OBJECTIVES

General

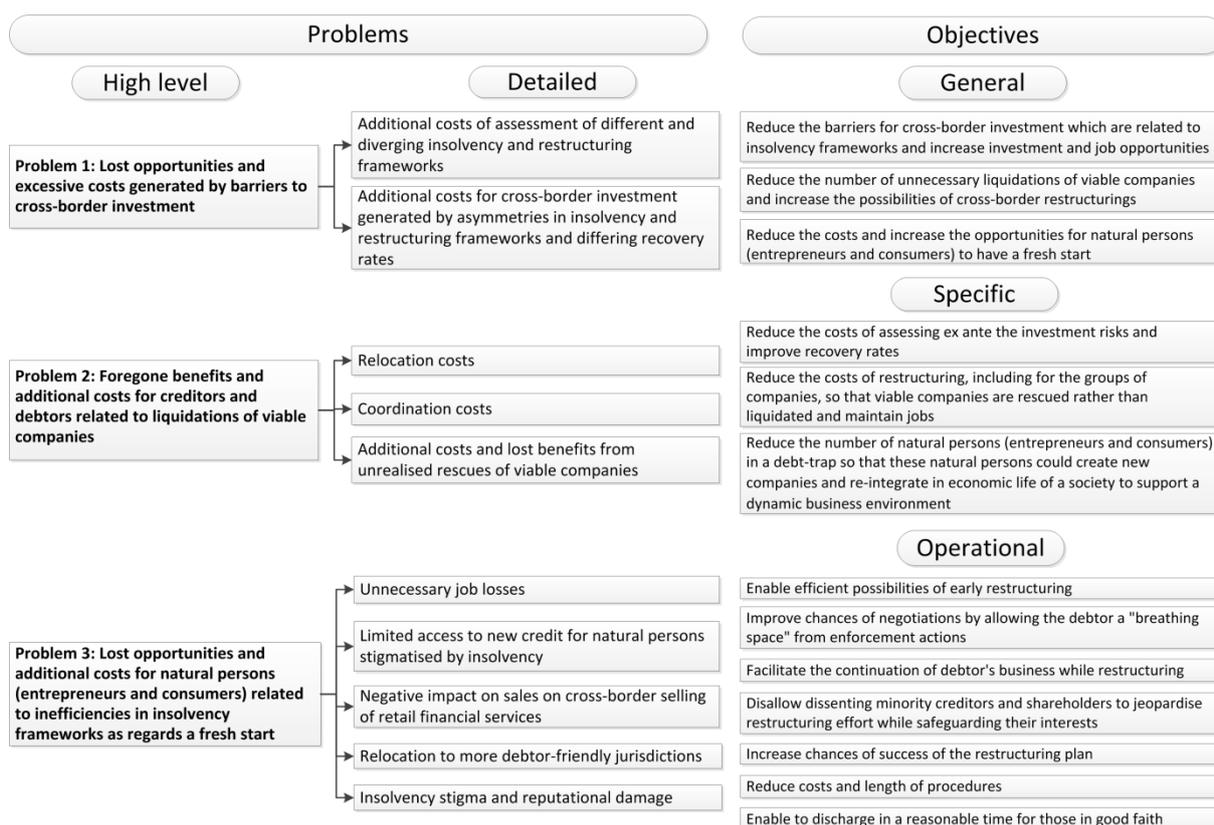
- Reduce the barriers for cross-border investment which are related to restructuring and insolvency frameworks and increase investment and job opportunities in the internal market
- Reduce the number of unnecessary liquidations of viable companies and increase the possibilities of cross-border restructurings in the internal market
- Reduce the costs and increase the opportunities for honest entrepreneurs to be given a fresh start

Specific

- Reduce the costs of assessing ex-ante the investment risks and improve recovery rates
- Reduce the costs of restructuring, including for groups of companies, so that viable companies are rescued rather than liquidated and maintain jobs
- Reduce the number of entrepreneurs who would need to relocate to escape a debt-trap and thus reduce costs of second chance and increase the number of persons who would re-integrate in the economic life to support a dynamic business environment

Operational objectives

- Enable efficient possibilities of *early restructuring*
- Improve chances of negotiations by allowing the debtor a "breathing space" from enforcement actions (*stay/moratorium*)
- Facilitate the continuation of debtor's business while restructuring (*debtor in possession*)
- Disallow dissenting minority creditors and shareholders to jeopardise restructuring efforts while safeguarding their interests (*majority voting; inter-class cram-down; treatment of shareholders in restructuring*)
- Increase chances of success of the restructuring plan (*protecting new financing; safe harbour for non-related party transactions; release of third parties*)
- Reduce costs and the average length of all types of restructuring, insolvency and second chance procedures (*minimum necessary court involvement in restructuring and second chance frameworks, raising court expertise, capacity to respond quickly, use of modern technology; harmonise quality of the profession of the insolvency practitioners*)
- Enable discharge in a reasonable time for entrepreneurs who are acting in good faith



4. HIGH-LEVEL OPTIONS

4.1. Description of high level options

Option 1: Maintaining the status quo (baseline scenario)

The expected evolution of status quo is described in section 2.4.

Option 2: Setting up a fully harmonised preventive restructuring procedure and a second chance framework

Under this option, key elements of at least one type of preventive restructuring procedure would be fully harmonised. For restructuring, in addition to the main principles which were defined in the 2014 Recommendation, many more rules would need to be harmonised, including for example the definition of 'insolvency' or 'likelihood of insolvency', the majorities required for plan adoption (e.g. a plan should be adopted by 75% in value of creditors' claims), the treatment of shareholders in restructuring (e.g. whether they should be treated as a separate class and given a right to vote or not) and protection on new financing (e.g. whether new financing should be given super-priority status in subsequent insolvency proceedings). Other more technical rules which make up national restructuring frameworks are those relating to whether to bifurcate secured claims according to the value of the collateral, or how to treat contingent and contested claims. On second chance, such harmonisation may include rules on the conditions for repayment plans, on filing of claims, on determining the disposable income of natural persons from which creditors can be repaid for the period of the discharge period etc.

Option 3: Introducing an alternative, optional EU restructuring and second chance regime for cross-border cases

This option would imply establishing, alongside national restructuring and insolvency procedures, an alternative EU procedure which could be chosen by the party initiating it, for example, the debtor, or the creditors with the debtor's consent¹⁵⁶. This European procedure could be available in principle in both cross-border insolvency cases and in domestic cases¹⁵⁷, but the experience with other European civil procedures shows that Member States will not accept the application of European procedures to purely domestic situations¹⁵⁸. In order to operate as a stand-alone restructuring and second chance framework, this option would require a full harmonisation as described in Option 2 above.

An optional regime available in both cross-border and domestic cases would need to be based on Article 114 TFEU. An optional regime available in cross-border cases only would need to be based on Article 81 TFEU on judicial cooperation in civil law matters.

Option 4: Setting up a minimum harmonised legal framework in the area of restructuring and second chance for entrepreneurs

High level principles accompanied by more targeted rules where necessary would follow in the steps of the 2014 Recommendation and provide an appropriate follow up response. It would allow Member States to choose the means of implementing these principles and rules. For example, the rule that creditors should vote in separate classes on the adoption of the plan, would need detailed rules on for example on how to deal with secured claims where the value of the collateral is lower than the claim (whether to bifurcate such claims or not). National law will also need to specify the majority(ies) needed to adopt a plan, be it one single majority in all classes (either simple majority or qualified majority), or different majorities for different classes (e.g. simple majority for unsecured creditors' class, qualified majority for secured creditors' class). Whilst the general rules would be established at the EU level to ensure coherence and consistent application, the detailed implementation rules would be established in national law .

This option would make binding the principles and rules set out in the 2014 Recommendation, but would significantly reinforce the framework with additional efficiency elements. For restructuring frameworks, such rules would be for example include early warning tools, the treatment of shareholders in restructuring procedures, the protection for interim financing necessary to keep the operations going throughout the negotiations; the duties of directors in the vicinity of insolvency. Furthermore, rules on the effectiveness of all restructuring, second chance as well as formal insolvency procedures could be envisaged, such as rules on the specialisation of judges and/or courts, on enhancing the quality of insolvency practitioners and on digitisation of procedures.

¹⁵⁶ Several responses to the Green Paper consultation on a Capital Market Union pointed to the desirability of such a regime. (Feedback Statement on the Green Paper "Building a Capital Markets Union" (Question 29), SWD(2015) 184 final, 30.9.2015, p. 59 and foll.)

¹⁵⁷ As opposed to Option 2, this option would leave national laws untouched. Jurisdiction would be established by the Insolvency Regulation on the basis of the COMI principle, but the law applicable to the proceedings would be the European procedure rather than the law of the COMI state (to make this possible, a modification of the Insolvency Regulation would be necessary).

¹⁵⁸ See for example the European Account Preservation Order, the European Small Claims Procedure, the European Enforcement Order.

4.2. Analysis of high level options and discarded options

Option 1: as already demonstrated in the assessment of the baseline scenario (point 2.4 above), if no further action is taken, the solutions between Member State laws will continue to diverge. This is likely to lead to important delays in concluding insolvency procedures and a low success rate for cross-border restructurings which would ultimately result in more unnecessary liquidations of viable companies, instead of restructuring and entrepreneurs and consumers being trapped in debt for too long¹⁵⁹. It would also be a deterrent to cross-border investments. This option needs therefore to be discarded.

Option 3 (optional instrument) has to be discarded as well since creating a European procedure competing with national procedures could prove highly contentious without bringing the desired benefits. First, litigations would arise in situations where at least some of the creditors would have more rights or more favourable treatment under the otherwise applicable domestic law¹⁶⁰. Second, debtors (when initiating the restructuring) and creditors (when considering whether to support the restructuring efforts) would likely make an assessment of whether the European or the domestic procedures are better suited for their interests. This assessment exercise – whether carried out *ex ante*, when investing or trading cross-border, or *ex post* when restructuring efforts start – would increase legal costs, decrease legal certainty and, in the *ex post* scenario, delay the restructuring procedures¹⁶¹. For the same reasons, a fully-fledged discharge framework for entrepreneurs and consumers defined at the EU level would not be a feasible variant either. Third, an optional instrument would not guarantee the necessary uptake to address the EU level scale of the problem and would likely not be applied by Member States anyway.

Additionally, there are also some political constraints to be considered under this option. Although in principle an optional regime could stand alongside national regimes and be 'chosen' in domestic cases also, this option would most probably be restricted in scope to cross-border insolvencies, as several European procedures show¹⁶².

Option 2 (full harmonisation) would facilitate the restructuring of groups of companies, increase legal certainty and reduce risk assessment costs for investors investing in more than one Member State. It would also reduce the number of unnecessary liquidations of viable companies in favour of successful restructurings. For such a solution to work efficiently, harmonisation of certain key formal insolvency aspects, such as the ranking of claims and avoidance actions in the event of the insolvency of the debtor, would also be necessary,

¹⁵⁹ The Commission Recommendation on restructuring and second chance may continue to inspire certain Member States to reform their laws, but it would not achieve a level playing field in terms of restructuring opportunities. Furthermore, in those areas which were not covered by the Recommendation on restructuring and second chance, such as the treatment of shareholders or the provision of interim financing, there will be little guidance to Member States on common best practices. This would most likely lead to an entrenchment of a few differing regulatory models rather than to an EU-wide convergence.

¹⁶⁰ At the same time, dissenting creditors and shareholders could legitimately argue that their rights are lowered as compared to what they receive under otherwise applicable domestic procedures.

¹⁶¹ In order to work properly, a European procedure would have to be self-standing and make no or limited reference to national laws (there are similarities here with Option 2). Such a European procedure would likely be based on Article 81 TFEU, which means that Denmark will not be bound by it and that United Kingdom and Ireland would have an opt-in possibility, which means that the internal market would not anyways be covered in its entirety.

¹⁶² E.g. the European Order for Payment Procedure, the European Small Claims Procedure.

including a single maximum discharge period for natural persons across the EU¹⁶³. While this option would be most effective in ensuring full legal certainty of insolvency laws across the EU, it would at this juncture be premature, too intrusive and does not seem feasible as an initiative at this stage given the current diversity in Member States' restructuring and insolvency frameworks¹⁶⁴ and the political reticence that such a proposal would face. This option must also be discarded, as politically unfeasible and clearly disproportionate.

Option 4, i.e. a binding instrument in the form of a Directive setting up a minimum harmonised framework covering a number of key aspects is conducive to effectively achieving the policy objectives in the areas of restructuring and insolvency¹⁶⁵, which are highly regulated at the national level.

It is true that in terms of addressing the full spectrum of drivers identified as triggering difficulties due to fragmented national legislation this option could be considered to remain below that of Option 2 (full harmonisation). However, fully harmonised rules in relation to these problems may seem to be a preferable solution only at first sight, but not necessary a workable solution required for overcoming the full set of problems. More specifically, a full harmonisation of insolvency law in general is a very complex option, not advisable at this stage for several reasons.

Firstly, account needs to be taken of the fact that these drivers are not isolated but have to be considered in the context of the entirety of national insolvency tools and that a certain degree of flexibility is needed to enable Member States to apply them in a suitable fashion. A minimum harmonization Directive would allow Member States to retain the most appropriate means to make those tools work in their national context. Secondly, in the light of numerous links of insolvency law with connected areas of national law, such as tax law, employment law, social security laws (to a good extent outside EU competence), fully harmonising only insolvency law could still not produce the desired effect of complete uniformity. Therefore, continuing to have a certain level of differences between Member States' regulations (and as a consequence still some costs relating to the need to identify and assess these differences), appears unavoidable. And thirdly, consideration of subsidiarity and proportionality of the EU intervention would have to be duly considered as regards a full harmonisation of insolvency related aspects.

Option 4 would be a tangible approach to substantial convergence of national frameworks based on key common rules applicable in all Member States to companies in financial difficulties, but viable and therefore susceptible to successful restructuring, as well as on the other individual aspects highlighted in this document. This would ensure major progress towards a functioning internal market. Under such a convergent framework cross-border investment would no longer be inhibited by concerns that, for example, preventive restructuring of the debtor is not effectively possible in all Member States or that shareholders may bloc a plan which is supported by creditors.

¹⁶³ This alternative would also probably require a harmonisation of the procedures themselves leading up to a discharge.

¹⁶⁴ It would also be probably very difficult to agree on such a complex new instrument, given the links of insolvency law with connected areas of law, such as tax law, employment law, social security laws.

¹⁶⁵ The 2014 Recommendation on restructuring and second chance was not coherently implemented across the EU due to its non-binding character.

For these reasons, it appears most appropriate to consider high-level Option 4 the preferred option and to assess in detail a number of sub-options only with regard to this high-level Option.

In terms of the material scope of a minimum harmonized legal framework, Option 4 focuses on early restructuring and second chance frameworks, but also aims at achieving more effectiveness of formal insolvency (liquidation procedures) and at amending such procedures in order to make early restructuring more attractive.

As regards early restructuring, the key aspects for consideration are as follows:

- the objectives of increasing recovery rates for creditors, saving jobs and know-how is best served by early restructuring of a viable company than by liquidation;
- early restructuring is also the first port of call for transforming a non-performing loan into one which performs;
- currently, the early restructuring frameworks in the Member States are developing, but there is little coherence between them,
- given the current diversity of rules, it is impossible to have a restructuring of a cross-border group of companies with members in more than two MS;
- the need to focus on restructuring rather than liquidation was confirmed by the results of two public consultations (one on CMU in spring 2015 and one on restructuring, insolvency and second chance in spring 2016), by discussions with a specially created expert group and a group of stakeholders representing a wide range of interested parties as well as by the two meetings with governmental experts from the Member States.

As for liquidation procedures, a thorough analysis of what could be harmonized for the purposes of improving the effectiveness of the procedures was performed. On the basis of this analysis only provisions directly linked with shortening the length of such procedures and to making early restructuring effective appear adequate to be covered at this stage by this EU initiative for the following reasons:

- in liquidation, the most important is legal certainty and the speed of the procedures, hence the provisions on courts, insolvency practitioners and digitalisation of procedures which are horizontal
- harmonising substantive liquidation issues such as the definition of insolvency, ranking of claims and avoidance actions would touch upon fundamental values in the Member States, such as the protection of workers and the safeguarding of security rights.
- in liquidation, there are important links with other areas of law, such as company law (definition of insolvency), property law (ranking of claims and avoidance actions), criminal law (disqualification of directors) which makes harmonization on the basis of minimum standards a disproportionately complex exercise.
- early restructuring happens 'in the shadow' of the alternative, which are formal insolvency (liquidation) procedures. For this reason, insolvency rules on avoidance actions need to be adapted to ensure that the early restructuring of companies in

difficulty is attractive for new investors and creditors, i.e. provides for sufficient guarantees that their investment will be protected in subsequent insolvency procedures.

Nevertheless, the measures to increase the effectiveness of the procedures have a horizontal scope and are equally valid for restructuring and for liquidation, or indeed second chance. In all types of procedures timing is of the essence: increasing the specialisation of courts and the professionalism of insolvency practitioners and by introducing the digitalisation of all types of restructuring and insolvency procedures should be able to address these issues. As a means to ensure the effectiveness of procedures, the collection and analysis of data on number and outcome of restructuring and insolvency procedures is of paramount importance.

Some elements of substantive law could therefore not be addressed at this stage, given the current diversity in Member States' restructuring and insolvency frameworks: harmonising the definition of insolvency, ranking of claims and avoidance actions (with the exception of those actions concerning transactions directly linked to preventive restructuring) would touch upon fundamental values in the Member States, such as the place of workers and of state creditors, and the safeguarding of security rights.

Because an initiative could not at this stage reasonably be able to fully harmonise all insolvency-related aspects, investors would still face additional costs when assessing or defending their rights in restructuring and/or insolvency. It is certain however that costs will be significantly reduced for investors.

First, the minimum harmonisation of some restructuring rules would mean that investors may still need to assess their position in the jurisdiction of the COMI state. For example:

- investors will have legal certainty as to the fact that a debtor in financial difficulties will have the right to a temporary, limited in time stay of individual enforcement actions and that they (the investors) will have a right to ask for the stay to be lifted in certain circumstances; however, investors may still need to investigate in which Member States that stay can be prolonged and for how long;
- while it will be possible to adopt restructuring plans by a majority of creditors and while creditors will have the certainty that they will have voting rights proportionate with the amount of their claim and in a class of similar claims, there will still be differences as to the exact proportion of claims needed under national law to adopt a plan;
- investors will have legal certainty that new and interim financing is protected everywhere in the EU from avoidance actions, but new investors may wish to know in which Member States they will be given even better protection by way of super-priority status in subsequent liquidation procedures;
- finally, even if it is not possible to harmonise at this stage the ranking of claims in the event of liquidation under national law, by incorporating the best interest of creditors' test and the absolute priority rule into the restructuring framework, creditors will have legal certainty as to the *de minimis* returns they have a right to in restructuring procedures.

Second, leaving large parts of the liquidation procedures non-harmonised would indeed mean that investors would still experience additional costs needed to assess ex-ante their rights where the debtor goes into liquidation as well as ex-post costs to manage liquidation

procedures in Member States where they have not contemplated that the COMI will be situated. However, even in the absence of harmonisation of liquidation procedures, this proposal would have positive effects in terms of increasing legal certainty for creditors, e.g. *vis a vis* avoidance actions of new and interim financing given in preventive restructuring procedures or the reduction of length of liquidation procedures and the increased participation of creditors via distance means - both leading to higher recovery rates for creditors.

Third, a discharge of debt alone may in some Member States not be enough to allow the entrepreneur to take up a new business activity. For example, where bankruptcy triggers a disqualification order which lasts for longer periods of time and which may be issued without consideration being given to whether the entrepreneurs was acting in good faith or not. In order to give honest entrepreneurs an effective second chance, disqualification orders linked to over-indebtedness should also be limited in time to expire at the latest when the discharge period ends. Other potential impediments to second chance stemming from the retention and use of personal data linked to an entrepreneurs over-indebtedness beyond a certain period of time, for example in credit rating databases, are sufficiently addressed by the provisions of the General Data Protection Regulation¹⁶⁶.

On second chance aspects, this option would give Member States the flexibility to determine the most appropriate means to achieve the following objectives:

- access of all honest debtors to a full discharge of debt after no more than 3 years;
- debtors must have effective access to early warning tools, just as business debtors;
- debtors unable to pay any part of their outstanding debt could be provided an opportunity of discharge without obligation of repayment;
- on expiry of the discharge period, debtors would be discharged of their debts without the need in principle to re-apply to a court.

As personal debts of professional and non-professional nature are often intertwined (and also that of families), Member States could try to consolidate such proceedings to achieve a coherent outcome, or, at the very least, should coordinate them.

As to consumers, their discharge treatment is in many Member States not different than that for entrepreneurs. Indeed, there is no apparent reason why consumers should have a different discharge regime than entrepreneurs: in both cases what is at stage is the personal liability of the debtor and in most cases it is very difficult or even impossible to distinguish between the professional and non-professional debts of the debtor¹⁶⁷. However, in view of the business focus of this initiative and its objective to primarily tackle internal market problems relating to the investment of capital and the freedom of establishment for entrepreneurs as self-employed persons and in view of the differences between discharge periods for entrepreneurs and consumers respectively particularly as regards the degree of an internal market problem¹⁶⁸ binding rules for consumer discharge periods should remain outside the scope of a potential

¹⁶⁶ Regulation (EU) 2016/679 of the European Parliament and of the Council on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC, OJ L 119/1, 4.5.2016.

¹⁶⁷ Since the adoption of the 2014 Recommendation on restructuring and second chance, several Member States introduced discharge procedures for the first time or shortened discharge periods under the existing procedures (see recent reforms in Spain, Romania, Hungary, Croatia or Poland).

¹⁶⁸ Point 2.6 above.

instrument. Nevertheless, taking into account that many Member States treat the discharge and second chance for natural persons in the same way irrespective of whether the indebted person is a consumer or entrepreneur it should remain possible and be encouraged, if outside the context of legal obligations, to coordinate of debt resolution procedures regarding sole entrepreneurs and consumers. Concrete sub-options concerning consumer discharge will be assessed in the light of these considerations.

5. SUBSTANTIVE SUB- OPTIONS AND ANALYSIS OF THEIR IMPACT

To achieve the objectives above, various substantive sub-options can be envisaged. The choice between the various substantive sub-options has no influence on the type of the instrument.

The objective of the instrument is to ensure that certain essential minimum standards are in place. As to the parameters of the restructuring procedure to be harmonised, the described substantive options are those which have most impact on ensuring a swift and efficient procedure. In general, these elements (i) early restructuring, (ii) shorter discharge periods for entrepreneurs, (iii) raising the quality and efficiency of courts and insolvency practitioners and (iv) digitalisation in all types of restructuring and insolvency procedures (including liquidation).

On most points, it suffices to introduce clear general principles without entering into too detailed and prescriptive regulation (e.g. shareholders should not be able to block a restructuring, debtors should remain in control of their assets and affairs). On certain points, however, it is necessary to be more specific in order to ensure a useful effect of the instrument. For instance, in order to prevent obstructing shareholders from blocking the adoption of a restructuring plan, the general principle should be established while leaving to Member States the exact details of how this may be achieved. On the other hand, when it comes to the stay of enforcement actions, one needs to address the duration of the stay and the conditions for its extension need to be addressed in order to meet creditors' concerns and reduce the length of restructuring procedures. The period of the stay (in principle no more than 4 months) has been established by looking at recent reforms in Member States e.g. DE, FR, ES, IE, PT, SI).

For the key sub-options on debtor-in-possession, stay of enforcement, cram-down, new finance the inspiration came originally from the work of INSOL Europe at the time of the 2014 Recommendation on restructuring and second chance¹⁶⁹, from best practices in this area, from the elements of restructuring identified in the World Bank Index, from the review of the implementation in the Member States. These rules have been further developed with the assistance of a specially created representative group of restructuring and insolvency experts from across the EU, also in the light of the results of two specific public consultations, on Capital Market Union (spring 2015) and on restructuring, insolvency and second chance (spring 2016) . For example, a new rule on the effects of the stay on early termination clauses in contracts was suggested by this group, as was the additional rules on safe harbour from avoidance actions provisions (there was high support for harmonising the rules on avoidance actions in the 2016 public consultation). Some other rules were inspired by the responses to

¹⁶⁹ Study on a new approach to business failure and insolvency – Comparative legal analysis of the Member States' relevant provisions and practices (INSOL Europe, 2014).

the public consultation (e.g. the rules on early warning are supported by Business Europe, UEAPME and other business organisations, those on the specialisation of courts and IPs are supported by the Association of Financial Markets in Europe). Where valid concerns were advanced by stakeholders, certain sub-options were not retained: this is the case with the rule on the release of third party guarantees.

Operational objective (Driver)	Sub-options: building blocks of the proposed framework		
EFFECTIVE RESTRUCTURING FRAMEWORK			
5.1. Enable early restructuring (Rules on the possibility of restructuring at an early stage)	Sub-option 1 The procedure is available when a viable debtor is in financial difficulties and there is a likelihood of insolvency.	Sub-option 2 Sub-option 1 + over-indebted but viable debtors must have a clear possibility to enter preventive restructuring.	Sub-option 3 Sub-option 2 + early warning tools (advice and/or alert systems) + model restructuring plan.
5.2. Improve chances of negotiations by allowing debtor a 'breathing space' (Rules on stay of enforcement actions (moratorium))	Sub-option 1 Moratorium affects individual enforcement actions and suspends formal insolvency proceedings.	Sub-option 2 Sub-option 1 + suspension of the right of essential suppliers to avail themselves of early termination clauses.	Sub-option 3 Sub-option 2 + moratorium of a short, limited duration no longer than 4 months and giving creditors right to ask for lifting the stay.
5.3. Facilitate continuation of debtor's business while restructuring (debtor in possession) (Rules on debtor-in-possession)	Sub-option 1 Debtor remains in possession, but Member States may enable courts to appoint a mediator and /or a supervisor.		Sub-option 2 Debtor remains in possession but a mediator or a supervisor is always appointed.
5.4. Disallow minority creditors and shareholders to jeopardise restructuring efforts (Rules on the preparation and adoption of restructuring plans)	Sub-option 1 The plan is adopted if the required majority in every class is in favour of the plan, provided that the minority creditors are not unfairly prejudiced; all classes of creditors can be affected by the plan, vote and be bound by it, including secured creditors	Sub-option 2 Sub-option 1 + Member States may also provide that the plan can be adopted if the required majority in at least one class of creditors is in favour of the plan, provided that dissenting classes are not unfairly prejudiced (inter-class cram-down).	Sub-option 3 Sub-option 2 + principle that shareholders should not be able to block the plan if their interests are protected (e.g. by including shareholders as class(es) of their own).
5.5. Increase chances of success of the restructuring plan (Rules on provision of new financing in restructuring)	Sub-option 1 Exempting new financing contained in the restructuring plan from avoidance actions. Member States may also provide for super-priority status to new financing, ranking it at least above unsecured creditors	Sub-option 2 Sub-option 1 + Non-related party transaction entered into before insolvency, but in connection with a restructuring plan adopted by creditors shall be exempted from avoidance actions (safe harbour provisions).	Sub-option 3 Sub-option 2 + limited co-obligors' and guarantors' releases under the plan

<p>5.6. Reducing the formalities relating to court proceedings (Intensity of courts' and insolvency administrators' involvement)</p>	<p>Sub-option 1: A flexible framework, which allows for a more limited involvement of courts.</p>	<p>Sub-option 2 Sub-option 1 + use of modern technology such as electronic voting</p>	
SECOND CHANCE FOR NATURAL PERSONS			
FOR ENTREPRENEURS			
<p>5.7.1. Enable the discharge for natural persons in a reasonable time for those in good faith (Rules on debt restructuring for natural persons - entrepreneurs, including discharge and second chance)</p>	<p>Sub-option 1: Discharge of debts for entrepreneurs within 1 year from start of liquidation proceedings, with limited exceptions.</p>	<p>Sub-option 2: Discharge of debts for entrepreneurs within 3 years from when liquidation proceedings are open or the repayment plan starts being implemented, with limited exceptions.</p>	<p>Sub-option 3: Sub-option 2 + the possibility to consolidate all personal debts of the entrepreneur in one procedure, be they business or non-business in nature</p>
FOR CONSUMERS			
<p>5.7.2. Enable the discharge for natural persons in a reasonable time for those in good faith (Rules on debt restructuring for natural persons - consumers, including discharge and second chance)</p>	<p>Sub-option 1: Discharge of debts for consumers within 1 year from start of liquidation proceedings, with limited exceptions.</p>	<p>Sub-option 2: Possible discharge of debts for consumers within 3 years from start of liquidation proceedings or the start of implementation of repayment plan, with limited exceptions.</p>	
EFFECTIVENESS OF RESTRUCTURING, SECOND CHANCE AND INSOLVENCY PROCEDURES			
<p>5.8. Reduce average length of procedures to 2 years or less in all Member States (Rules to increase effectiveness of procedures)</p>	<p>Sub-option 1: specialisation of judges, training and professional standards for practitioners in the area of restructuring, insolvency and second chance</p>	<p>Sub-option 2 S/o 1 + digitisation of court procedures</p>	<p>Sub-option 3: S/o 2 + monitoring and data collection on number and outcome of procedures</p>

5.1. Early restructuring possibility

5.1.1 Description of sub-options

Sub-option 1: Since the concept of 'likelihood of insolvency' is not defined in the Insolvency Regulation, one option would be to simply leave it up to the Member States to define the concept, however diverse their approaches.

Sub-option 2: Legal certainty could be enhanced by having a common definition of 'insolvency' or at least of 'likelihood of insolvency'. However, Member States are almost unanimously opposed to such a harmonisation. Nevertheless, the situations could be improved if Member States which apply the over-indebtedness test as a trigger for the duty to file for insolvency would enable directors of viable debtors to enter preventive procedures at any time before the business becomes illiquid.

Sub-option 3: it is not sufficient to enable debtors to restructure at an early stage. Additional measures need to be taken to incentivise SMEs in particular to access early restructuring procedure. For example, SMEs should be helped to detect early their financial difficulties and to obtain support in drafting good restructuring plans and making the necessary disclosures to creditors adaptable to the needs of every SME.

5.1.2. Assessment of impact of the sub-options and the preferred sub-option

Sub-options	Sub-option 1	Sub-option 2	Sub-option 3
<i>Sub-option summary</i>	Restructuring framework available when viable debtor is facing a 'likelihood' of insolvency.	Sub-option 1 + over-indebted but viable debtors must have a clear possibility to enter preventive restructuring	Sub-option 2 + early warning tools (advice and/or alert systems) + model restructuring plan
Impacts			
<i>Reduced costs of assessing risk by investors</i>	<p>+</p> <p>The risk that debtors could not access early restructuring would be removed, but the intricacies in determining if the conditions of 'likelihood of insolvency' are met in each Member States would still be costly. In particular, investors would face uncertainty in MS where the debtor might have a duty to file for formal insolvency proceedings when over-indebted.</p>	<p>++</p> <p>Ensuring that viable businesses can access restructuring procedures when over-indebted but not illiquid everywhere in the EU will increase legal certainty for investors and, thus, reduces the costs with risk assessment even more. The potential risk of moral hazard could be addressed by a safeguard ensuring that when debtors are illiquid courts should decide whether to allow the debtor to continue the restructuring efforts or whether the channel them toward liquidation.</p>	<p>+++</p> <p>An early warning mechanism may lead to debtors taking action earlier rather than later, and therefore indirectly to lower risks for investors.</p>
<i>Reduced costs of restructuring, in particular of cross-border groups</i>	<p>+</p> <p>Being able to access restructuring proceedings before a duty to file for formal insolvency will enable the early restructuring of each member of the group, thus ensuring the higher benefits of early restructuring (e.g. higher returns to creditors) for the group as a whole.</p>	<p>++</p> <p>As compared to Sub-option 1, this sub-option would further reduce costs, because group members in countries where over-indebtedness may trigger a duty to file would have increased legal certainty that they can access such restructuring procedures before they are illiquid. The restructuring of several members of the group or even the entire group could then be launched in tandem</p>	<p>+++</p> <p>The availability of a model restructuring plan may facilitate the adoption of a coherent group plan, especially when the group members are SMEs.</p>

		in the different jurisdictions.	
<i>Effectiveness</i>	+	++	+++
	Increase the number of preventive restructuring procedures, and consequently of business and jobs being saved, increase creditors' recovery rates including state creditors, and increase productivity since only profitable parts of the business are likely to survive while other resources can be reallocated.	As compared to Sub-option 1, this sub-option will further increase the number of businesses potentially accessing preventive restructuring possibilities.	In helping SMEs detect earlier signs of financial distress and helping them draft good quality restructuring plans, this Sub-option would represent an improvement compared to Sub-option 2.
<i>Legal systems</i>	-	--	--
	This sub-option would enlarge the restructuring possibilities for debtors in those Member States where restructuring procedures are available only if the debtor is actually insolvent or his insolvency is 'imminent'. Sub-sequent changes may be needed in company law for example.	This sub-option will require that in some Member States the restructuring framework is amended to allow a clear choice for debtors in financial difficulty between preventive restructuring and formal insolvency proceedings. Sub-sequent changes may be needed in company law for example.	Some Member States may need to provide for early warning tools, but these may not necessarily be costly (e.g. making information publicly available on-line, requiring that Chambers of Commerce provide advice). Almost all Member States will need to implement national model restructuring plans (UK is an exception).

Summary assessment of the preferred sub-option: Sub-option 3 is the preferred sub-option since it ensures an early possibility of restructuring which can be effectively used also by SMEs. By lowering the thresholds on access to such procedures, the preferred sub-option will ensure a higher number of applications from viable enterprises at an early stage. Certain **downside risks** which could be associated with the possibility of early restructuring have been identified and can be addressed in a proportionate manner. First, there may be a concern that allowing the debtor an easy access to preventive restructuring procedures will lead many unviable enterprises in financial difficulties to enter restructuring negotiations simply to postpone the moment of filing for insolvency and thus potentially deplete assets from the insolvent estate. On the other hand, a too restrictive access into such procedure discourages debtors and translates in very low numbers of filings. There should be therefore a balance between the possibility of debtors to enter easily into such procedures, but at the same time to have in place possibilities for creditors to terminate negotiations where they are not likely to lead to a successful restructuring. Second, this sub-option may bring about a risk of misuse or high costs. However, the fact that there need to be a likelihood of insolvency suggests a real threat to the existence of the company.

This sub-option does not have negative impacts on **fundamental rights**, as most Member States have now recognised that the need to safeguard the rights of creditors must be balanced against the general interest of saving companies and jobs, and for this reason some interference with (dissenting) creditors' rights in order to make restructuring effective is justified. The **social impacts** of such procedures should be positive, as one of the main objectives of early restructuring procedures is to save jobs by saving the companies which employ them. While it is true that as a result of a restructuring some jobs might be lost, such losses would have to be expected as being greatly lower than in a liquidation scenario, and

putting a company back on a growth path has also the potential of creating new jobs. For example, the restructuring of an old-fashioned factory may require the introduction of more modern technologies which require less operating personnel. But the loss of machine-operating jobs may be compensated by the creation of other types of jobs, such as product design, sales or marketing.

Most Member States supported the idea of early restructuring already at the time of the Recommendation on restructuring and second chance. In the performed public consultation the majority of respondents were in favour of early restructuring procedures while a smaller part believed that restructuring should be available at any time. Member States¹⁷⁰ agreed on the necessity of preventive measures enabling early restructuring of viable businesses. During the dedicated meetings with the Member States, they were of the view that when the viability of the business is threatened due to over-indebtedness, the businesses should have a right to access an early restructuring framework. However, almost all MS (e.g. AT, EE, FI, DE, IE, PL, PT, ES, SE) were opposed to harmonising the definition of insolvency or that of the likelihood of insolvency. All the Member States advocated for early warning mechanisms and tools, but there was no consensus regarding the modalities how these systems should be established and operated (whether they should be funded and monitored by the State or by the private sector). As for model restructuring plans, although the majority of Member States expressed concerns regarding the effectiveness, they were in favour as long as these models are optional and can be adapted to each case.

The business sector (Eurochambers, Independent Retail Europe, EUAPME) was strongly in favour of early restructuring for viable businesses when there is a likelihood of insolvency and they underlined the importance for early warning tools. Some business organisations (Independent Retail Europe, EUAPME) also stressed that models for restructuring plans could be used as a starting point in order to reduce costs for SMEs, as long as they are optional and flexible.

Legal practitioners, insolvency practitioners and academics were in favour of early restructuring for viable debtors, when there is a likelihood of insolvency, including when the viability of the business is threatened due to over-indebtedness. They were also in favour of early warning mechanisms and facilitating access to advice. As for the model restructuring plans, although some professionals (ACCA) expressed feasibility concerns, others (CCBE, ELI) were in favour.

The financial sector (EBF, AFME) supported option 3 and advocated for more efficient alert mechanisms, such as tax and social security authorities flagging a negative development of a business.

Trade unions (ETUC) agreed that an early restructuring framework should be available to viable debtors in financial difficulties when there is a likelihood of insolvency. However, they reminded of abusive practices by which insolvency proceedings, and in particular restructuring, are deliberately used to evade responsibilities under labour law. An easier access to preventive restructuring framework should be counterbalanced by safeguards against 'tactical insolvencies', for the protection of workers' rights. Additionally, they advocated that the EU labour *acquis* should not be affected.

¹⁷⁰ 18 Member States replied (AT, DE, EL, CZ, EE, MT, PL, SK, SE, SI, LT, LV, HU, FR, IT, IE, FI and BE), but several asked for their contributions to remain confidential.

5.2. Stay of enforcement actions (moratorium)

5.2.1. Description of sub-options

Sub-option 1: In order to ensure that the debtor can effectively conduct restructuring negotiations, the legal framework must allow it a 'breathing space', i.e. the possibility to address the problem of hold-out creditors who might have an interest in enforcing their individual claims immediately rather than participate in the negotiation process and saving the debtor. The exact configuration of the stay can vary but it should also suspend the duty to file for formal insolvency procedures in order to be effective.

Sub-option 2: Contracts usually contain clauses enabling one of the parties to terminate early or the counter-party enters insolvency proceedings. Such clauses are also often extended to situations where the debtor enters restructuring procedures. As a minimum, such clauses should not be enforceable for the period of the stay in respect of essential supplies necessary for the continuation of the business.

Sub-option 3: Creditors' rights are safeguarded by limiting the duration of the stay and by giving them the right to ask for the stay to be lifted in certain circumstances.

5.2.2. Assessment of impact of the sub-options and preferred sub-option

Sub-options	Sub-option 1	Sub-option 2	Sub-option 3
<i>Sub-option summary</i>	Moratorium which suspends individual enforcement actions and the duty to file for formal insolvency proceedings.	Sub-option 1 + suspension of the right of essential suppliers to avail themselves of early termination clauses.	Sub-option 2 + moratorium of a short, limited duration no longer than 4 months and giving creditors the right to ask for lifting the stay.
Impacts			
<i>Reduced costs of assessing risk by investors</i>	<p>+</p> <p>In principle, the more elements are harmonised across the EU, the lower the costs for investors in assessing risks in different MSs, and the more favourable the conditions for lending. A stay which suspends the enforcement actions to address the hold-out problem gives investors a better</p> <p>The risk on the one hand that the debtor might become illiquid before the stay period expires and still be allowed the benefit of the stay and on the other hand that significant restructuring efforts could be wasted if the procedure is stopped and the debtor channelled to insolvency/liquidation, can be addressed by requiring</p>	<p>++</p> <p>Investors will be able to predict better the chances of survival of their distress debtor if during the stay the essential supplies are kept in place to ensure that the debtor can continue operating relatively normally for the period of the stay.</p>	<p>+++</p> <p>This option adds important safeguards to creditors that the stay will not be abused in order to delay formal insolvency procedures and in the meantime to deplete the estate of important assets. As such, this sub-option will reduce more costs for investors first because they will have more predictability across the EU on the length of the stay and the conditions for the lifting of the stay.</p>

	the intervention of a court on whether to allow the procedure to go on or not.		
<i>Effectiveness</i>	<p>+</p> <p>Suspension of individual enforcement actions means, first, protection of normal activity of the debtor and preservation of value for the estate and consequently for the investors etc. It also ensures an equal situation for all creditors. According to a UK report, a stay on debt collection for viable businesses in distress should enable businesses to restructure more easily and deliver improved business rescue outcomes, it is estimated that this will deliver benefit to creditors of between £2m and £60m, with a best estimate of £31m per year¹⁷¹.</p>	<p>++</p> <p>If during negotiations on a restructuring plan, trade creditors who have the benefit of a clause allowing them to terminate their contract unilaterally in the event of the insolvency of the debtor would cease supplying the debtor, the debtor would not be able to continue operating the business. Stay should therefore be extended to the enforcement of early termination clauses. However, as a means of protecting affected suppliers, they should be paid in full during the stay period and such payments be protected from avoidance actions in subsequent insolvency procedures.</p>	<p>+++</p> <p>A limited, short period of the stay provides an incentive to speed up the negotiations between the debtor and his creditors.</p> <p>The short stay period will reduce the length of the procedure in Member States where restructuring procedures last too long (e.g. up to 24 months in LU, up to 18 months in FR), to the detriment of creditors. At the same time, where the complexity of the case requires it and where progress in negotiations has been made, Member States could enable the courts to extend the stay period. An absolute cap would however need to put at 12 months, which according to experts in the Expert group is the most a restructuring procedure should take.</p>
<i>Creditors' rights</i>	<p>+</p> <p>The stay of enforcement ensures that no creditor can run for the assets of the debtor, disregarding the collective benefit of restructuring the debtor's business. However, a stay should not create unfair prejudice to any creditor. Where the stay would create such unfair prejudice, even in respect of one single creditor, the courts should refuse to grant it.</p>	<p>++</p> <p>A stay which at the same time improves the chances of the debtor to continue operating during negotiations increases the likelihood of viable businesses being saved and thus improves the likely returns to the body of creditors.</p>	<p>+++</p> <p>A short stay which could also be lifted on request by creditors under certain conditions is likely to mitigate further possible damaging impacts under Sub-option 2.</p>
<i>Judicial authorities</i>	<p>0</p> <p>A stay is always granted by a judicial authority, whether in a specific decision or as part of a decision to open restructuring procedures.</p>	<p>-</p> <p>May require courts to assess what are essential suppliers; may cause some additional litigation.</p>	<p>--</p> <p>Slightly more negative if the possibility to lift the stay results in additional litigation.</p>
<i>Legal systems</i>	-	--	--

171

<i>of Member States</i>	The concept of a stay is almost universally recognised in MS which have preventive procedures (AT is an exception). The suspension of the obligation to file for insolvency may be more controversial in some MS (e.g. DE). As explained above, to balance the interests of effective restructuring with those of preservation of the insolvency estate for the good of creditors, a court could be called on to decide if the illiquid (not over-indebted) debtor should continue the restructuring process or should enter formal insolvency procedures.	In several MS it is not yet possible to prevent contracts being terminated during restructuring negotiations (e.g. the UK is now considering a reform which would make this possible).	This may require changes in several Member States, either because the stay periods are currently not limited in time (in FI for example they last for as long as necessary) or because the time limits are currently too long (e.g. 24 months in LU).
<i>Fundamental rights</i>	- Without appropriate safeguards this option could unfairly prejudice the creditors' property rights. This risk should be mitigated by the fact that the stay should not be granted or extended if such unfair prejudice exists. The right to a fair trial may be affected since the creditors are not able to object to the stay in an oral hearing.	- Without appropriate safeguards this option could unfairly prejudice the creditors' property rights if for example they would not be able to terminate contracts early. To mitigate this risk, such effects could be limited to essential contracts which are needed to ensure the continuation of the debtor's activity.	+ This option balances the creditors' property rights and the societal interest in saving a viable business in financial difficulties, because it provides adequate protection also in the form of a short period of stay, of prolongation of the stay period only when necessary to ensure the adoption of a successful restructuring plan and the possibility to ask for the stay to be lifted at any time when it no longer fulfils its objective. The right to a fair trial would be justified in the light of the objectives of the stay and the fact that it is granted for a short period of time.

Summary assessment of the preferred sub-option: *Sub-option 3* is the preferred sub-option since it balances the interests of all parties and does not have detrimental effects on the availability and cost of credit while also supporting the continuation of the debtor's business. Certain downside risks have been identified and addressed by the preferred sub-option. First, there is a risk that the stay will not fulfil its purpose of supporting negotiations but rather be misused to delay the initiation of insolvency procedures, thus leading to further devaluation of the business. This potential risk is addressed by the short stay period, the possibility of lifting it at the request of creditors and the conditions which need to be fulfilled for its potential extensions. Second, there is a risk that the right to property or the right to a fair trial may be negatively affected. Several safeguards will need to be put in place to ensure that **fundamental rights** are not affected (stay cannot be granted or extended and it can be lifted where creditors are unfairly prejudiced, court oversight when an extension of the stay is

sought etc.). Third, in terms of **social impacts**, workers could be negatively affected if the stay of enforcement would suspend their possibility to recoup salaries and if the Member States have not provided for the means to ensure the payment of workers' salaries (eg. by extending the coverage of insolvency guarantee funds also to preventive procedures). Member States would therefore need to make available safeguards to adequately protect the payment of salaries for the period of the stay.

A tendency in Member States which have a stay is to have shorter stays up to three or four months as a consequence of their reforms in past decades. Longer stays are becoming more and more an exception. Moreover a number of safeguards to prevent that the exemption situation (1 year) turns into the majority practice would need to be in place, such as: the extensions of the 4 month period can be granted by the court only, it can be granted only on the basis of a justified request and is conditional upon evidence of progress in the negotiations.

In the public consultation, the majority of stakeholders agreed that a stay of individual enforcement actions should be available in preventive procedures. The vast majority were in favour of limited stay periods with a possibility of renewal in certain circumstances, or of any time limit set by the court. Particularly, in the public consultation and the dedicated meetings with the stakeholders, businesses and business support organisations were in favour of a short limited stay (2-3 months) for individual enforcement actions, while some of them (UEAPME) underlined that a stay should be granted for a period set by the court.

Financial institutions were of the view that a short stay (2-3 months) should not be automatically pronounced by the court, but only ordered in specific situations, with the possibility to be lifted at the request of the creditors.

Legal and insolvency practitioners were in favour of a short stay of 3-4 months with the possibility of renewal under certain circumstances and be lifted by the creditors. Some of them (INSOL Europe) underlined that where creditors are stayed from enforcing their rights it is advisable to institute effective supervision.

Trade Unions underlined that workers should not be treated worse in preventive restructuring scenarios than in case of insolvency proceedings.

Member States in general supported a short stay (4 months) with the possibility of its prolongation under certain circumstances, while diverse views were expressed as to the maximum period envisaged. Some Member States (FI, SE) were in favour of a general stay, while others (NL) supported only a stay on individual enforcement actions. Most of the Member States (PL, PT, ES, SE, IT, AT) were in favour of an automatic stay (which can be ordered without the obligation for the debtor to prove chances of success of the restructuring), but with the possibility to be lifted by the creditors.

5.3. Debtor in possession

5.3.1. Description of sub-options

Sub-option 1: An obligation to appoint in court a professional insolvency practitioner in all cases may increase the costs which can make the procedures prohibitive for SMEs. However, in certain circumstances a mediator is necessary to broker a deal with the creditors, especially in cases of companies with few financial creditors, sometimes one bank, and a few main

clients. In other cases (for example where transactions out of the ordinary course of business need to be concluded during this period), the debtor would need to be supervised if he is to benefit from protection from avoidance actions later on.

Sub-option 2: Having a mediator and/or supervisor appointed in every case may enhance the trust in the procedure but it would also raise costs.

5.3.2. Assessment of impact of the sub-options and preferred sub-option

Sub-options	Sub-option 1	Sub-option 2
<i>Sub-option summary</i>	Courts may appoint, on request by the debtor, the creditors or any interested party (e.g. a regulator) a mediator and /or a supervisor (insolvency practitioner).	Debtor remains in possession but a mediator and/or a supervisor (insolvency practitioner) is always appointed
Impact		
<i>Reduced costs of assessing risk by investors</i>	<p>+</p> <p>A procedure where there is no blanket supervision obligation by a professional may raise costs for investors in assessing when such a mediation or supervision is needed.</p>	<p>++</p> <p>If a professional is always appointed, there are less risk assessment costs for the investor.</p>
<i>Reduced costs of restructuring of cross-border group</i>	<p>0</p> <p>Cross-border groups are likely to involve complex restructurings with external professionals brought by the debtor and/or the creditors. Such professionals may work for the interest of the group as a whole, rather than for one member of the group.</p>	<p>-</p> <p>Cross-border groups are likely to involve complex restructurings with external professionals brought in by the debtor and/or the creditors. An obligation for a court-appointed mediator/supervisor in each jurisdiction may make restructuring more difficult.</p>
<i>Effectiveness</i>	<p>+</p> <p>A mediator may be appointed on court's initiative or on request by the debtor or creditors where the parties cannot manage the negotiations by themselves to help reach a compromise.</p> <p>A supervisor may be appointed on a case-by-case basis, e.g. where there is a risk of abuse of the stay or of high-risk transactions being undertaken by the debtor.</p>	<p>+</p> <p>A full-time mediator/supervisor appointed by a court is likely to increase confidence in the procedure and the quality of the process. He may also increase the quality of the restructuring plan and reduce the likelihood of challenges at a later stage.</p> <p>In many Member States it may be considered a necessary condition to reduce the involvement of the court in the procedure. However, such appointment would add to costs which would in turn undermine the attractiveness of the procedure for SMEs in financial difficulty already short of funds.</p>
<i>Impact on creditors</i>	<p>+</p> <p>When insolvency practitioners have a key say in deciding on the viability of the</p>	<p>++</p> <p>As compared with Sub-option 1, this sub-option could in principle further contribute</p>

	<p>distressed debtor, recovery rates for creditors are more than 10% higher¹⁷². However, this sub-option is likely to</p>	<p>to increasing recovery for creditors, but an obligation to have a supervisor may prove in some cases prohibitively costly. The trade seems to be between having more restructuring cases and less, bearing in mind that the administrative costs are a high obstacle to entry.</p>
<i>Costs of procedure</i>	<p>+</p> <p>This sub-option could be more costly for certain debtors, but the costs are mitigated by the benefits of having a mediator helping with negotiations or, in more complex cases, a supervisor advising on the legality of certain actions of the debtor and creditors.</p> <p>Still, the reduction in costs is significant compared to those preventive national procedures where a supervisor is always appointed, as the fees of insolvency practitioners are the biggest single cost element of insolvency procedures.</p> <p>The reduction of costs of restructuring is crucial for allowing SMEs to benefit from restructuring procedures.</p>	<p>-</p> <p>The costs of having a fulltime supervisor will be high, even prohibitive for smaller businesses. The services of a mediator may be somewhat less costly.</p>
<i>Legal systems</i>	<p>-</p> <p>Some Member States already provide for the possibility that a mediator/supervisor need not a priori be appointed by a court (PT, BE, EL, IT, ES).</p> <p>Other Member States would need to remove the obligation to appoint a mediator or a supervisor in every case and specify the conditions under which such appointment would always be necessary.</p>	<p>-</p> <p>Similar to sub-option 1 some MS already have such obligations, while in others this is not the case.</p>
<i>Judiciary authorities</i>	<p>0</p> <p>A supervisor is a guarantor of procedural fairness, so this sub-option may reduce the burden on the judiciary at the stage of confirmation of the plan or challenging the plan. However courts may have to play a more prominent role in more simple restructuring cases where an insolvency practitioner is not appointed.</p>	<p>0</p> <p>In practice, there is likely to be no significant difference in the number of cases where a supervisor is appointed in sub-options 1 and 2. As compared to Sub-option 1, this sub-option would lead to less restructuring applications, but not necessarily less workload for the courts as debtors who are not restructured early go into liquidation procedures. .</p>

Summary assessment of the preferred sub-option: *Sub-option 1* is the preferred sub-option since it allows for a reduction of the costs of procedures, which could be significant for SMEs, while at the same time it ensures necessary assistance and supervision from an independent insolvency practitioner in more complex cases. This possibility is not hampered by the principle that appointment of a mediator or a supervisor needs to be made on a case-by-case basis. This option does not have any apparent impacts on fundamental rights or social

¹⁷²

http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2013/02/26/000333037_20130226123527/Rendered/PDF/752400BRI0SMAR0urable0Results0FIXED.pdf

impacts. The downside risk that debtors may abuse of the debtor-in-possession possibility to engage in transactions affecting negatively the rights of creditors is addressed to some extent by rules on liability of directors and on avoidance actions which are already in place in the Member States.

In the public consultation the vast majority of respondents were of the view that debtors should be allowed to keep control over the day-to-day operation of the business, in order to maintain the productive capacity of the debtor.

From the public consultation and the dedicated meetings with the stakeholders, businesses and business support organisations were strongly in favour of sub-option 1. They particularly underlined that if the appointment of a supervisor/mediator is optional, this could reduce costs for SMEs. Some of them were also of the view that when rights of third parties are not affected, the decision of the appointment of a supervisor should be confidential.

Practitioners were in favour of debtor-in-possession principle with the possibility for appointing a supervisor. They were however reluctant to harmonising the conditions for appointing an insolvency practitioner.

Credit and financial institutions were of the view that the debtor should in principle remain in possession and they fully supported the principle according to which the appointment of a mediator in a preventive restructuring framework should not be mandatory, but made by the court on a case by-case basis. They also underlined the importance of transparency of information for creditors.

Trade Unions supported the debtor-in-possession principle, but underlined that the workers' rights to information and consultation should not be affected.

Almost all the Member States (AT, BE, EE, DE, EL, HU, IE, FR, FI, IT, LV, LT, PL, SK, SI) were in favour of the debtor remaining in possession, but subject to supervision by a suitably qualified mediator/ supervisor/ court. They also agreed that the appointment of a mediator or supervisor (insolvency practitioner) should remain optional, but were not in favour of harmonising the conditions for appointment.

5.4. Plan approval by a majority of creditors

5.4.1. Description of sub-options

Sub-option 1: Creditors act individually and are unaware of the broader impact that their actions will have on businesses, causing rescue to become more difficult and therefore worsening the position for creditors as a whole¹⁷³.

Sub-option 2: This sub-option includes the first sub-option and, in addition, allows Member States to foresee that the plan can be adopted if the required majority in at least one class of creditors is in favour of the plan, provided that dissenting classes are not unfairly prejudiced (inter-class cram-down).

Sub-option 3: Equity holders may also oppose the adoption of restructuring plans in some Member States, even when the value of the company is so low that they are no longer 'in the

¹⁷³ A review of the corporate insolvency framework, UK Insolvency Service, 1 March 2016, available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/525529/Consultation_stake_corporate_insolvency_consultation_Impact_Assessment_-_Mar_2016.pdf

money'. Appropriate safeguards for equity holders should accompany any such measure (e.g. business valuation test, right to challenge the plan in court) to ensure that they are not effectively expropriated.

5.4.2. Assessment of impact of the sub-options and preferred sub-option

Sub-options	Sub-option 1	Sub- option 2	Sub-option 3
<i>Sub-option summary</i>	The plan is adopted if the required majority in every class is in favour of the plan, provided that the minority creditors are not unfairly prejudiced; all classes of creditors can be affected by the plan, vote and be bound by it, including secured creditors.	Sub-option 1 + the plan can be adopted if the required majority in at least one class of creditors is in favour of the plan, provided that dissenting classes are not unfairly prejudiced (inter-class cram-down).	Sub-option 2 + principle that shareholders should not be able to block the plan if their interests are protected (e.g. by including shareholders as class(es) of their own)
<i>Reduced costs of assessing risk by investors</i>	+ The more predictable the conditions for adoption of restructuring plans by creditors across the EU Member States, the lower the up-front costs for investors.	++ This sub-option will provide better chance for quick adoption of a plan despite the dissent of one or more classes of creditors, so costs of assessing risk will be potentially lower..	+++ The option reduces additional source of risk to be assessed, namely the opposition of shareholders to a plan which is otherwise capable of returning the debtor to viability.
<i>Reduced costs of restructuring of cross-border group</i>	+ The more uniform the rules on the adoption of restructuring plans, the lower the costs for running parallel restructurings for members of the cross-border group.	++ This sub-option enables a quicker and more feasible adoption of a restructuring plan in a group context, so additional costs of restructuring for cross border groups will be limited.	+++ Enabling the adoption of viable plans despite the opposition of shareholders would further reduce the risk of delays and possible failures to restructure one or more members of the cross-border group.
<i>Effectiveness</i>	+ Without a majority rule binding secured creditors, restructuring would not be effective: most cases include debt restructuring of companies whose business is otherwise sound; and most financial claims (e.g. bank loans) enjoy some form of collateral.	++ This sub-option would be more effective since classes of creditors which do not have a stake in restructuring (because the valuation of the company shows that in a liquidation scenario they would recuperate very little or nothing) would not be able to obstruct the restructuring process. This sub-option will therefore result in a higher number of restructurings. Such restructuring are also likely to be more sustainable in the long run, since they will be able to effect more radical changes needed to rescue the business (such as sales of parts of the	+++ This sub-option will be even more effective and would allow for example debt-to-equity swaps as a means to restructure the capital structure of the company – a measure which is unlikely to be supported by shareholders who would see their shares devalued as a consequence. This option would increase the number of successful restructurings in Member States where currently shareholders are able to block the adoption of a restructuring plan.

		business) without the need to 'buy' the support of classes of creditors which do not have an interest in the restructuring.	
<i>Availability and cost of credit</i>	0 This sub-option would have negative impacts on the availability and cost of finance if dissenting creditors would not be adequately protected to ensure that they do not lose more in restructuring than in liquidation (best interest of creditors test). Appropriate valuation requirement should also be put in place	0 This sub-option may have in the short term negative impacts on the availability and cost of finance, as lenders adapt to the new rules. To mitigate such risks, appropriate safeguards should be put in place to ensure that dissenting creditors do not lose more as a result of the restructuring plan than they would in liquidation (best interest of creditors test). Appropriate valuation requirement should also be put in place.	0 This option may have in the short term negative impacts as equity investors may in principle shy away unless they can be confident that their interests are protected. Appropriate safeguards need to be put in place so that shareholders do not lose more than they would in a scenario where the debtor's business is sold as going concern (shareholders are normally last in the distribution of proceeds from liquidation, but in preventive procedures they receive normally some proceeds if there is still value in the company). Appropriate valuation requirement should also be put in place.
<i>Legal systems</i>	- Those Member States where preventive procedures do not contain such a feature will need to amend existing procedures (AT, EE, EL, LV, LU, NL, PT, SE).	- Some Member States already have such possibility in place (e.g. FI), while others will have to create such a possibility in order to facilitate the adoption of restructuring plans.	- - Member States which have no system of ensuring that shareholders cannot block restructuring plans will need to provide for such means. Because treatment of shareholders raises some sensitive constitutional concerns about the protection of the right to property, the means of implementing this rule should be left to the Member States, provided they are effective. There may be a need to adapt the company law (rights of shareholders) legislation as well.
<i>Fundamental rights (right to property)</i>	- A minority of creditors may need to accept a significant reduction in their claim without their consent. In order to ensure that such measures do not amount to expropriation, the restructuring plan should	- Still higher risk for minority creditors or creditors from dissenting classes. To limit this risk, the best interest of creditors test should be applied (i.e. they should receive at least what they would be entitled to in the	- Expropriation risks are not higher in case of shareholders since in liquidation proceedings they would likely receive nothing. However, in many Member States shareholders rights are seen as being

	guarantee that dissenting creditors receive at least the liquidation value of their claims.	event of liquidation) and the absolute priority rule (meaning that junior classes must receive nothing in order to cram-down over a senior class). A court would need to confirm such a restructuring plan after ensuring that dissenting creditors are not unfairly prejudiced. Second, creditors and shareholders should also be able to challenge the valuation and the distribution of rewards made under the plan.	essentially different than creditors' rights. For this reason, Member States should be allowed some flexibility as to how they understand to implement this rule (e.g. by opening formal insolvency proceedings).
--	---	---	---

Summary assessment of the preferred sub-option: *Sub-option 3* is the preferred sub-option since it is the most likely to lead to a higher number of adopted restructuring plans. The risk that, in the absence of full harmonisation, the Member States could set a too high majority (e.g. 90%) or a double majority (both in amount of claims and in number of creditors) which would effectively raise the obstacles to plan adoption should be addressed by limiting the maximum majority which can be required by Member States (e.g. 75%) and by establishing a simple majority only (i.e. in amount of claim). In order not to negatively impact **fundamental rights** (i.e. the right to property of dissenting creditors and shareholders) and to avoid opportunistic behaviour on the part of a majority of creditors to the detriment of the minority, this option must be accompanied by several safeguards (eg. the best interest of creditors' test, the absolute priority rule). Member States will be able to set up the majorities they consider appropriate, although a qualified majority of the value of claims should be recommended. Given the sensitivity of reducing shareholders' rights, Member States should have greater flexibility in deciding which measures are more appropriate to achieve the objective of enabling plans to be confirmed despite the shareholders' opposition when this is not justified. In respect of **social impacts**, this procedure will be without prejudice to the workers' rights to information and consultation which are laid down in other EU instruments. Where they are affected as a class, workers will have the same rights to vote on a plan as other creditors.

In the performed public consultation, most respondents were in favour of a plan binding on secured creditors, while a smaller part of stakeholders said that secured creditors should be exempted. The majority also supported a cross-class cram-down, provided that appropriate court supervision and the principle of "no creditor worse-off" are observed. More specifically, business organisations and insolvency practitioners supported in general that the plan should be adopted if the required majority in every class is in favour provided that the minority creditors are not unfairly prejudiced and that all classes of creditors should be affected by the plan. They were strongly of the view that secured and unsecured creditors should be treated in separate classes.. As for shareholders' position, various views were expressed; some stakeholders were more reluctant to introducing mandatory provisions regarding shareholders in preventive restructuring, while others (EBF, AFME) were of the view that although shareholders should be involved in the negotiations, they should not have a hold out position if they are out of the money.

Financial institutions were not opposed to sub-option 3, but they underlined that adequate safeguards should exist for secured creditors, because the write off of claims of a secured creditor without individual consent could generate the type of uncertainty that may result in

higher costs of financing. They were also of the view that shareholders' rights might need to be limited in certain circumstances, i.e when they prevent the plan from being adopted although this plan is likely to ensure the continuation of the company's activity and the recovery of the debts.

The majority of the Member States were in favour of sub-option 2, as long as appropriate safeguards are put in place. However, views were diverging with regard to majorities required, exceptions and safeguards. As for the position of shareholders in early restructuring, despite the fact that all the Member States supported the rationale, some of them (FI, ES, BE, IE) were concerned about the idea of introducing mandatory detailed rules, because of potential implications on company law and constitutional protection of property rights.

5.5. New financing and interim financing, safe harbour provisions and third party releases

5.5.1. Description of sub-options

Sub-option 1: Protection of new financing - necessary to implement a restructuring plan - and of interim financing, necessary to keep the debtor operating during restructuring negotiations - is essential to make funds available to distressed businesses and for companies to keep operating while negotiating a restructuring plan. In both cases, protection can range from exemption from avoidance actions to a priority allowing the provider of new financing to rank above unsecured creditors.

Sub-option 2: In addition to protection from avoidance actions, protection of new financing in the form of rebuttable presumption ensures safe harbour from challenges for non-related party transactions which were concluded during negotiation of a restructuring plan.

Sub-option 3: Finally, release of third parties related to the insolvent subject from contractual obligations under the restructuring plan may be useful to strengthen the chances of restructuring of a business in difficulty. However, given the risks of interfering with the national provisions on guarantees and the security of transactions, such release provisions should be limited to two situations:

- a debtor must be released from recourse claims of other affected obligors or guarantors in the same way as he is discharged of the claims of the guaranteed creditors;
- except for legal entities, co-obligors and persons who have granted a personal guarantee or allocated or assigned an asset as collateral may avail themselves of the provisions of the restructuring plan confirmed by a court.

5.5.2. Assessment of impact of the sub-options and preferred sub-option

Sub-options	Sub-option 1	Sub-option 2	Sub-option 3
<i>Sub-option summary</i>	Exempting new financing contained in the restructuring plan and interim financing necessary to support the debtor during negotiations from avoidance actions. Member States may also provide for super-priority status to new financing, ranking it at least	Sub-option 1 + Non-related party transaction entered into before insolvency, and in connection with a restructuring plan adopted by creditors shall be exempted from avoidance actions (safe harbour provisions).	Sub-option 2 + limited co-obligors' and guarantors' releases under the plan

	above unsecured creditors.		
Impacts			
<i>Reduced costs of assessing risk by investors</i>	<p>+</p> <p>Ex ante, investors need to know what protection they will enjoy in case of failure of the business or, in case they are investing in a going concern business, in case of failure of the restructuring plan. The more elements of the investors' protection are harmonised, the lower the costs of assessing risks for investors across the EU. The protection for avoidance actions is a minimum level of protection; although many MS have super-priority rules for new financing in order to encourage investors, this is not accepted across the Union. Legitimate concerns as to the protection of the expectations of existing investors are often invoked. Moral hazard risks related to new and interim financing are addressed by the fact that protection shall not be available where there is fraud or bad faith.</p>	<p>++</p> <p>This sub-option would ensure more certainty as to which transactions are not likely to be annulled or declared void in subsequent insolvency proceedings.</p>	<p>-</p> <p>Banks might incur higher costs in assessing <i>ex-ante</i> the costs of releasing guarantors even in limited circumstances than making that assessment on a case-by-case basis <i>ex-post</i>.</p>
<i>Reduced costs of restructuring of cross-border group</i>	<p>+</p> <p>Protection for new financing and interim financing across the Member States will increase the chances of success of restructuring members of groups of companies in a coordinated and efficient way.</p>	<p>++</p> <p>Harmonisation of additional elements of the functioning of the debtor reduces the costs of restructuring of cross-border groups. This sub-option will protect from avoidance actions transactions which are necessary for the execution of an approved restructuring plan potentially in several Member States without having been specifically mentioned in the plan itself.</p>	<p>+++</p> <p>This sub-option would ensure that the restructuring of the mother company does not trigger financial difficulties for a subsidiary in another Member State.</p>
<i>Effectiveness</i>	<p>+</p> <p>More companies would be restructured successfully, since new and interim financing can be crucial for the rescue of business in difficulty.</p>	<p>++</p> <p>Even more companies may be successfully restructured in comparison with sub-option 1. Likely to increase the willingness of creditors to</p>	<p>+++</p> <p>Even more companies restructured successfully in comparison with sub-option 2. Third party releases would incentivise entrepreneurs to</p>

	Minimum protection for their investments will encourage lenders to support viable companies in financial difficulties by extending new financing and by supporting the continuation of operations by the debtor during restructuring ¹⁷⁴ .	extend credit to the debtor undergoing restructuring negotiations and to help the debtor continue its daily operation of the business. Directors will be more willing to enter transactions with non-related parties to save the businesses if they are not risking personal liability actions.	file early in order to benefit from the provisions of the plan. This will also consolidate the position of the restructured debtor who will not fear a right to recourse from third parties which could annul the benefits of the restructuring.
<i>Costs of restructuring procedure</i>	- Since many restructuring attempts are still likely to be unsuccessful and end in insolvency, the protection of new and interim finance may reduce the pool of assets for the pre-restructuring creditors. Giving new finance super-priority may impact even more heavily on the recovery by pre-restructuring creditors.	- Since many restructuring attempts are still likely to be unsuccessful and end in insolvency, the protection of non-related party transactions may reduce the pool of assets for the body of creditors. No change compared with Sub-option 1.	- - Such a provision would allow lenders such as banks to deal with both the principal loan and its guarantee in one single procedure rather than in separate procedures. Banks may need to factor in the possibility of third party releases when extending credit. This may increase the cost of credit. However, banks may already do so on a voluntary basis.
<i>Legal systems</i>	- In some Member States, changes to the rule on avoidance actions, suspect periods and the civil and criminal liability of lenders to companies in distress would need to be made.	- Similar to sub-option 1. This measure would not exempt transactions from avoidance actions, but simply shift the burden of proof on the insolvency administrator or creditors wishing to challenge a transaction concluded in the vicinity of insolvency as detrimental to the general body of creditors ¹⁷⁵ . Member States may need to amend their provisions on burden of proof in relation to avoidance actions, but could keep other provisions unchanged, including on suspect periods and definition of 'non-related party'.	- - Some additional changes in relation to sub-option 2 in national legislations on enforcement of guarantees may be necessary.
<i>Fundamental rights – right to property</i>	- Super-priority rules may impair the rights of pre-petition creditors to property. As a safeguard, a liquidation value test should be carried out by a court, and challenges should be	0 Avoidance actions are already an expression of the competing rights to enforceability of contracts and legal certainty and protection for the interests of creditors. A large margin of	- Lenders may face the additional threat of not being able to fully enforce collateral. For this reason, such measures should be allowed only in limited circumstances, and only if

¹⁷⁴ See Annex 2 on the analysis of the results of the performed public consultation.

¹⁷⁵ Non-related party transactions are less likely to be fraudulent and for this reason in almost all Member States there are shorter suspect periods in respect of such transactions.

	allowed. Super-priority can remain an option for the Member States or for creditors themselves.	appreciation is already found in the Member States.	adequate safeguards are put in place.
--	---	---	---------------------------------------

Summary assessment of the preferred sub-option: Sub-option 2 is the preferred sub-option since it provides the necessary incentives for investors to support the company while negotiations are on-going and ensuring that restructuring plans can be successfully implemented by providing for new financing. These objectives could be achieved without excessively affecting the property rights of existing creditors, especially banks, and without raising the costs of credit. There is a risk that, in the absence of unified rules on affording new and interim finance super-priority status in the context of subsequent insolvency proceedings, investors would not be sufficiently encouraged to support restructuring efforts. However, if new investment would indeed be crucial to the survival of a viable debtor, such super-priority status could be contractually agreed upon among creditors via inter-creditor agreements. **Moral hazard** risks should be addressed for example by ensuring that the protection for new financing and interim financing is not available where there is evidence of fraud or bad faith. There are no discernible social impacts related to this sub-option.

In the public consultation, the vast majority of respondents agreed that interim and new financing is needed for the successful restructuring and continuity of the business. Most stakeholders from the business sector were of the view that financing should be protected if agreed in the restructuring plan and confirmed by the court, while some of them believed that new financing should always be protected. Particularly, business organisations such as UEAPME, Independent Retail Europe and BusinessEurope mentioned that adequate protection of providers of new financing will provide incentives for early restructuring.

Legal and insolvency practitioners were in favour of providing protection for new financing and, for the sake of greater certainty, they supported the idea of a safe harbour provision equipped with adequate safeguards. However, they were opposed to harmonising substantive definitions of avoidance actions and look back periods, because of the existing divergence in national systems. Although they were not entirely opposed to specific rules on third party releases, they remained reluctant, mainly because of fear of moral hazard.

Financial institutions were in favour of adequate protection for new financing provided that it was agreed in the plan and confirmed by the court. They were opposed to any rules on third party releases due to potential implications in cost of credit. They were also opposed to any harmonisation of ranking of claims.

During the dedicated meetings, the majority of the Member States (NL, AT, SI, RO, PT, IE, PL, EL) were in favour of general principles for the protection of new and interim financing, provided that there are appropriate safeguard against bad faith behaviour and fraud. Member States were, nevertheless, opposed to mandatory provisions granting super priority for new money or to any rules, which would affect domestic systems of ranking of claims and securities. As to safe harbour provisions, the majority of the Member States (RO, PT, ES, DE, PL, IT, BE) were in favour of providing a safe harbour for transactions which are closely connected with the negotiation of a restructuring plan and which are adopted by the creditors and confirmed by the court, as long as European legislation remains at the level of principles and there are no too detailed provisions. A few Member States (DE, FI, AT) expressed concerns with regard to legal certainty and the danger of abuse. Finally, the majority of the Member States were opposed to any rules on third party releases.

5.6. Reducing the formalities relating to court proceedings

5.6.1. Description of sub-options

Sub-option 1: Courts need to be involved only in case procedural acts will have legal effects on third parties or where abuses need to be avoided. In a preventive procedure, the court needs only be involved at two moments: (1) when a moratorium is sought against creditors and (2) when a plan needs to be approved in order to bind a minority of creditors or to provide security to new lenders. Removing the involvement of courts in other steps, such as formally opening a court procedure, convening creditors' committees and taking a vote among the creditors present in a court hearing would make these procedures less costly and speedier. At the same time, it must be acknowledged that a high level of court involvement may produce more trust in the procedures especially in Member States where insolvency practitioners are not highly specialised.

Sub-option 2: Full involvement of courts, e.g. for opening formally restructuring procedures, for appointing in every case a practitioner in the field of restructuring, for taking a vote among creditors etc.

5.6.2. Assessment of impact of the sub-options and the preferred sub-option

Sub-options	Sub-option 1:	Sub-option 2:
	A flexible framework, which allows for a more limited involvement of courts	Full involvement of courts
<i>Reduced costs of assessing risk by investors</i>	+ Courts should be guarantors of the rights of the parties. Where their involvement is limited to steps where the rights of such parties are affected, this may reduce the elements on which creditors would need to perform due diligence.	- There will be more costs with determining the legal requirements for involving courts in such steps as convening creditors' committees and organising a vote among creditors.
<i>Reduced costs of restructuring of cross-border groups</i>	+ Since in some Member States courts are involved fully while in other they are not, the costs of restructuring of cross-border groups can be made more complex, less predictable and therefore more costly. Ensuring that courts are involved only when rights of third parties are effected will lead to a reduction of costs overall..	- While there will be more legal certainty in such cases, there will also be unnecessary court involvement across the Member States which is likely to push up the costs of restructuring on individual members of the group.
<i>Effectiveness</i>	+ Evidence from the Member States shows that reducing the courts' involvement in the procedure results in significant cost savings for the debtor and creditors. Hybrid procedures are cheaper than fully formalised court proceedings. The time required to adopt a restructuring plan may also be significantly reduced.	- Too formalised procedures may be an additional guarantee of legality especially in very complex restructurings, but in most restructurings full court involvement may only add to the length of procedures.

<i>Rights of creditors</i>	0 Reducing court involvement to where it is necessary to protect the rights of creditors will not negatively affect creditors.	0 If a court is always involved when a creditor's rights are affected, this option should not have a significant impact as compared with Sub-option 1.
<i>Judicial authorities</i>	+ Reduce the workload of courts in Member States where preventive procedures are highly formalised and even more so in Member States where full insolvency procedures are used to restructure or where the existing preventive procedures are not accessible to debtors. As more of these insolvencies will be channelled towards the preventive procedures, courts would become less burdened	- A full court involvement requires that more steps on the procedure should be organised or directly supervised by the court. Such an approach is likely to increase the workload of the courts.
<i>Legal systems</i>	- Member States which now provide for a full involvement of courts would need to provide that certain steps could be taken out court.	- Member States which now provide for a targeted involvement of courts would need to provide for more court involvement.
<i>Fundamental rights</i>	0 Court involvement is necessary when third parties' rights are affected. Court oversight guarantees that there is a justified interference with the right to property. Equally, where third parties' rights are affected, they should have the right to an effective remedy and to a fair trial requires that creditors can challenge or appeal decisions on the confirmation of a restructuring plan.	0 Where third parties rights are not affected, involving courts does not guarantee more protection of fundamental rights.

Summary assessment of the preferred sub-option: *Sub-option 1* is the preferred option since it balances both the need to reduce length and costs of procedures and at the same time to safeguard the procedural right of the parties. There is a risk that the involvement of courts could raise costs and discourage restructurings. However, the need for a court to be involved whenever there is an impact on their parties' rights is an important safeguard against moral hazard when entering such procedures, on the side of both debtors and creditors, since the refusal to confirm a restructuring plans adopted by creditors after months of negotiations would lead to potentially significant losses for all involved. The benefits for the internal market will be considerable: not only will more restructurings happen simply because of the guarantee of legality which the involvement of a court pre-supposes; but also because court decision can circulate and be recognised across-borders under the Insolvency Regulation (such as a decision to grant a stay, or a decision to confirm a plan). It is also likely that 'in the shadow' of a strong legal framework able to cram-down on dissenting creditors, more out-of-court restructurings will take place to avoid a court procedure. There is also a risk that, to the extent court systems still need to be involved, lack of efficiency of courts in some Member States may be a deterrent. This risk could be managed by targeted provisions on the specialisation of courts and the use of modern communications technology. This sub-option is not likely to have negative social impacts. **Fundamental rights** of right to property and right to an effective remedy and to a fair trial are guaranteed under this sub-option.

In the public consultation, many respondents said that the involvement of a court or other competent authority is necessary when a moratorium is granted or in case of a confirmation of a restructuring plan, while a smaller part of stakeholders were of the opinion that the involvement of a court is not an absolute requirement.

Particularly, in the public consultation and the dedicated meetings, business organisations and financial institutions welcomed a fast, cheaper and less court-driven procedure.

Trade Unions underlined that the aim of shortening the length of the proceedings cannot disregard the workers' rights to information and consultation.

During the dedicated meetings, the vast majority of the Member States (AT, BE, EE, FR, DE, EL, HU, IT, LT, MT, NL, PL, SK, SI) favoured the opening of some sort of formal procedure in which a court (or other competent authority or body) is involved from the moment it becomes necessary to stay enforcement actions or obtain confirmation for the restructuring plan.

5.7. Lowering and aligning discharge periods for natural persons

5.7.1. Entrepreneurs

5.7.1.1. Description of sub-options

Sub-option 1: Reducing the stigma culture and encouraging restarters rests on a distinction between honest and dishonest entrepreneurs and a reduction of the discharge period for the honest bankrupts. While the concept of dishonesty should in principle cover fraudulent conduct, Member States may also extent it to bad faith either before or after the opening of bankruptcy procedures. A discharge could be offered after 1 year to debtors who have no assets and no income (NINAs), e.g. after a liquidation of assets. One suggestion made in the Insolvency Conference on 12 July 2016 was that natural persons should be distinguished, for the purposes of insolvency/repayment plan procedures and discharge, not by their economic activity (entrepreneurs v consumers), but by whether they are high net worth or low net worth debtors. Sub-option 1 and Sub-option 2 attempt to make that distinction.

Sub-option 2: A maximum discharge period of 3 years would address all debtors, including those who still have income to repay creditors under a repayment plan. In fact, Sub-option 2 could be combined with Sub-option 1 for NINA¹⁷⁶s.

Sub-option 3: A second chance would not be effective if entrepreneurs would not be able to discharge both their professional and their personal debt together. This option proposes therefore a consolidation of proceedings in one procedure.

5.7.1.2. Assessment of impact of the sub-options and preferred sub-option

Very small businesses (i.e. one person business or businesses with up to four workers) accounted for more than 95 % of new businesses in the different Member States in 2013 and

¹⁷⁶ No income, no asset (person). See Glossary in Annex 5.

30 % of them did not survive their first 2 years¹⁷⁷. It is important to allow entrepreneurs a quick re-entry into the productive economy.

Sub-option	Sub-option 1	Sub-option 2	Sub-option 3
<i>Sub-option summary</i>	Discharge of debts for entrepreneurs with no assets and no income and low levels of debt within 1 year from start of liquidation proceedings, with limited exceptions (e.g. fraud, bad faith, gross negligence).	Discharge of debts for entrepreneurs within 3 years from start of liquidation and start of implementation of the repayment plan, implemented, with limited exceptions (e.g. fraud, bad faith).	Sub-option 2 + possibility to consolidate all personal debts of the entrepreneur - be they business or non-business in nature - in one procedure.
Impacts			
<i>Costs of relocation: cross-border impact on creditors</i>	<p>+</p> <p>Incentives for relocation for the purposes of taking advantage of more favourable discharge periods would be reduced, and therefore the additional costs such relocations would entail for creditors (potential ex ante costs assessing the risk of relocation of the debtor to the most friendly jurisdiction in the EU; costs of enforcing or trying to enforce in another MS; costs resulting from the need to write off debts following a discharge decision in another MS), will be reduced. This sub-option will have however a limited impact: NINAs are also the less likely to be able to relocate given the financial constraints.</p>	<p>++</p> <p>Because this sub-option will capture more over-indebted entrepreneurs, its impacts will be necessarily more significant. Reducing the risk of relocation of entrepreneurs with higher amounts of debt will also lead to more significant savings for creditors of these entrepreneurs (as otherwise they may have higher amounts to write off as a results of discharge in another MS).</p>	<p>+++</p> <p>There may be significant additional cost savings where the same creditors will have professional as well as personal claims against the same debtor.</p>
<i>Cost of relocation: cross-border impact on entrepreneurs</i>	<p>+</p> <p>Some NINAs who might have otherwise relocated will be able to have cost savings (such as travel costs to another MS, finding a job in less than 3 months, living in that MS for at least 6 months or more in order to establish COMI change).</p>	<p>++</p> <p>Significantly more entrepreneurs will be able to avoid relocation, hence significantly more savings from reducing the need for relocation.</p>	<p>+++</p> <p>Consolidating procedures will lead to a more effective, quicker second chance, hence the additional cost savings for entrepreneurs.</p>
<i>Entrepreneurship</i>	+	++	+++

¹⁷⁷ Annual Report on European SMEs 2015/2016, SMEs as the engine of growth in 2016, SME Performance Review 2015/2016, March 2016, prepared for Directorate-General for Internal Market, Industry, Entrepreneurship and SMEs, p. 59.

	<p>A short discharge period would have positive effects on the level of entrepreneurship, as the possibilities for a second and more successful start increase.</p> <p>Exceptions allow Member States to filter out dishonest or fraudulent entrepreneurs.</p>	<p>A medium length discharge period would have positive effects on the level of entrepreneurship, albeit less than Sub-option 1. If discharge periods will be reduced to no more than 3 years in all Member States, the number of newly created SMEs would be 5.9% higher than today¹⁷⁸.</p>	<p>This sub-option will increase even more the positive effects on the number of second starters and the speed with which they return to activity.</p>
<i>Jobs</i>	<p>+</p> <p>The option would have a positive impact on re-starting business by previously defaulting entrepreneurs. More of them (and more new entrepreneurs) will re-start businesses and create new jobs. Some increase of jobs, but substantially lower than 3 million assessed for option 2. However, it may happen that some proportion of defaulting entrepreneurs (without any assets) will not restart business.</p>	<p>++</p> <p>Number of jobs in the SME sector could be 3 million higher than it is at present¹⁷⁹.</p>	<p>+++</p> <p>As compared to Sub-option 2, entrepreneurs are likely to benefit further from being able to resolve all their debts in one procedure and thus to be more willing to restart business.</p>
<i>Impact on GDP</i>	<p>+</p> <p>As the proportion of defaulting entrepreneurs without assets would not be substantial, some limited boost of GDP possible. Effect rather due to more encouragement of entrepreneurship.</p>	<p>++</p> <p>A GDP boost by between 0.2% and 2.1% in the long run¹⁸⁰.</p>	<p>++</p> <p>At least the same as Sub-option 2, or higher due to bigger number of second starters.</p>
<i>Availability and costs of credit</i>	<p>+</p> <p>A short discharge period may have negative impact on availability and costs of credit, as the creditors may fear that they are likely to have more claims unpaid due to the discharge.</p>	<p>+</p> <p>However, risks are usually calculated on the basis of rates of default, not rates of discharge. Compared to sub-option 1, the negative effects on availability and costs of credit should be limited. There is no evidence of positive correlation between interest rates and length of discharge periods in Member States.</p>	<p>+</p> <p>Same as Sub-option 2.</p>
<i>Legal systems</i>	---	--	-

¹⁷⁸ Idem, p. 65.

¹⁷⁹ Idem, p. 54.

¹⁸⁰ Idem, p. 66.

	Almost all Member States (except IE and UK) would have to change their laws to enable such a short discharge period.	Many Member States (except e.g. FI, SE) would have to provide for shorter discharge periods, while some Member States may only have to reconsider the conditions under which discharge is granted (e.g. FR, DE, SK, CY).	Many Member States have such a possibility in their law (BE, FR, FI, DE, UK), others would have to adapt.
<i>Fundamental rights</i>	0 Given that debtors benefiting from such short periods of discharge have low amount of debts, creditors are not likely to suffer significant detriment. Creditors' rights have to be balanced against the right of debtors to human dignity and to engage in work, which the absence of discharge renders very difficult.	0 Compared to Sub-option 1, the change would strike less controversially the balance between the creditors' right to property and the debtor's right to human dignity and to engage in work.	0 Same as Sub-option 2

Summary assessment of the preferred sub-option: Sub-option 3 is the preferable sub-option as it provides for a fair balance between the rights of the creditor and the rights of the debtor, while having a most positive impact on the levels of entrepreneurship. In terms of **fundamental rights**, this sub-option will have positive impacts in terms of right to human dignity and right to engage in work, which do not appear to be outweighed by the potential harmful impact on creditors' property rights, in particular when taking into consideration that in practice recovery rates are very low during these periods and creditors' rights are therefore not effectively protected. A short discharge period is a concern from a moral hazard point of view. Reducing the discharge period is often feared to incentivize debtors to take on debts with no intention of repaying them. Such a fear is not supported by evidence. Research¹⁸¹ shows that the key reason of over-indebtedness of sole entrepreneurs, which represent important part of SMEs, resides in the lower resistance of SMEs to external economic shocks due to their lower ability to mobilise reserves for the period of economic downturns. Negligence or intention to repay the contracted business loans is a reason for default of their obligations only in a very low number of situations. There is a potential downside risk that discharge alone could not give entrepreneurs effective access to second chance. Other flanking measures could therefore be necessary, for example limiting the duration of disqualification order which are issued for honest entrepreneurs simply because they were involved in a bankruptcy procedure.

In recent decades a number of Member States reduced the time limit of discharge period and there is no information that in any of those Member State the amount of unpaid loans would have increased due to an increased moral hazard risk. At the same time, Member States with very short discharge periods (for example 1 year in the UK) do not report higher levels of unpaid loans or higher costs for obtaining credit due to the moral hazard than Member States with long discharge period (for instance Greece with 10 years).

¹⁸¹ Quoted by Annual Report on European SMEs 2015/2016, p.62.

In general, in the performed public consultation, the majority of the respondents were in favour of full discharge of debt for entrepreneurs who are 'honest'. Respondents also said that such a measure should be complemented by disincentives for dishonest conduct. The majority was also of the opinion that the test of honesty should be harmonised at EU level, with many indicating that a presumption of honesty should be put in place. The views were more diverse when it came to the length of the discharge (many of them agreed to less than 3 years and a smaller part of stakeholders was in favour of 5 years) and whether discharge should be conditional upon repayment of a certain amount of debt

More specifically, stakeholders in the business sector as well as professional associations strongly supported the objective of offering honest bankrupt entrepreneurs a second chance reducing the stigma of insolvency and allowing them to return to economic life in a reasonable timeframe. They were in favor of a 3-year discharge period, but underlined that consideration should be given to clarifying certain criteria for 'honesty', so that there is appropriate legal certainty about the cases when a facilitated discharge should be allowed. Additionally, during the stakeholder meetings, business organisations as well as legal professionals and accountants voiced that, where the entrepreneur has personal debts, both generated by his/her business activity and by his/her non-business activity, the proceedings should be consolidated for the purposes of the discharge.

The banking sector was of the view that honest bankrupt entrepreneurs should be discharged from debts after a relatively short period of time (3 years) only if a certain amount of the debt is repaid (threshold should not necessarily be statutory, but may also be determined by the courts on a case-by-case basis). Access to such discharge should be possible only when restructuring measures have failed or are impossible. Financial institutions also advocated that a 'second' full discharge should only be available after a longer period of time in order to exclude incentives for bad practices (and avoid moral hazard). Additionally, they were not in favour of consolidation of economic and private debts.

Trade Unions supported the objective of second chance, but they warned from too generous rules which can facilitate the so-called "phoenix syndrome"¹⁸².

Although all Member States supported, in principle, the idea of a second chance for entrepreneurs, providing for a reduced discharge period, various views were expressed with regard to the conditions and exemptions. During the informal governmental expert group meetings, some Member States (BE, FR, FI) were in favour of introducing a presumption of honesty, while others (PL, NL) spoke against. In addition, views were diverging with regard to the issue of introducing a limited time-period within which a discharged entrepreneur would be banned from another discharge procedure. Some Member States (DE) pointed out that a full discharge of debt should be possible only after the repayment of a predefined portion of the debt. Finally, many Member States were in favour of consolidation of economic and private debts (BE, FI, FR, NL, ES).

Consumer organisations strongly supported a three-year discharge period, not only for entrepreneurs but for all honest bankrupt individual debtors.

¹⁸² This is defined as a situation where controllers of a company that becomes insolvent by reason of their acts or omissions are enabled to be relieved of their failure and debts and immediately re-establish themselves in a new enterprise effectively carrying on the same business and still availing of the privilege of limited liability.

5.7.2. Consumers

5.7.2.1. Description of sub-options

Sub-option 1: The regulation of personal insolvency has an influence on how individuals deal with risks in their economic activity, and determines whether individuals suffering from an excessive debt burden can return to a productive economic life. 'Discharge is the essential feature and one of the most salient characteristics of modern systems for the regulation of the insolvency of natural persons. One of the principal purposes of an insolvency system for natural persons is to re-establish the debtor's economic capability, in other words, economic rehabilitation,⁴⁸ and discharge is the most effective way in which the debtor can resume productive activity for society. It is also the most effective incentive for the use of a personal insolvency regime.'¹⁸³

Sub-option 2: As a matter of principle, there is no need to distinguish in term of discharge periods between entrepreneurs and consumers. First, the same arguments linked to re-integration in to the economic life play out for both. Second, in many cases it will be difficult to draw the line between the personal debts incurred as a result of the business activity of the debtor and those incurred for other reasons. In such cases, different discharge periods may make procedures more cumbersome and costly, with even more losses to creditors and more hardship to debtors. For these reasons, the same sub-options should be kept for both entrepreneurs and consumers. *Sub-option 1* and *Sub-option 2* are therefore similar to *Sub-option 1* and *Sub-option 2* under the section on discharge for entrepreneurs.

5.7.2.2. Assessment of impact of the sub-options and preferred sub-option

Sub-options	Sub-option 1	Sub-option 2
<i>Sub-option summary</i>	Discharge of debts for consumers could take place within 1 year from start of liquidation proceedings, with limited exceptions (e.g. fraud or bad faith).	Possible discharge of debts for consumers could take place within 3 years from the start of liquidation proceedings or the moment when the repayment plan starts being implemented, with certain exceptions (e.g. fraud or bad faith).
Impacts		
<i>Effectiveness</i>	<p>+</p> <p>This option would help in cases of no-assets-no-income debtors with debts of a relatively small value (e.g. under 10,000 euro). It would address an important segment in the society, i.e. those who cannot enter a repayment plan because they do not have any income.</p> <p>A 1 year discharge period would not be appropriate for debtors who still have the possibility to repay their creditors or for</p>	<p>++</p> <p>A medium length maximum discharge period for all over indebted debtors, i.e. NINAs¹⁸⁴ but also those still able to make repayments to creditors and those having large amounts of debt, would have positive effects overall on affording debtors a reasonable second chance with much less risk of moral hazard than in option 1. A 3 years repayment period is, according to evidence¹⁸⁵, an optimal period which encourages repayment to creditors. Longer</p>

¹⁸³ Garrido, J. M., The Role of Personal Insolvency Law in Economic Development, An Introduction to the World Bank Report on the Treatment of the Insolvency of Natural Persons, World Bank, http://elibrary.worldbank.org/doi/pdf/10.1596/978-1-4648-0037-5_ch5, p. 124.

¹⁸⁴ No income, no asset (person). See Glossary in Annex 5.

¹⁸⁵ Garrido, J. M., The Role of Personal Insolvency Law in Economic Development, An Introduction to the World Bank Report on the Treatment of the Insolvency of Natural Persons, World Bank,, http://elibrary.worldbank.org/doi/pdf/10.1596/978-1-4648-0037-5_ch5, p. 124 and foll.

	those who have large amounts of debt.	discharge period may also make too big sacrifices in the terms of private life of the debtors. While NINAs would arguably be better off with a shorter discharge period, the lack of experience in the Member States with such short discharge periods may create a rather negative perception of second chance provisions. According to the World Bank, experience with voluntary workout arrangements indicated that expecting debtors to live longer than three years at a subsistence level would be “from a social point of view not responsible.” Practice in many countries has indicated that plans longer than three years produce more failure than success. In one large system, for example, a consistent two-thirds of all payment plans fail before they reach the end of their five-year term. ¹⁸⁶
<i>Bankruptcy tourism(relocation)</i>	+ Incentives for relocation for the purposes of taking advantage of more favourable discharge periods would be reduced for those debtors who have smaller amounts of debt and no income..	++ Incentives for relocation for the purposes of taking advantage of more favourable discharge periods would be greatly reduced for all honest debtors.
<i>Legal certainty for creditors</i>	+ Certainty for creditors (assessment of risk-given-default) would be greatly improved, in particular with respect to the least creditworthy borrowers.	++ Certainty for creditors (in respect of risk-given-default) would be greatly improved for all categories of borrowers.
<i>Availability and cost of credit</i>	- A too short discharge period may have negative impact on availability and costs of credit, as lenders may fear they are likely to have more claims unpaid due to the moral hazard which a short discharge period would generate. In practice, such a risk is mitigated by the fact that only debtors with small amounts of debt would be addressed.	++ Compared to sub-option 1, the negative effects on availability and costs of credit are limited, as in practice lenders calculate the cost of credit based on the rate of default and rather recovery rates that the length of discharge. Furthermore, more legal certainty in this area would help lenders foresee better the risk-given-default.
<i>Promotion of responsible lending</i>	+ Creditors would limit irresponsible lending as they would be discouraged to offer credit to not creditworthy consumers.	++ This option would limit tendency to irresponsible lending (application of too low creditworthiness standards) by creditors to all categories of borrowers.
<i>Impact on legal</i>	+	++

¹⁸⁶ Working Group on the Treatment of the Insolvency of Natural Persons Report on the Treatment of the Insolvency of Natural Persons, World Bank, http://siteresources.worldbank.org/INTGILD/Resources/WBInsolvencyOfNaturalPersonsReport_01_11_13.pdf, p. 86.

<i>systems</i>	Many Member States (except UK) would have to change their laws to adjust to the new discharge period.	Many Member States (except e.g. FI, SE) would have to provide for shorter discharge periods, while some Member States may only have to reconsider the conditions under which discharge is granted (e.g. FR, DE, SK, CY). Compared to sub-option 1, the legal system of Member States is less affected.
<i>Facilitate return of debtors to consumption</i>	+ This option will address the poorest borrowers. The Impact on consumption and growth will be positive, but limited due to their limited income. The impact on social security expenditures will be positive (less help needed if people able to get back to work).	+ The positive impact of this option on consumption and growth may be substantial, as borrowers freed from debt will come back to higher consumption levels. Some limited impact on expenditures on social help (less help needed if over-indebted back to work and normal life).
<i>Create a favourable entrepreneurship climate</i>	+ Limited positive impact, as the beneficiaries of this option can hardly become entrepreneurs.	++ Potential positive effect, as previously over-indebted could start a business (or restart, if their debts were partly due to previous professional activity) .
<i>Fundamental rights</i>	+ The change may be somewhat detrimental in the short term to the creditors' right of property in some Member States, although the impact on creditor is likely to be minimal given that this sub-options concerns consumers with no income and no assets. Debtors, on the other hand, would benefit from less interference with their private life, as creditors can enforce claims for a shorter period of time. Positive impact on the right to decent life, in particular if over-indebtedness is due to external reasons.	++ Compared to sub-option 1, the change would strike a better balance between the creditors' right of property, due to the limited discharge period, and the interference with the debtor's private life following a limited discharge period. Positive impact on the right to decent life, in particular if over-indebtedness due to external reasons.

Summary assessment of the preferred sub-option: Sub-option 2 is the preferred sub-option because overall it would have an impact on a larger group of citizens, provide a better balancing of the need to afford debtors a second chance while at the same time encouraging repayment of debts and therefore creating a better perception of second chance provisions. It would also be less sensitive with Member States which currently have longer discharge periods. The risk of moral hazard is reduced, as a Study on consumer over-indebtedness¹⁸⁷

¹⁸⁷

THE OVER-INDEBTEDNESS OF EUROPEAN HOUSEHOLDS: UPDATED MAPPING OF THE SITUATION, NATURE AND CAUSES, EFFECTS AND INITIATIVES FOR ALLEVIATING ITS IMPACT, Report prepared by Civic Consulting of the Consumer Policy Evaluation Consortium (CPEC) for the European Commission (DG SANCO), Report published in 2014, p.167. Available at: http://ec.europa.eu/consumers/financial_services/reference_studies_documents/docs/part_1_synthesis_of_findings_en.pdf.

confirms that the reasons of consumer over-indebtedness are mostly external and objective (loss of employment, divorce, disease).

In terms of impacts on **fundamental rights**, this options strikes the right balance between the creditors' right of property, due to the limited discharge period, and the interference with the debtor's private life following a limited discharge period. Positive impact on the right to decent life is expected, in particular if over-indebtedness is due to external reasons. **Social impacts** will be positive, as more debtors will be able to have a second start, escape debt traps and possibly avoid going on the black market to find for sources of income.

In the 2016 public consultation, most of the respondents agreed that consumers should be given the chance to restructure their debt, supporting also that a full discharge of debts, possibly subject to certain conditions, should be offered to consumers provided that they are 'honest' debtors. They particularly mentioned that this needs to be complemented by disincentives for dishonest conduct. The majority also replied that over-indebted consumers should have access to free or low cost advice.

Whilst there is support for some harmonisation of rules on discharge of debt for consumers among business stakeholders, some (e.g. Bundesverband der Deutschen Industrie e.V) highlight that a too short period for discharge can be an incentive for misuse. Some business stakeholders¹⁸⁸ are also of the opinion that consumer insolvency and discharge should be dealt with separately and should not form part of the effort to create an efficient insolvency framework for businesses. Additionally, financial institutions are strongly opposed of including rules on consumer insolvency.

Family and consumer protection stakeholders on the contrary strongly endorse minimum standards on consumer insolvency and discharge and stress that there are no convincing arguments for differentiating between entrepreneurs and consumers with regard to the applicable conditions.

Given the insufficiently developed body of evidence of the positive impacts of discharge periods for consumers on the internal market as well as the differences in rationale between this initiative focused on the improved functioning of the capital market union and the freedom of establishment for self-employed persons, the principle in *Sub-option 2* above should be set as a possibility in a soft law instrument rather than in binding legislation, as already set out above¹⁸⁹. However, this possibility would need to be considered in light of the ongoing developments in Member States as regards national reforms of consumer insolvency laws and existing frameworks for addressing the problem at this stage, as described under Problem 3. It is true that soft law already exists in that respect in the form of the 2014 Recommendation. However, it needs to be taken into account that Member States would be obliged to regulate a discharge period for entrepreneurs in line with the minimum requirements of a Directive. In those circumstances even non-binding provisions on the extension of that regulation to consumers could have tangible impact on the ground over and above the 2014 Recommendation, particularly in view of the fact that many Member States have common rules for entrepreneurs and consumers and that in practice very often the consumer and business debts of an entrepreneur can hardly be distinguished.

¹⁸⁸ BUSINESSEUROPE, European Banking Federation (EBF) and European Mortgage Federation-European Covered Bond Council (EMF-ECBC).

¹⁸⁹ Point 4 *in fine*.

5.8. Measures to increase the effectiveness of restructuring, insolvency and second chance procedures

5.8. Description of sub-options

Sub-option 1: courts or judges dealing with restructuring, insolvency and second chance procedures will need to be appropriately trained and specialised; practitioners in these fields will need to be professional, abide t ethical standards, be monitored and have a disciplinary system, and be remunerated in a manner which encourages them to achieve sustainable outcomes in the short time period possible. Increasing the performance of courts and practitioners will also contribute to making the system less vulnerable to moral hazard: when people know the system works well and is transparent, there is less room for moral hazard.

Sub-option 2: the introduction of electronic means of communication for procedural steps such as filing of claims, notifications to creditors, voting of restructuring plans, lodging challenges and appeals will reduce the length of restructuring, insolvency and second chance procedures, increase the participation of creditors, especially cross-border creditors with small amounts of debt which would otherwise not consider it worthy to travel to another Member State in order to vote on a restructuring plans or to file an appeal; and the data collection exercise under Sub-option 3 below.

Sub-option 3: This sub-option will add an element of monitoring of restructuring, insolvency and second chance procedures. Member States will be asked to collect data on the number of filings, the outcomes of procedures, and the sustainability of restructuring and second chance outcomes (by collecting data on re-applications of debtors who already went one through such procedures). Such data shall be collected on the basis of a standard data collection form and will be communicated to the Commission.

5.8. Assessment of impact of the sub-options and preferred sub-option

5.8. Increase the effectiveness of procedures	Sub-option 1: specialisation of courts or judges, training and professional standards for practitioners in the area of restructuring, insolvency and second chance	Sub-option 2 S/o 1 + digitisation of court procedures	Sub-option 3: S/o 2 + monitoring and data collection on number and outcome of procedures
<i>Reduce costs of assessing risks by investors</i>	+ Investors' confidence in the courts and judges as well as in the practitioners assisting the courts where their debtor has its COMI is crucial to their decision to invest (AFME).	++ Increasing the creditors' possibility to participate in restructuring, restructuring and second chance procedures reduces the risks for creditors, in particular small, cross-border investors who would be otherwise unable to participate in person or by representation and thus	+++ Publicly available data on the length of the different types of procedures, the likely outcomes of such procedures etc. provides better information for investors, much as the WB Ease of doing business Index does currently. The advantage of such monitoring at EU level has the advantage

		influence the process or defend their interests ¹⁹⁰ .	that it will provide concrete data rather than expert estimates.
<i>Reduce costs of restructuring of cross-border groups</i>	+ Costs will be reduced as the courts' capacity to respond quicker and with more authority to urgent requests, as so often in restructuring and insolvency cases, would be enhanced in all jurisdictions where a group has subsidiaries. This effect will be compounded if the practitioners assisting courts and the parties are also enjoying a high level of professionalism in all Member States.	++ Communication in cross-border cases between the parties (debtors, creditors, shareholders etc.), between parties and practitioners appointed by a court and between courts would be greatly facilitated and made speedier if procedures were digitised.	++ No significant additional direct impact as compared to Sub-option 2. Indirectly, data on the effectiveness parameters in each Member State may help those restructuring groups of companies to take preventive action. If for example a legal system is known to produce delays, the group may decide or a targeted COMI shift of a certain subsidiary.
<i>Effectiveness</i>	+ In the public consultation, among the measures which would contribute to increasing recovery rates for creditors, insolvency practitioners were mentioned by most respondents, followed by avoidance actions and specialisation of courts or judges	++ This sub-option would reduce the costs of creditors' participation in restructuring procedures, in particular in cross-border cases. A higher participation of credits will in turn result on a more balanced and therefore more viable restructuring plan.	+++ Monitoring of procedures in each Member States will enable legislators to identify the soft spots of these systems and act in a targeted way to address them. For example, if the number of filings is too small, further incentives could be put in place.
<i>Judicial authorities</i>	+ Specialisation of courts or judges would contribute to reducing the time necessary to deal with cases, thus leading to a reduction of the overall workload in courts..	++ This sub-option would have positive impacts on the legal system, as it reduced delays and antiquated communication systems.	++ This sub-option should not require more work at the level of courts, if the steps in the procedure are digitised and can then feed into a dedicated database.
<i>Legal systems/Administrative costs</i>	- This sub-option may require that Member States re-think the organisation of courts and implement some substantial changes. To avoid any risks of dysfunctions in the short term, a longer	- No significant changes in the legal system, but there would be additional costs for the justice budgets to implement such measures. However, the digitisation of procedures is a trend in all Member States, any the upfront	- If procedures are digitised, the costs of this sub-option would be reduced to the costs of developing a software aggregating relevant data which already exists in the system in a special database. These costs are

¹⁹⁰ Flash EB 422 of 2016 on Domestic and foreign claims of EU businesses shows that enforcement of foreign claims is relatively rare and rather for higher value of claims, which may suggest many low value claims are abandoned.

	<p>implementation period should be considered for such measures. Organisational changes would imply some one-off costs but would result in efficiency gains within the judiciary that should more than compensate for these costs in the longer term.</p> <p>There may be some further costs linked with the training of insolvency practitioners, and with the supervision of their activity. However, these costs should not necessarily be made from the public purse, but rather by the associations of lawyers, insolvency practitioners and other professionals who perform the tasks of insolvency practitioners and should be part of their life-long learning and self-regulation expenditure.</p>	<p>costs putting it in place are likely to be quickly offset by the gains in the reduction of the length of procedures.</p>	<p>negligible in comparison with the costs under Sub-option 2.</p>
--	---	---	--

Summary assessment of the preferred sub-option: Sub-option 3 is the preferred sub-option because it has the highest impact on the reduction of the length of procedures, the increase of confidence in the operation of courts and the professionalism of insolvency practitioners. This is the most likely sub-option to lead to a reduction of average insolvency proceedings in the Member States where procedures are too lengthy. The internal market objective would be best achieved by this sub-option which would ensure a considerable reduction of the investors' costs of assessing risk ex-ante and of coordinating procedures ex post. No significant impacts on fundamental rights or social impacts can be discerned.

In the public consultation, many respondents stated that a court system in terms of speed, cost and specialisation may have an impact on saving viable businesses and increasing the recovery rates.. More specifically, the vast majority of the respondents were of the view that minimum standards on qualifications and training for insolvency practitioners would help to increase the efficiency and effectiveness of insolvency proceedings, while more than half called for minimum standards on licensing and registration requirements, liability and a Code of Ethics. In addition, specialisation of courts and digitalisation was also mentioned as a potential incentive to reduce the length of insolvency proceedings.

Particularly, in the public consultation and the dedicated meetings with the stakeholders, business sector welcomed minimum standards for practitioners in the field of restructuring and insolvency. Many of them advocated the introduction of a code of conduct for insolvency practitioners.

Financial institutions in general would welcome the introduction of minimum standardised rules on the role of mediators and supervisors, which should include among others: (i) professional qualification standards; and (ii) general principles covering their remuneration. They were also of the view that the effective length of insolvency proceedings, as well as the skill of insolvency practitioners and the specialisation of courts and judges, have an enormous impact on the debt recovery rate.

However, insolvency practitioners' organisations were reluctant to detailed provisions regarding insolvency office holders. INSOL Europe stressed that although harmonisation would be in general desirable, only common principles in cooperation matters, independence and continuous education are advisable at this stage, due to the great diversity of national rules with regard to all aspects related to insolvency office holders (types, nature of employment, size, qualification, training, appointment, remuneration and liability issues).

Academics and experts were of the view that qualification, training and independence of insolvency practitioners as well as courts' specialisation are of key importance for an efficient early restructuring legal framework.

In the public consultation and the meetings with governmental experts from the Member States, the majority of the Member States (PT, DE, ES, FR, NL, FI, IE) supported the objectives of adequate qualification and training of insolvency practitioners. Many Member States voiced that EU intervention should remain at the level of general objectives and provide a rather flexible approach, especially regarding the appointment and remuneration of practitioners. With regard to specialization of the judiciary, the majority of the Member States welcomed the general objectives of proper qualification, training and specialisation of judges, but expressed concerns regarding a provision on the concentration of courts in insolvency cases, since it affects the organisation of the internal judiciary system, which is a matter of national competence.

6. THE PREFERRED HIGH-LEVEL OPTION 4

The preferred option is Option 4 with the following combination of selected substantive sub-options:

Operational objectives	The preferred sub-option
<p>Enable efficient possibilities of early restructuring</p>	<p>Sub-option 3</p> <p>(i) A restructuring procedure must be available when the debtor is in financial difficulties and there is a likelihood of insolvency.</p> <p>(ii) Over-indebted but viable debtors must have a clear possibility to enter preventive restructuring.</p> <p>(iii) A model restructuring plan must be made available to SMEs to assist them in drafting plans and making the necessary disclosures to creditors, accompanied by early warning tools or advice mechanisms.</p>
<p>Improve chances of negotiations by allowing the debtor a "breathing space" by way of stay of enforcement actions (moratorium)</p>	<p>Sub-option 3</p> <p>(i) The moratorium suspends individual enforcement actions and the duty to file for formal insolvency proceedings.</p> <p>(ii) The moratorium also suspends the right of essential suppliers to avail themselves of early termination clauses.</p> <p>(iii) The moratorium is of a short, limited duration of no longer than 4</p>

	months and gives creditors right to ask for lifting the stay.
Facilitate the continuation of debtor's business while restructuring	Sub-option 1 Debtor remains in possession, but courts may appoint on a case-by-case basis a mediator or a supervisor
Disallow dissenting minority creditors and shareholders to jeopardise restructuring effort while safeguarding their interests	Sub-option 3 (i) The plan is adopted if the required majority in every class is in favour of the plan, provided that the minority creditors are not unfairly prejudiced; all classes of creditors can be affected by the plan, vote and be bound by it, including secured creditors. (ii) Member States may also provide that the plan can be adopted if the required majority in at least one class of creditors is in favour of the plan, provided that dissenting classes are not unfairly prejudiced (inter-class cram-down). (iii) Shareholders should not be allowed to block restructuring plans, provided their legitimate interests are protected, for example, by including shareholders as class(es) of their own).
Increase chances of success of the restructuring plan	Sub-option 2 (i) Exempt new financing contained in the restructuring plan as well as essential interim financing from avoidance actions. Member States may also provide for super-priority status to new financing, ranking it at least above unsecured creditors. (ii) Non-related party transaction entered into before insolvency, but in connection with a restructuring plan adopted by creditors shall be exempted from avoidance actions (safe harbour provisions)
Reduce costs and length of restructuring procedures	Sub-option 1 A flexible framework, which allows for a limited necessary involvement of courts, for example, for granting a moratorium and for confirming the plan
Enable the discharge for natural persons in a reasonable time for those in good faith	Sub-option 3 (i) Discharge of debts for entrepreneurs within 3 years from start of liquidation and start of implementation of the repayment plan, implemented, with limited exceptions (e.g. fraud, bad faith). (ii) Possibility to consolidate all personal debts of the entrepreneur - be they business or non-business in nature - in one procedure. Member States could also reduce discharge periods for consumer debts to 3 years from the start of liquidation proceedings or the moment when repayment plan starts being implemented, with certain exceptions (e.g. fraud or bad faith). A coherent discharge regime for all natural persons would facilitate the consolidation of all debts of the entrepreneurs for the purposes of obtaining a discharge.
Increasing the effectiveness of restructuring, insolvency and second chance procedures	Sub-option 3 (i) Specialisation of judges and enhancing the quality of insolvency practitioners. (ii) Digitisation of procedures. (iii) Data collection

The selection of sub-options was also inspired by well-performing national frameworks¹⁹¹. Hence, the provisions of the future directive will not require significant changes in those Member States, while allowing those Member States which need to improve a reasonable degree of flexibility.

For example, on restructuring:

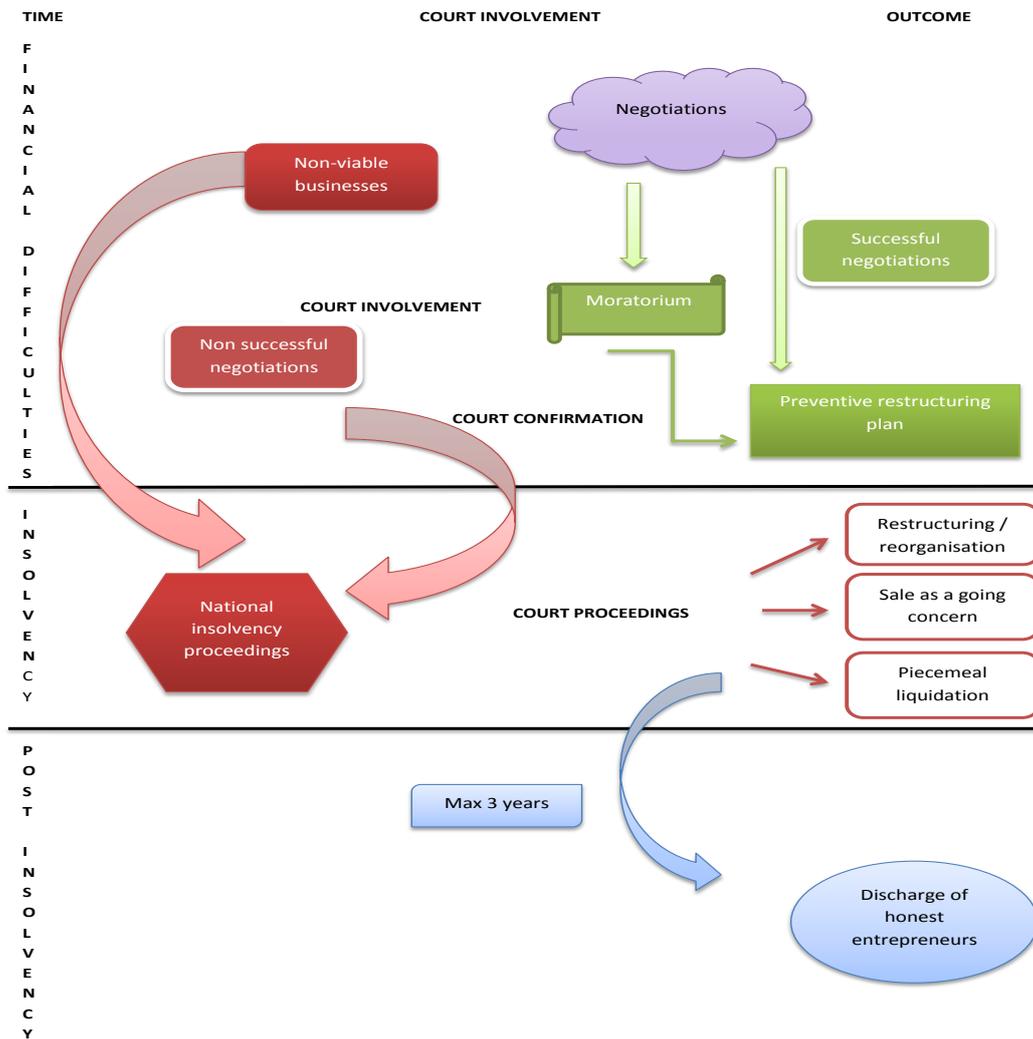
- a stay of enforcement actions is necessary to address the problem of a minority of creditors who have no interest in restructuring the debtor and who may therefore obstruct the negotiations. at the same time, a too long stay period may be detrimental to creditors, therefore increasing the number of those who would be opposed to restructuring the debtor's business
- the inspiration for a short stay period of no longer than 4 months came from France (the ad-hoc and conciliation procedures), Germany, Spain and a number of Member States which reformed very recently in this area (Slovenia for example); the inspiration for allowing MS the discretion to prolong the stay period up to 12 months provided that certain conditions are met came from Finland and France (the sauvegarde procedure) where more complex restructurings can take place.
- the preferred option will therefore not change what works well in several Member States, while addressing the biggest problems with the stay which are: too long stay periods (24 months in Luxembourg) with no control and therefore potentially open to abuse and (2) no stay possibility at all (Austria).

For discharge: the trend is clearly towards reducing the discharge period for natural persons.

- following the 2014 Recommendation, most reforms took place in this area: Spain, Romania, Hungary, Croatia have for the first time introduced the possibility of a discharge of debt after a number of years – this is a positive development, but the discharge period implemented in these countries is 5 years and not the recommended 3 years
- in some Member States the existing discharge periods were reduced to 3 years, e.g. Greece (for entrepreneurs only, from 10 years)
- several Member States where entrepreneurship is very dynamic have short discharge periods, e.g. UK, NL, FI - they were the inspiration probably also for the 2011 Competitiveness Council conclusions which recommended 3 year discharge periods to be implemented in the Member States by 2013.

¹⁹¹ See Annex 6 Overview of Member States frameworks.

Chart 6: An illustration of how a restructuring framework including the preferred sub-options could work in practice



7. ANALYSIS OF OVERALL IMPACTS OF THE PREFERRED HIGH-LEVEL OPTION 4

There is a substantial amount of evidence that the approach to restructuring that is set out in the preferred option, of giving preference to restructuring over liquidation, and of facilitating a fresh start for failed entrepreneurs and consumers can give rise to significant economic benefits¹⁹². However, the insufficient granularity and lack of data comparability between Member States as regards the number and types of restructuring and insolvency proceedings, and essential elements of such proceedings, such as their length, costs and recovery rates - make it challenging to make precise quantitative estimates of the scale of the positive impacts that the preferred Option 4 is expected to generate.

Thanks to its binding character, Option 4 will introduce a new culture of rescuing viable businesses in those Member States (mostly central, eastern and southern EU Member States) where such approach is currently virtually non-existent and which the 2014 Recommendation could not bring about given its non-binding character.

Option 4 provides for key effectiveness and efficiency elements of restructuring proceedings which have been elaborated together with a group of insolvency experts as well as the key stakeholders. Given the large divergences between the substantive insolvency frameworks in Member States as attested by the comparative study, Option 4 tries to put in place a minimum, targeted effectiveness and efficiency framework while at the same time not upsetting the existing insolvency and restructuring procedures in the Member States where these work well. A degree of flexibility for Member States to decide on the means to achieve the objectives is necessary because in practice we observe that different approaches could work well in practice. For example, Member States have different approaches to class formation (for example whether to bifurcate secured claims in different classes based on the value of the collateral) and to the majorities required for the plan to be adopted (for example whether simple or qualified majority), therefore the details in these matters were left to their discretion.

Furthermore, Option 4 will create a framework where restructuring of cross-border groups of companies will be possible – thanks to the common binding minimum standards. This will be an important progress compared to the existing situations where, according to the stakeholders, cross-border restructurings with application of multiple Member State insolvency laws are currently unfeasible due to the inefficiency or divergences of national restructuring frameworks. By more coherent insolvency law, current barriers which hold back cross-border investments would be removed. However, Option 4 does not attempt to introduce a new European preventive restructuring procedure, but it rather defines certain efficiency measures which Member States should implement in their existing (or to be introduced) preventive restructuring procedures.

¹⁹² Annual Report on European SMEs 2015/2016, SMEs as the engine of growth in 2016, SME Performance Review 2015/2016, March 2016, prepared for Directorate-General for Internal Market, Industry, Entrepreneurship and SMEs.

Objectives / impacts	Assessment of impacts of the high-level option 4 (with selected substantive sub-options against status quo)
General objectives	
<i>Reduce the barriers for cross-border investment which are related to insolvency frameworks and increase investment and job opportunities</i>	<p>Less distortion of investment decisions and facilitated resolution of non-performing loans. The preferred option will contribute to reducing barriers to cross-border investment. When investing in the EU on a cross-border basis, the investor has to make an assessment of as many substantive restructuring regimes as is the number of Member States he intends to invest in. By reducing the differences between these restructuring regimes, the costs of their assessment will decrease. Consideration of rights against foreign debtors would be an important factor impacting on a decision to invest abroad for almost a half of companies already having foreign debtors. The proportion of companies that would consider those rights is particularly high in Poland, Croatia, Romania, Bulgaria, Latvia, Slovenia, Malta, Greece and Lithuania. The majority of companies (55%) find it difficult to find the information on those rights. Lack of knowledge of foreign law is considered by almost a half (47%) of interviewees a potential obstacle to invest abroad, while around 40% of companies find practical difficulties to file a claim in another country or cost of pursuing this claim, or cost of legal advice a potential obstacle to invest¹⁹³.</p>
<i>Reduce the costs of restructuring, including for groups of companies, so that viable companies are rescued rather than liquidated and maintain jobs</i>	<p>The preferred option 4 would result in more viable business being rescued than at present since:</p> <ul style="list-style-type: none"> - Minority creditors will not be able to destabilise the negotiation process in the hope of extracting some commercial advantage, e.g. by forcing an early recovery of their debt. - Cross-class cram-down will ensure that creditors with no economic interest in the company are not able to hinder the adoption of restructuring plans. Shareholders will not be able to oppose a restructuring which restores the viability of the company. This will improve the restructuring frameworks in particular in BG, DK, SK, SI, HR, CY, EE, IE, LT, LU, NL, PL, RO where currently the restructuring is not effective (too late, formal, inefficient, lack of enabling framework). - Viable SMEs in financial distress with a relatively simple debt structure would benefit in particular. - This option will reduce the spill-over effects of insolvency which result in delayed payments or defaults by other businesses in the supply chain.
<i>Reduce the costs of and increase the opportunities for natural persons to have a fresh start</i>	<p>Option 4 would partially fulfil the objective of reducing the costs of and increasing the opportunities for natural persons to have a fresh start as regards natural persons (entrepreneurs). The risk of bankruptcy is what Europeans fear most about setting up a new business. In Flash Eurobarometer¹⁹⁴, 49% of Europeans have declared that they would not start a business because of the fear of failure. That fear is justified given that 50% of businesses do not survive the first 5 years of their existence</p>

¹⁹³ Flash Eurobarometer, Report Insolvency, no. 442, 2016.

¹⁹⁴ Flash Eurobarometer 354, ENTREPRENEURSHIP IN THE EU AND BEYOND, June - August 2012.

	and that in many Member States it takes a long time for a bankrupt person to obtain a discharge of debt.
Specific objectives	
<i>Reduce the costs of assessing ex-ante the investment risks and improve recovery rates</i>	<p>The costs of assessing ex-ante the investment risks will be reduced and recovery rates in insolvency proceedings will be improved. The greater alignment of restructuring regimes would reduce the cost of legal advice currently used to avoid application of multiple national restructuring and insolvency frameworks. Stakeholders, and especially those in the banking and investment sector reported that greater convergence of insolvency frameworks would enhance predictability, reduce risk assessment costs and encourage investors establishing their business activities in other Member States. At the same time, this alignment would prevent inefficiencies of the cross-border investment structures which are so designed in the economically most efficient way, but in order to circumvent the application of certain inefficient insolvency and restructuring laws. Although it is difficult to assess how much in assessment of recovery rate can be associated with parts of the insolvency framework on restructuring and second chance, if all EU Member States were to reach a recovery rate of 85 percent, this would imply a permanent increase in GDP of €41bn to €78bn (or between 0.3% and 0.55% of EU28 GDP). The distribution of macroeconomic effects suggests that much of the absolute gains from insolvency reform could flow to Italy, Spain and France, as well as some central European member states such as Poland, Hungary and Romania¹⁹⁵.</p>
<i>Reduce the costs of restructuring, including for the groups of companies, so that viable companies are rescued rather than liquidated</i>	<p>The impacts of the preferred option 4 on restructuring costs will be potentially significant in several Member States (in particular BG, DK, SK, SI, HR, CY, EE, IE, LT, LU, NL, PL, RO) and of minimal order of magnitude in terms of savings in other Member States (€135-223 m in particular in BE, DE, FR, FI, SE, LV), plus other unquantified savings. Option 4 would enhance the prospects of realising a higher number of restructurings of cross-border groups the costs of which are currently prohibitive due to widely differing national restructuring laws. Furthermore, the solution under the preferred option 4 will reduce the barriers for cross-border crediting of SMEs: an efficient restructuring procedure would enable SMEs to recover more than in the case of the insolvency of the debtor, since creditors' recovery rates are in general higher where the insolvency framework allows for early and efficient restructuring of viable firms and quick resolution of the non-viable ones. Moreover, in the public consultation and the dedicated meetings with the stakeholders, business and banking sector considered that minimum standards on insolvency practitioners and specialisation of judges could contribute significantly to the increase in recovery rates.</p> <p>The majority of the respondents in the performed public consultation agreed that measures enabling the rescue of viable companies are essential for mitigating the problem of non-performing loans, while less were of the view that measures to improve the effectiveness of</p>

¹⁹⁵

Idem.

	<p>insolvency proceedings can also contribute to reducing the problem of non-performing loans. It was in general stressed that the problem of NPLs can be dealt more effectively in a system providing for realistic possibilities of an effective restructuring and debt enforcement on the one hand and a prompt discharge of what is not realistically recoverable on the other hand. More particularly, the banking sector and legal and insolvency practitioners supported the view that early restructuring measures result in better recovery for lenders since they can allow rescued companies to repay their loans (at least in part) and to continue to make a positive contribution to the economy. Also in the view of financial and banking sector, creditors and investors' certainty concerning legal outcomes particularly as to the enforceability of the loans and the effectiveness of the restructuring initiatives will lead to the efficient resolution of NPLs in Europe.</p> <p>In concrete terms, the length of procedures will be reduced in a number of ways:</p> <ul style="list-style-type: none"> • a maximum four months limit to the stay of enforcement actions; prolongation would be possible but only upon evidence of progress in the negotiations and in any case it should not be longer than 12 months, • courts must decide with expedience, • challenges and appeals shall not be able to suspend confirmation and application of restructuring plans. <p>Finally, by requiring specialisation of insolvency courts and judges, the proposal will oblige Member States to enhance quality and speed of restructuring procedures which are of essence for successful restructurings.</p> <p>Conservatively, if only the reduction of the stay period should have an impact (assuming all other elements are complied with), one can estimate that length of restructuring procedures will, for example, be halved in LU and reduced by 1/3 in France.</p>
<p><i>Reduce the number of natural persons (entrepreneurs and consumers) in a debt-trap so that these natural persons could create new companies and re-integrate in economic life of</i></p>	<p>The selected option 4 will reduce the number of natural persons-entrepreneurs trapped in debt. This will also increase the rate of self-employment in the EU since a reduction in the discharge period increases the rate of self-employment in total employment¹⁹⁶. During the ‘Sounding Board’ meetings, business and practitioners’ organisations, consumers organisations as well as academics acknowledged that a second chance approach accompanied with adequate safeguards will be beneficial for allowing entrepreneurs to re-enter in the productive economy. At one end of the spectrum there are countries such as Cyprus, Hungary, Italy, Lithuania, Malta, Portugal, and Romania, where currently there is no discharge period for entrepreneurs and where the impact of 3-year discharge period would be significant. The number of new</p>

¹⁹⁶ Annual Report on European SMEs 2015/2016, SMEs as the engine of growth in 2016, SME Performance Review 2015/2016, March 2016, prepared for Directorate-General for Internal Market, Industry, Entrepreneurship and SMEs, p. 63.

<i>a society to support a dynamic business environment</i>	businesses each year in Greece, for example, would double. On the other hand, in the countries which have already have a period to discharge of less than 3 years or even less than a year (Belgium (less than 1), Bulgaria (1), Denmark (3), Estonia (3), France (3), Ireland (3), Latvia (3), the Netherlands (3), Poland (1), Slovakia (3) and the United Kingdom (1)) the impact would be only marginal and would be achieved by reducing in practice the discharge period to even less than what it is now.
Key impacts	
<i>Entrepreneurship and innovation</i>	The impact on entrepreneurship will be positive. The latest analysis of enterprise mortality rates shows that on average across Member States, only 82% of firms created in 2012 and 67% of firms created in 2011 survived in 2013. In other words, the death rate of newly created firms is about 1/3 after two years ¹⁹⁷ . Since any liquidation can potentially cause a chain effect of further insolvencies (according to most recent Eurostat data available for 2011, cross-border sales constituted 17,6% of the whole value of sales in Europe) firms further upstream or downstream in the supply chain in one Member State may face financial difficulties because of the insolvency of a firm in another Member State, even if they have no direct dealings with that firm. By promoting a more flexible restructuring framework and better conditions for fresh start upon failure, the death rate of companies can be reduced as well as the negative knock-on effects of related insolvencies in the supply chain. Easier discharge conditions for entrepreneurs also contribute to greater innovation ¹⁹⁸ .
<i>Consumption and growth</i>	The option will positively contribute to consumption and growth, due to enhanced possibilities for companies to continue their operations and keep employment. Since (i) more efficient restructuring procedures lead to a speedier normalisation of portfolios of non-performing loans, and (ii) there is a significant negative relationship between resolution of corporate non-performing loans and GDP growth - 1 percentage point reduction in the ratio of debt to financial assets leads to about 0.4 percentage points less GDP growth – increasing efficiency of restructuring proceedings should positively influence the growth of GDP. It will have a positive impact for natural persons-entrepreneurs to come back to professional life and previous consumption, after using discharge and second chance possibility. Furthermore, according to a study carried out in 2006, GDP growth is positively correlated with a favourable attitude towards second chance ¹⁹⁹ . <i>Chart 7: Estimated impacts of insolvency reform on GDP and</i>

¹⁹⁷

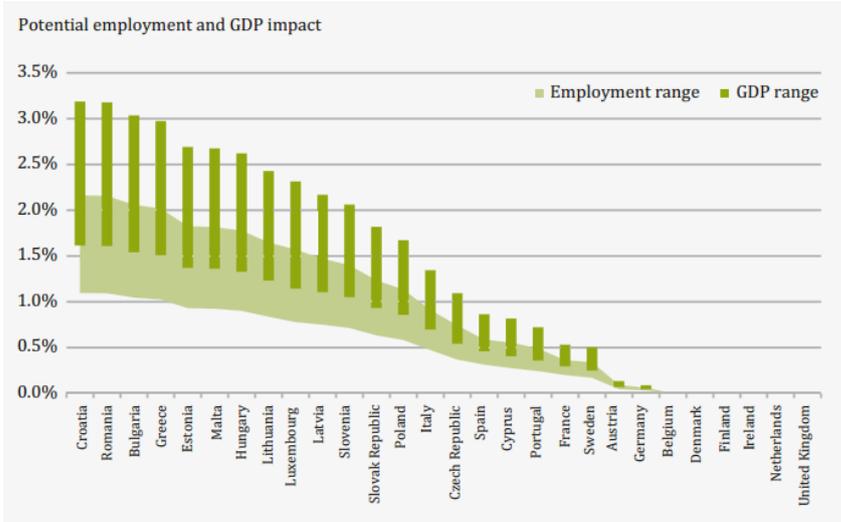
Ibid.

¹⁹⁸

Bankruptcy codes and innovation, CEPR, May 2007, <http://www.cepr.org/pubs/dps/DP6307.asp>

¹⁹⁹

Burchell and Hughes, 2006, *The Stigma of Failure: an international comparison of failure tolerance and second chancing.*

	<p>employment in the EU28</p>  <p>Source: Frontier Economics and Weil, for AFME, Potential economic gains from reforming insolvency law in Europe, February 2016, based on Datastream, World Bank, S&P and Moody's data</p>
<p><i>SMEs</i></p>	<p>The impact on SMEs will be positive. SMEs as debtors are most likely to succumb to temporary financial difficulties, as (i) their smaller size may mean that they have fewer financial reserves on which they can draw in case of financial difficulties – often triggered by the financial difficulties of a bigger company in their network, (ii) they are most affected by the cost of restructuring and the reticence of lenders to extend new finance to companies in financial distress. A more accessible, cheaper, and faster preventive restructuring framework would afford SMEs more chances to restructure successfully and therefor are more resilient to shocks in the supply chain.</p>
<p><i>Competitiveness</i></p>	<p>The preferred option will contribute to higher competitiveness of EU companies since it is expected that it will lead to increases in recovery rates which, in turn, lead to lower borrowing costs²⁰⁰. The lower borrowing costs for EU companies will have a positive effect on their competitiveness.</p>
<p><i>Jobs and social impacts</i></p>	<p>The preferred option will have a positive impact on employment.</p> <p>Since early restructuring saves companies rather than drive them into liquidation, it is expected that jobs will be saved rather than lost. It was hard to measure the exact impact on jobs, but it is expected that a significant proportion of the 1.7 million jobs which are lost to insolvency every year will be saved. Benefits will be seen in particular in particular in BG, DK, SK, SI, HR, CY, EE, IE, LT, LU, NL, PL, RO.</p> <p>The selected option will not impact on the protection of workers, including their rights to information and consultation, as guaranteed by EU law. This will be clearly spelled out in the proposal. Furthermore, it</p>

²⁰⁰ A 10 percentage point increase in expected recovery rate is associated with a 37 basis point fall in bond spread (Potential economic gains from reforming insolvency law in Europe, AFME, Frontier economics, Weil, February 2016, p. 34).

	<p>contains a flexibility to ensure that workers as a class can be adequately protected. For example, courts can exempt an entire class of creditors from the stay of enforcement if such a class will be unfairly prejudiced by the stay. Furthermore, possibilities for the salaries to be paid during the stay period and protected under the 'safe harbour' provision would be introduced. Also, plans will not be confirmed by a court if they do not guarantee at least liquidation value to all creditors.</p> <p>Second chance provision will also have a positive impact on jobs. Restarters could create up to 3 million new jobs²⁰¹. The measures on discharge period also have an impact on preserving a decent livelihood for debtors (who can otherwise slide into the grey or black economy).</p>
<p><i>Financial institutions</i></p>	<p>The preferred option will have a mostly positive impact on financial institutions. The positive impacts will result from the expected increase in recovery rates and from the accelerated rate of reduction in the share of non-performing loans. This will be due in particular to easier detection of viable debtors, shorter and less costly process of restructuring or liquidation. Financial sector will benefit from better crediting capacity and higher demand for credit (due to better standing of the economies) Higher convergence of discharge regimes for debtors will have a positive impact on financial institutions as creditors, by enabling them to better foresee the prospects of repayment of debts by companies and individuals. Some negative impact may come from the moratorium on enforcement actions of secured creditors. The provision on majority decision on the restructuring plan binding all types of creditors may lead financial institutions to think that they have less control over their loans held against borrowers in distress or insolvent. However, specific safeguards are foreseen in Option 4 to mitigate potential negative impacts. For example, the duration of the moratorium has been designed to be limited and short. Court confirmation of a restructuring plan must hinge on whether the plan is fair towards dissenting creditors (i.e. best interest of creditors test and the absolute priority rule).</p>
<p><i>Impact on unsecured creditors</i></p>	<p>In liquidation proceedings, creditors with no security suffer the biggest losses: this reality is universally valid, and consequently the World Bank Ease of Doing Business Index measures only recovery rates for secured creditors. Precisely because liquidation would be so disastrous, unsecured creditors are the most likely to benefit from the rescue of the debtor's business: even if subject to a long stay, unsecured creditors would at the end, if restructuring is successful, be able to claim and obtain compensation for the unpaid debts, where as in case of liquidation they will get close to nothing.</p> <p>Nevertheless, it is important to ensure that the debtor is able to continue</p>

²⁰¹ Annual Report on European SMEs 2015/2016, SMEs as the engine of growth in 2016, SME Performance Review 2015/2016, March 2016, prepared for Directorate-General for Internal Market, Industry, Entrepreneurship and SMEs. According to another study, Additional employment in the EU28 would increase by between 600,000 jobs in the low scenario and 1.2 million jobs in the high scenario, see *Potential economic gains from reforming insolvency law in Europe*, AFME, Frontier economics, Weil, February 2016, p. 5.

	operating during the stay period, therefore his essential suppliers should not be able to terminate contracts provided the debtor fulfills his obligation. They should also not be able to terminate contracts for debts which arose before the stay was granted.
<i>Impact on consumers</i>	Although the proposal would not lay down mandatory rules on consumer discharge, it would encourage that the same regime applies to entrepreneurs and to non-entrepreneurs (consumers). Many Member States already treat the discharge and second chance for natural persons in the same way irrespective of whether the indebted person is a consumer or entrepreneur. It should also be made possible where it is not currently the case.
<i>Non-performing loans</i>	<p>A solid restructuring framework will prevent the accumulation of bad debts by putting in place tools that allow the transformation of non-performing loans into performing ones, or alternatively to channel non-viable companies to quick liquidation. The preferred option is also expected to have a positive impact on contributing to reducing the NPLs accumulated in the balance sheets of banks issue, although it will not fully solve it (at least not in a very short time span). More specifically, the NPLs will be tackled by:</p> <ul style="list-style-type: none"> - rescuing viable companies in financial difficulties: such company will mostly owe to a bank a performing loan (which is not yet due but the due date coming close). Rescuing a higher number of companies will ensure that new NPLs are not added. However, since it cannot be excluded that a viable company in financial difficulties may also owe a non-performing loan (which is already due), there is a twofold indirect link between early restructuring and reduction of non-performing loans. First, higher recovery rates are more likely in economies where restructuring is the most common insolvency proceeding. For example, 45 percent of OECD economies use reorganization as the most common insolvency proceeding to save viable firms, leading to an average recovery rate of 83 cents on the dollar, as opposed to 57 cents on the dollar with liquidation (World Bank, Doing Business Report, 2013). There is also solid evidence from the US showing that an insolvency system which favours restructuring is more resilient to economic shocks. - by making restructuring frameworks more effective and efficient, the costs of enforcement of non-performing loans through restructuring will decrease, so that banks will be able to deleverage a higher number of those loans through restructuring channel (the other channel of deleveraging of non-performing loans in insolvency is through a piecemeal liquidation). This effect has been observed in several countries which recently introduced some sort of restructuring proceedings and faced a problem of a high number of non-performing loans, such as Slovenia. In addition, in the performed public consultation, the banking sector agreed that early restructuring and efficient insolvency procedures can have a very positive impact on recovery rates and non-performing loans.
<i>Tax revenues and</i>	The preferred option will have a neutral impact on tax revenues and

<i>state aid rules</i>	state aid rules. The preferred options complies with the "private investor test" since it treats both the public and the private investors in the same way. In particular, a public creditor agreeing with a reduction of its claim under in a restructuring plan will be subject to the same haircut as the private creditor in the same position. If the public creditor will be among the dissenting creditors, he will be entitled to no less than the liquidation value of the restructures business. Thus, no loss of value meaning no loss of actual or potential revenues for public budgets will occur. Also the stay on enforcement action (the moratorium) limited in time and strictly linked to the preparation of a viable restructuring plan is in accordance with the state aid rules and principles in the area of rescue and restructuring.
<i>Legal systems of Member States</i>	The preferred option will require a modification of restructuring and second chance frameworks in certain Member States. The preferred option will require some Member States to put in place a preventive procedure or adapt a procedure already notified under Annex A of the Insolvency Regulation. Some changes to the law of companies may be needed to implement the provision on shareholders.
<i>Moral hazard</i>	<p>The preferred option should in principle not affect moral hazard elements neither on the side of lenders nor on the side of borrowers due to the safeguards provided for each risk element of the procedure. For example:</p> <ul style="list-style-type: none"> • in respect of the stay of enforcement: creditors can ask the court for lifting the stay when creditors are unfairly prejudiced; • courts have to confirm both the stay and the restructuring plan, making sure that the procedural steps were respected, that dissenting creditors are not unfairly prejudiced and that the plan is not clearly unviable; • creditors can appeal the courts' decision and thus challenge the restructuring plan; • in respect of second chance: Member States can reduce the access to the discharge period or extend the discharge period in case of dishonesty of the debtor.
<i>Fundamental rights</i>	The impact on fundamental rights will be neutral. The right to conduct a business and engage in gainful employment will be enhanced, since companies will be able to continue operating, and entrepreneurs would be able to have a second chance. Although certain elements of the procedure may affect the right to property and the right to an effective remedy and to a fair trial, safeguards will be foreseen in each case in order to ensure that these are proportionate in view of attaining the objectives and respect the rights and principles set out in the Charter of Fundamental Rights, in particular those in Article 17 (right to property), Article 16 (freedom to conduct a business), Article 15 (freedom to choose an occupation and right to engage in work), Article 47 (2) (right to a fair trial), Article 27 (on the workers' rights to information and

	consultation), as well as Article 8 (protection of personal data) and Article 7 (respect for private and a family life).
<i>Third countries, international trade or investment</i>	The impact on third countries, international trade or investment will be positive. The selected option will stimulate international investment from third countries into the EU, as investors will likely face fewer obstacles when entering the EU market.
<i>Court workloads</i>	The preferred option 4 will decrease the workload for courts by reducing the necessity of involving courts in many restructuring proceedings and by introducing the digitisation of procedures. Where the proposed procedure is used, the courts' involvement would only be limited and they would have the possibility of concentrating on formal insolvency procedures.
<i>Public administrations</i>	The impact on costs for public administrations of Member States will be limited. Where preventive procedures are introduced for the first time Member States would need to provide training for their courts and for insolvency practitioners. These training costs will be of one-off character in the range of €950-1300 per judge in those countries where a preventive procedure is used for the first time. Exchange of best practices could be done in the context of the European Judicial Network, at no extra cost for public administrations. Cost of reporting obligations: many Member States already have statistical data, and only need to make it available to the Commission once a year. For the rest of the Member States, the costs of gathering such data are not expected to be significant.

8. MONITORING AND EVALUATION

The implementation of the Directive in the Member States will be followed in the context of the European Judicial Network, which will act as a forum for the exchange of best practices on restructuring and second chance frameworks at EU level. Currently, national official sources (e.g. justice ministries or national statistical institutes) provide information on the number of insolvency cases filed. In some Member States, additional breakdown of different types of insolvency proceedings – which may include restructuring proceedings – can be available.

Although some cross-country data on the number of insolvencies are assembled and reviewed by international institutions²⁰², currently, it is not possible to distinguish the number of national proceedings with a cross-border element from the total number of insolvency proceedings²⁰³; the same applies to restructuring proceedings. Due to the aforementioned limitations in availability of real data on insolvency, it is currently not possible to say what the actual costs of cross-border insolvency or restructuring proceedings and cross-border recovery rates²⁰⁴. With respect to time needed for resolving insolvency cases, estimations on the basis of insolvency practitioners experience are available²⁰⁵. Introducing performance reporting by national insolvency agencies (e.g. on costs, timescales and asset recovery percentage) has been suggested by private stakeholders²⁰⁶ as well as international organisations, such as the IMF²⁰⁷.

In the proposed instrument, it would be necessary to include an obligation for Member States to provide annual statistical data on:

- (i) the number of preventive restructuring procedures opened by enterprises in difficulty,
- (ii) the number of liquidations and sales as a going concern,
- (iii) the average length of proceedings, including particular procedural phases (e.g. before courts, out-of-court),
- (iv) the size of the debtors involved in such proceedings (medium, large or micro-enterprises), and
- (v) the outcome of the procedures opened, including the recovery rates in different types of procedures.

The evaluation of statistical data will allow the Commission to decide on the appropriate follow-up.

²⁰² For example, the OECD indices on the number of insolvencies in "Entrepreneurship at a glance - 2015", or insolvency data published by Creditreform (2015). "Corporate insolvencies in Europe, 2014/15". As the data used relies on national sources, comparability is hampered by the fact that there can be discrepancies in the definition of insolvency and the criteria used for the construction of the statistics.

²⁰³ For example, it is currently not possible to find out from the national statistics on insolvency proceedings, where they exist, (i) whether a certain procedure is a secondary proceeding conducted in parallel to the main proceedings taking place in another EU Member State or purely a self-standing national proceeding; or (ii) whether there is a non-domestic real asset (located in the EU) in the estate of the company subject to restructuring or presence of a non-domestic EU based creditor

²⁰⁴ For example, with respect to the Czech Republic the analysis made by Insolcentrum available at: <http://www.insolcentrum.cz/kompletni-databaze-insolvencnich-rizeni>.

²⁰⁵ This lack of reliable data prevents comparisons and assessments on the strengths on insolvency and restructuring frameworks of different Member States, in terms of costs and recovery rates.

²⁰⁶ Potential economic gains from reforming insolvency law in Europe, AFME, Frontier economics, Weil, February 2016, p. 6.

²⁰⁷ IMF: Euro Area Policies – Selected Issues, IMF Country Report No. 15/205, July 2015, Euro Area Policies, IMF Country Report No. 15/2014, July 2015.

9. ANNEXES

ANNEX 1. PROCEDURAL INFORMATION CONCERNING THE PROCESS TO PREPARE THE IMPACT ASSESSMENT REPORT AND THE RELATED INITIATIVE

ANNEX 2. SUMMARY OF CONSULTATIONS OF STAKEHOLDERS, INCLUDING THE OUTCOME OF THE PUBLIC CONSULTATION ON AN EFFECTIVE INSOLVENCY FRAMEWORK WITHIN THE EU

ANNEX 3. THE IMPACT OF THE INITIATIVE AND DATA

ANNEX 4. LEGAL BACKGROUND

ANNEX 5. GLOSSARY

ANNEX 6. OVERVIEW OF MEMBER STATES' RESTRUCTURING FRAMEWORKS

ANNEX 7. WHO IS AFFECTED BY THE INITIATIVE AND HOW

ANNEX 8. EVALUATION OF THE IMPLEMENTATION OF THE COMMISSION RECOMMENDATION of 12.3.2014 ON A NEW APPROACH TO BUSINESS FAILURE AND INSOLVENCY

ANNEX 1

PROCEDURAL INFORMATION CONCERNING THE PROCESS TO PREPARE THE IMPACT ASSESSMENT REPORT AND THE RELATED INITIATIVE

1. REGULATORY SCRUTINY BOARD

The Impact Assessment Report was examined by the Regulatory Scrutiny Board on 28 September 2016. Recommendations from the Board were transmitted on 30 September 2016 and were implemented into the resubmitted version of the IA Report as follows:

Board's Recommendations	Implementation of the recommendations into the revised IA Report
<p>(1) The policy context should better justify the need to act now, only two years after the related Recommendation.</p> <p>The policy context should better justify the need to act now. Member States have had relatively little time to implement the 2014 Recommendation. What is the evidence that suitable implementation will not take place over time without further EU action?</p>	<p>(1) The section on policy context (section 2.1) was further improved by additional details on the assessment of the evaluation of the 2014 Insolvency Recommendation showing the inconsistencies in the existing restructuring and second chance frameworks in Member States as well as the diverging character of the national reforms in the pipeline. This need for current action is evidenced by the Feedback Statement on the Green Paper "Building a Capital Markets Union" in relation to insolvency and restructuring, the Economic Analysis accompanying Action Plan on Building a Capital Markets Union (both published in 2015) and the independent external evaluation of the implementation of Recommendation on restructuring in the Study on a new approach to business failure and insolvency performed by the University of Leeds (January 2016). A new annex 8 summarising the evaluation of the implementation of the Recommendation in 2015 and 2016 on the basis of Member States reporting was added.</p>
<p>(2) The report should better justify the initiative's internal market aspects and minimum harmonisation approach. It should elaborate on the cross border dimension of restructuring. It should develop the justification for</p>	<p>(2) The internal market aspects of both restructuring and second chance was substantially improved. From the economic perspective, data about (i) cost of the cross-border dimension of insolvency procedures, including restructuring, for large companies and SMEs, and (ii) the additional costs of</p>

the specific features put forward for harmonisation. It should also clarify the internal market aspects of 'second chance.'

The report should provide more detail on the cross-border dimensions of restructuring cases. Notably, it should justify the internal market aspects of the various provisions of the initiative. For instance, it should explain why the proposal covers all potential cases (including purely domestic) rather than only those with a direct debtor/creditor cross-border dimension. The report should also explain how harmonizing specific features would achieve stated objectives. What will be the gains from harmonizing early restructuring, stay, debtors' business continuation, safeguarding of minority interests, possibility of new financing, costs and length of restructuring procedures and discharge? In line with the proportionality principle, the report needs better address the issue raised by stakeholders on 'principle' versus 'detailed' regulation. Clarify what the proposed approach implies for Member States and their degree of flexibility in implementation. Explain the internal market dimension of the second chance provision. The 'discharge for consumers' option is presented as a recommendation to Member States - how would this be more effective than the 2014 recommendation in that respect?

insolvency, including restructuring proceedings with cross-border element(s) compared to domestic procedures were inserted as provided in the meantime by the final report of the contractor for the economic analysis study of the restructuring and second chance proposal (section 2.3.2). Additional data on cross-border aspects of debt resolution from the 2016 Insolvency Eurobarometer were provided (section 2.3.2 and 2.5). From the legal perspective, it was explained that due to the divergences in restructuring frameworks in Member States no restructuring plan involving the continuation of the business of groups of companies has ever been accepted in more than two jurisdictions (section 2.3.2). As regards the discharge period, evidence about its application and duration in Member States was supplemented based on the information provided by the Study on a new approach to business failure and insolvency performed by the University of Leeds (January 2016) and the Bankruptcy and Second Chance for Honest Entrepreneurs of 2014 elaborated by Ecorys. (section 2.3.1 part B) The justification of specific features of restructuring and second chance which merit harmonisation was strengthened by the propositions expressed by stakeholders in the sounding board meetings and experts in the meetings of the expert group organised for this purpose during the impact assessment processed Detailed explanation with examples showing why a dedicated restructuring regime limited to cases of EU cross-border restructuring is a not a viable possibility was added. The internal market dimension of the second chance provision was supplemented by the explanation showing that different discharge periods may lead bankrupt entrepreneurs to exercise their free movement rights and relocate to a more debtor friendly jurisdiction (section 2.3.2) . The IA Report also clarified that the issue of discharge and second chance for consumers will not be dealt with under the current proposal and that it will keep the status quo foreseen by the 2014 Recommendation of restructuring and

	second chance (section 4.2 or 5).
<p>(3) Stakeholder views should feature throughout the assessment of the various policy options. Clearly present differences in views across the stakeholder groups.</p> <p>Stakeholder views should feature more prominently throughout the report. This would strengthen the evidence base and enhance policymaker assessment of options. When doing so, it is important to present differences across stakeholder (sub-) groups. The report should justify the inclusion of a soft law instrument in the preferred option against the background of the stated ineffectiveness of the 2014 Recommendation.</p>	<p>(3) In Chapter 5 of the Report containing the analysis of the impact of the various substantive options, we included to each element the opinions of the stakeholders grouped according to sectors. Furthermore, we amended extensively ANNEX 2 on stakeholder consultation. This new version of the ANNEX identifies the consulted stakeholders in a more detailed manner (listing them according to sectors); contains short paragraphs summarizing the views of the main European stakeholder organizations, includes with regard to each issue addressed by the public consultation the structured presentation of stakeholders' opinion by sectors, and disposes of a table explaining why certain proposals recommended by different stakeholders were not taken on board by the initiative. In this respect, the relevant stakeholders' views on the specific sub-options have been added, based on their input according to the public consultation (stakeholders' position papers and EU-Survey questionnaire) and dedicated stakeholders' meetings ('Sounding Board' meetings and bilateral meetings). There is a clear breakdown of stakeholders (business sector, financial institutions, practitioners in the field of restructuring, trade Unions, consumer organisations, academics and experts). Stakeholders' different views and concerns/suggestions with regard to different policy options are made clear. The IA Report clarified that the issue of discharge and second chance for consumers will not be dealt with under the current proposal and that it will keep the status quo foreseen by the 2014 Recommendation of restructuring and second chance (section 4.2 or 5).</p>
<p>(4) Clarify the overall impacts of the package, notably with regard to fundamental rights and social aspects. Identify potential downside risks, such as moral hazard and limited capacity of the courts to implement new</p>	<p>(4) Additional analysis how key effectiveness and efficiency elements of restructuring proceedings have been identified and elaborated together with a group of insolvency experts as well as the key stakeholders was added. A new section 4.2 containing analysis of high level options</p>

provisions.

The report should strengthen the section on the impacts of the different sub-option beyond the currently descriptive presentation. It should discuss risks involved in the implementation of the proposal. The package of preferred options represents an add-on to national insolvency proceedings. It entails elements that will have to work in close sync with existing national systems. Given this dependence and the diversity of legal systems across the union, harmonization would seem to entail risks as well as benefits. The report ignores administrative costs such as the provisions of the preferred option requiring specialised judges.

The report should also consider risks related to moral hazard problems occurring in the restructuring process. It needs to explain better how this relates to the problem of non-performing loans, and it should estimate the extent to which the proposal will have an impact on these. Given that restructuring may involve situations with lay-offs, outsourcing, etc., the impact assessment also needs to cover social impacts of the preferred options better. It should spelling out any links to the social dialogue and workers' rights (including on information and consultation). The link with – and impact on – fundamental rights should also be clarified.

and discarded options was included. Impact on fundamental rights, in particular social aspects was further improved both in the IA Report and in the Annex 3 (Chapter 5). As to the issue of the moral hazard, further conclusions from past research on moral hazard performed in relation to the assessment of impacts of household indebtedness were added (section 2.4 and 5.7) : The research (Quoted by Annual Report on European SMEs 2015/2016) shows that the key reason of over-indebtedness of sole entrepreneurs, which represent important part of SMEs, resides in the lower resistance of SMEs to external economic shocks due to their lower ability to mobilise reserves for the period of economic downturns. Negligence or intention to repay the contracted business loans is a reason for default of their obligations only in a very low number of situations. Information about experience in recent decades in a number of Member State which reduced the time limit of discharge period was added. This experience shows that in none of those Member State the amount of unpaid loans would have increased due to the moral hazard issue. At the same time, Member States with very short discharge periods (for example 1 year in the UK) do reports how a higher level of unpaid loans due to the moral hazard issue than Member States with long discharge period (for instance Greece with 10 years) (section 5.7). The study on consumer over-indebtedness further confirmed that the reasons of consumer over-indebtedness are mostly external (loss of employment, divorce, disease) and does not find confirmation for moral hazard behavior on the side of over-indebted consumers. Research on US (having liberal insolvency regime) quoted in this study confirms that only 15% of mortgage defaults may be strategic (THE OVER-INDEBTEDNESS OF EUROPEAN HOUSEHOLDS: UPDATED MAPPING OF THE SITUATION, NATURE AND CAUSES, EFFECTS AND INITIATIVES FOR ALLEVIATING ITS IMPACT, Report prepared by Civic Consulting of the

	<p>Consumer Policy Evaluation Consortium (CPEC) for the European Commission (DG SANCO), Report published in 2014). Moreover, better clarification on numerous safeguards against moral hazard, namely possibility to reduce stay on creditors request, confirmation of restructuring plan by the court, limiting access to discharge to dishonest debtors were added to an additional section in the IA Report (section 7). The impact on the capacity of courts further considered and explained.</p>
<p>(D) Procedure and presentation</p> <p>The report should clarify concepts and definitions of 'discharge' and 'recovery rates.' The mandatory annex (2) on stakeholder identification should be added.</p>	<p>(D) The concept of discharge and recovery rates defined in the Glossary were further clarified in the report, additional explanations as to the contents of the notion of recovery rates and its calculation was added in Section 8 of Annex 3. Mandatory annex on stakeholder identification was added.</p>

2. IMPACT ASSESSMENT STEERING GROUP

This Impact Assessment was drawn up by Directorate-General for Justice and Consumers (DG JUST).

An Impact Assessment Steering Group (IASG) was set up to bring in views of other services of the Commission. DG Competition, DG Economic and Financial Affairs, DG Financial Stability, Financial Services and Capital Markets Union, DG Internal Market, Industry, Entrepreneurship and SMEs, DG Justice, Secretariat General, Legal service, DG Taxation and Customs Union, DG Employment, Social Affairs and Inclusion and DG Communications Networks, Content and Technology accepted the invitation.

The Impact Assessment Steering Group met 3 times and was consulted by writing on 9 February 2016. The first meeting took place on 11 December 2015, the second - on 30 June 2016 and the third - on 20 July 2016. The minutes of the two last meetings may be found in section 2 (below).

3. THE MINUTES OF THE TWO LAST MEETINGS OF THE IMPACT ASSESSMENT STEERING GROUP

4th Inter-Service Meeting on initiative on preventive restructuring and second chance frameworks

Commission services represented: GROW, CNECT, ECFIN, TAXUD, FISMA, EMPL, DGT, JUST, SG

A **fourth inter-service meeting** on the initiative on preventive restructuring and second chance frameworks took place on **22 September 2016**. The purpose of the meeting was to discuss the content of the new initiative based on a **first draft Directive on preventive restructuring and second chance frameworks**.

Horizontal provisions - Judges and practitioners in the field of restructuring, insolvency and second chance

DG FISMA welcomed the provisions on specialisation of judges and insolvency practitioners, as the rationale aligns with many country specific recommendations on improving the efficiency of insolvency frameworks.

Employees

DG EMPL referred to the importance of employees' standing and suggested that a clear reference to the fact that the current Directive will not affect EU labour acquis should be made. In addition, they expressed concerns regarding the impact of the stay period (which can be up to 12 months) on workers.

DG JUST welcomed the suggestion made and will reflect further on a possible solution in order to clarify the effect of the stay on employees.

Stay of individual enforcement actions

DG FISMA expressed concerns with regard to the length of the stay period (up to 12 months). They would favour a proposal of a stay of 3 or 4 months with the possibility for renewal or extension in prescribed circumstances (up to 6 or 8 months), especially when the recourse to restructuring is not limited to a clear viability test.

DG JUST underlined the significant divergence regarding the characteristics and period of stay in Member States and referred to the safeguards provided for creditors so as to address moral hazard: the stay can be lifted any time on the request of one creditor; the extension of the stay will be decided by a court, only if there is evidence of relevant progress in the negotiations on the restructuring plan and evidence that the continuation of the stay is not detrimental to the creditors' rights.

DG ECFIN remarked that the safeguards introduced depend largely on the quality of the judiciary.

DG FISMA expressed concerns with regard to the suspension of acceleration/termination clauses foreseen for executory contracts during the stay period. They required certain clarifications in order to remove uncertainty and ensure compatibility with the Financial Collateral Directive.

DG JUST stressed that the early termination/suspension will apply mostly to non-financial contracts. Additionally, the future Directive provides that the creditors should be paid during the stay as only pre-commencement claims are affected. Finally, in collaboration with DG FISMA, these provisions could be fine-tuned in order to be in accordance with the Financial Collateral Directive.

DG FISMA expressed concerns with regard to the suspension of the obligation to open insolvency proceedings for the duration of the stay.

DG JUST explained that in some jurisdictions over-indebtedness or the prospect of illiquidity could trigger the obligation to file for insolvency. The future Directive provides safeguards so as to ensure that only viable companies can benefit from preventive restructuring, since creditors can lift a stay at any time and the court will reject the plan if it is clearly non-viable. Additionally, the Insolvency Regulation already provides that secondary proceedings can be suspended for three months.

Discharge for entrepreneurs

DG FISMA and DG ECFIN suggested that the wording used in Article 22(1), which allows Member States to restrict the access to discharge or lay down longer discharge periods for dishonest entrepreneurs should be looked at in order to disincentive dishonesty.

DG TAXUD suggested leaving flexibility to the Member States in this matter.

DG JUST explained that flexibility is provided to Member States to restrict access or to lay down longer periods for debtors when there is bad faith or fraud and that the Member States can also exclude some kinds of debt from discharge. A Recital would be added in order to underline further the need to disincentivise dishonest debtors.

Discharge for consumers

DG FISMA and DG ECFIN expressed concerns about the provision encouraging Member States to envisage debt discharge for households, given the current vulnerabilities in EU banking system and the focus of the initiative on business restructuring and second chance for entrepreneurs. They suggested that explanation (Recital) should be improved in order to clarify that what is intended is not to change the status quo.

DG JUST explained that this is not a mandatory provision and is in line with the 2014 COM Recommendation.

The SJ would be invited to look at whether a reporting obligation could be inserted when there is no substantial obligation (i.e. also for those Member States who did not take up an option to extend to consumers).

Explanatory Memorandum

SG suggested improving the text of the explanatory memorandum providing for more visibility on the broader goals (CMU, Single Market).

* * * *

Summary record of the 3rd Inter-Service Meeting on the insolvency initiative - BERL 20.07.2016

Participants: P. Stachowiak (COMP); N. Philipponnet (ECFIN); O. Martinez De Briones (EMPL); N. Bohan, M. Parmentier, F. Poliani (FISMA); D. Tsagkris (GROW); J. Lopez Rodriguez (TAXUD); K. Vandekerckhove, M. Carpus-Carcea, O. Vondracek, A. Chra, M. Maily, P. Sziranyi, M. Lissowska, M. Janschek (JUST); W. Sleath, A-L. Barreau (SG)

Agenda: Discussion of the draft impact assessment before the submission to RSB

Meeting document: Draft impact assessment

Discussion:

K. Vandekerckhove (JUST) provided an update on the state of play of the initiative and explained the evolution of the text since the last inter-service group meeting and further meetings with Member States. Some adaptations would be made in terms of the baselines, the impacts and stakeholders' views. It had been a conscious choice to change the order of the presentation of the options, but if this was to be retained, the rationale would be explained. It was noted that the Communication planned to accompany the proposal would be an opportunity to provide the broader context, including on the relationship with the Capital Markets Union and the Single Market Strategy, so this could be kept relatively brief in the impact assessment report. Personal insolvency would be dealt with in a separate recommendation.

N. Philipponnet (ECFIN) commented on the following aspects:

- The scope of the initiative should be clarified. It would be useful to explain why the initiative focuses on restructuring and does not address other aspects of the insolvency framework. This could help anchor expectations on the potential impact of the initiative.
- With regard to the choice of instrument, it would be useful to develop further why other legislative instruments could not be used.
- Regarding the sub-options, there could be more clarity on what the criteria for their selection is, and whether they are exhaustive and exclusive.
- The consistency between the options and the objective could be improved. The overall objective of the initiative is to reduce the cost of cross-border insolvency. However in section 7 on the overall impact of the instrument, the improvement of the performance of the insolvency systems at the national level is given more prominence. The impact on cross-border flows of capital could also be better articulated.
- There could also be a more cautious approach to the quantification of the benefits, given that restructuring agreements were only one element.
- More globally, the general approach and the communication could underline that a positive environment for start-ups needed the right balance between liquidation and restructuring.

JUST agreed to seek to adjust the text accordingly.

N. Bohan (FISMA) underlined the following elements:

- The text could have a more logical frame to better link the identification of the problem in the draft impact assessment with the intention to come with a proposal confined to business restructuring. The problem definition and objectives should more clearly lead to the options identified.
- In terms of criteria for assessing options, a specific objective / criterion should be added related to the way in which the restructuring solution balances the interests of creditors and debtors; financial stability should be a criterion in assessing all the options. The regime should ensure adequate protection for creditors and limit the

scope for tactical abuse of restructuring systems (for example, through excessive delay). It should be clear that for some companies, liquidation will always remain the best option.

- A specific option for SMEs could be included.

JUST agreed that the overall narrative needed to explain the more specific place of restructuring (and its limits), including why acting on restructuring would help banks to deal with non-performing loans, also noting that this would be an important element for the chapeau communication.

J. Lopez Rodriguez (TAXUD) considered that the problem driver stressed too heavily the impact of differences of national legislation/fragmentation, as opposed to the shortcomings of some (but not all) national approaches. It would be useful to identify further national practices creating problems and gaps, so as to address them as objectives and in the policy options.

O. Martinez De Briones (EMPL) considered that the area of ranking of claims is missing in this draft impact assessment. She also underlined the need for better protection of employees. JUST explained that the ranking issue was left to national legislation.

D. Tsagkris (GROW) raised the issue of early warning provisions for SMEs. Generally it was noted that the costs of restructuring could be prohibitive for the smallest companies, pointing that the "second chance" through liquidation is taking place in the majority of cases rather than restructuring.

Next steps:

- The draft impact assessment will be submitted to the RSB in August
- The RSB will meet on 28 September
- The next ISG meeting will take place in the second half of September. The objective of next meeting is to have a look at the proposals and the Communication ahead of the inter-service consultation.

4. LIST OF STUDIES RELEVANT FOR THE PREPARATION OF THE IMPACT ASSESSMENT

FORTHCOMING

- Annual Report on European SMEs (2016): Work Package 1 - Section 'What is the situation as regards the availability of a 'second chance' for honest failed/bankrupt entrepreneurs in the EU', DG GROWTH, [forthcoming]
- Rescue of Business in Insolvency Law, European Law Institute (commissioned by DG JUST), [forthcoming]
- 'Promoting protection of the right to housing. Homelessness protection in the context of evictions (Pilot Project)', FEANTSA [forthcoming]²⁰⁸
- Statement of principles for a global approach to multi-creditor workouts, INSOL International, 2nd ed. [forthcoming]
- Impact assessment study on policy options for a new initiative on minimum standards in insolvency and restructuring law, JIIP consortium (commissioned by DG JUST), [forthcoming]
- Flash Eurobarometer 2016, Report Insolvency, [forthcoming]

²⁰⁸ See Terms of Reference available at: <http://ec.europa.eu/social/main.jsp?catId=624&langId=en&callId=387&furtherCalls=yes>

2016

- Doing Business: Resolving insolvency, World Bank Group (2016)
- Study on 'Harmonising insolvency law in the Euro Area: rationale, stock taking and challenges. What role for the Eurogroup?', European Parliament, July 2016, PE 574.428
- Impact Assessment 'A review of the corporate insolvency framework', UK Insolvency Service, 1 March 2016
- SME Performance Review 2015/2016, DG GROWTH, March 2016
- Turnaround Wing Guidelines for Restructuring and Turnaround Professionals, INSOL Europe, March 2016
- Report on 'Potential economic gains from reforming insolvency law in Europe', AFME, Frontier Economics and Weil Gotshal & Manges LLP, February 2016
- Study on 'A new approach to business failure and insolvency. Comparative legal analysis of Member States' relevant provisions and practices', University of Leeds (commissioned by DG JUST), January 2016.
- Study on 'Consumer vulnerability across key markets in the European Union', London Economics, VVA Consulting and IPSOS Mori consortium (commissioned by DG JUST), January 2016

2015

- Doing Business: Resolving insolvency, World Bank Group (2015)
- 'Corporate insolvencies in Europe 2014/15', Creditreform (2015)
- Nordic-Baltic Recommendations on Insolvency Law, revised version of 15 December 2015
- 'Upgrading the Single Market: more opportunities for people and business', European Commission, COM(2015) 550 final, 28 October 2015
- Feedback Statement on the Green Paper 'Building a Capital Markets Union', SWD(2015) 184 final, 30 September 2015
- Economic Analysis accompanying the Action Plan on Building a Capital Markets Union, SWD(2015) 183 final, 30 September 2015
- 'The Economic Impact of Rescue and Recovery Frameworks in the EU', Commission Staff Discussion Paper (n°4), September 2015
- Euro Area Policies – Selected Issues, IMF Country Report No. 15/204, July 2015
- Euro Area Policies – Selected Issues, IMF Country Report No. 15/205, July 2015
- 'Tackling Small and Medium Sized Enterprise Problem Loans in Europe', IMF Staff Discussion Note, March 2015

2014

- Doing Business: Resolving insolvency, World Bank Group, 2014
- Economic Review for the European Union, OECD, 2014
- Study on 'Bankruptcy and second chance for honest bankrupt Entrepreneurs', ECORYS (commissioned by DG Enterprise & Industry), November 2014
- Study on a new approach to business failure and insolvency – Comparative legal analysis of the Member States' relevant provisions and practices, INSOL Europe (commissioned by DG JUST), May 2014
- Impact Assessment accompanying the Commission proposal of the Directive of the European Parliament and of the Council on single-member private liability companies, COM SWD(2014) 124 final, 9 April 2014
- Impact Assessment accompanying the Commission Recommendation on a New Approach to Business Failure and Insolvency, SWD(2014) 61 final, 12 March 2014.

- Study on 'Consumer Protection Aspects of Financial Services', European Parliament, February 2014, PE 507.463
- Report on 'The treatment of the insolvency of natural persons', World Bank, January 2014

2013

- Study on 'The over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact', Civic Consulting (commissioned by DG SANCO), December 2013
- Report on 'Overindebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives, for alleviating its impact', Civic Consulting (commissioned by DG SANCO), December 2013
- Selected Issues, IMF Country Report No. 13/299, September 2013
- Study on 'The functioning of consumer credit market in Europe, IPSOS and London Economics (commissioned by Executive Agency for Health and Consumers (EAHC) on behalf of DG SANCO), July 2013
- 'Unlocking funding for European investment and growth. An industry survey of obstacles in the European funding markets and potential solutions', Oliver Wyman (commissioned by AFME), June 2013
- Study on 'Directors' Duties and Liabilities', London School of Economics (commissioned by DG MARKT), April 2013
- 'Dealing with Private Debt Distress in the Wake of the European Financial Crisis: A Review of the Economics and Legal Toolbox', IMF Working Paper No. 13/44, February 2013
- 'Measureable Results! Doing Business Project Encourages Economies to Reform Insolvency Frameworks', IFC World Bank Group, January 2013
- UNCITRAL Legislative Guide on Insolvency Law, Part Four: Directors' obligations in the period approaching insolvency (2013)

2012

- Report on the application of Council Regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings, COM(2012)743, December 2012
- Impact Assessment accompanying the Revision of Regulation (EC) No 1346/2000 on insolvency proceedings, SWD(2012) 416 final, 12 December 2012
- 'Directors' duties and liabilities in the EU', European Commission, DG MARKT, December 2012
- Study on 'Means to protect consumers in financial difficulty: Personal bankruptcy, datio in solutum of mortgages, and restrictions on debt collection abusive practices', London Economics (commissioned by DG MARKT), December 2012
- Global Principles for Cooperation in International Cases ('Global Principles'), American Law Institute (ALI) and International Insolvency Institute (III), June 2012
- 'Out-of-court Debt Restructuring, World Bank Studies No. 66232, January 2012

2011

- Preliminary Report to the Insolvency Service into Outcomes in Company Voluntary Arrangements, Prof. Adrian Walters and Dr Sandra Frisby, March 2011
- 'Business Dynamics: Start-ups, Business Transfers and Bankruptcy. The economic impact of legal and administrative procedures for licensing, business transfers and bankruptcy on entrepreneurship in Europe', European Commission, DG Enterprise and Industry, January 2011

- 'Harmonisation of insolvency law at EU level with respect of opening of proceedings, claims filing and verification and reorganisation plans', European Parliament Briefing Note 2011, PE 432.766
- 'Harmonisation of insolvency law at EU level: Avoidance actions and rules on contracts', European Parliament Briefing Note 2011, PE 432.767

2010

- 'Harmonisation of insolvency law at EU level', European Parliament Study, 2010, PE 419.633
- 'Household Indebtedness in the EU', European Parliament Briefing paper 2010, PE 433.453
- 'Internationalisation of European SMEs', DG Enterprise and Industry, 2010
- 'Financial exclusion in the EU, New evidence from the EU-SILC special module', DG Employment, Social Affairs and Equal Opportunities, November 2010

2007

- 'Bankruptcy Codes and Innovation', CEPR Discussion Paper No. DP6307, May 2007

2006

- 'The stigma of failure: An International Comparison of Failure Tolerance and Second chancing', Centre for Business Research, University of Cambridge, Working Paper No. 334, December 2006

ANNEX 2

Summary of consultations of stakeholders, including the outcome of the public consultation on an effective insolvency framework within the EU

Table of Contents

1.	LIST OF MOST IMPORTANT CONSULTATIONS.....	118
2.	MAIN FINDINGS.....	119
2.1.	General attitude towards the initiative.....	119
2.2.	The affectation of internal Market by current rules.....	124
2.3.	Impact of the proposed measures on the creation of new companies.....	127
2.4.	Impact of the proposed measures on the increase of recovery rates of debts.....	128
2.5.	The impact on the problem of non-performing loans.....	129
2.6.	Cross-border element and its impact on restructuring.....	130
2.7.	The characteristics of an appropriate restructuring framework at EU level.....	131
2.7.1.	Situation of debtors.....	131
2.7.2.	Involvement of national courts.....	133
2.7.3.	Publicity related to proceedings.....	134
2.7.4.	'Debtor-in-possession arrangements'.....	134
2.7.5.	Enforcement actions – stay and its duration.....	136
2.7.6.	Creditors' rights - 'cross-class cram down' (i.e. the confirmation of the restructuring plan supported by some classes of creditors in spite of the objections of some other classes of creditors).....	138
2.7.7.	Protection of new financing.....	139
2.7.8.	Role of directors in preventing insolvencies.....	140
2.7.9.	Role of Member States in preventing insolvencies.....	141
2.7.10.	Avoidance actions.....	141
2.7.11.	Insolvency practitioners.....	142
2.8.	Second chance – debt discharge for natural persons.....	143
2.8.1.	General considerations.....	144
2.8.2.	Affectation of the Internal Market.....	145
2.8.3.	Advice to debtors.....	145
2.8.4.	Discharge of debts.....	146
2.8.4.1.	Entry conditions for the discharge procedure.....	147
2.8.4.2.	Discharge period.....	148
2.8.4.3.	Exclusion from discharge.....	149
2.9.	Outside restructuring framework and second chance.....	149

2.9.1. Duration of insolvency proceedings	150
2.9.2. Directors' disqualification.....	151
2.10..... Stakeholder suggestions which were not taken on board by the initiative	152

1. LIST OF MOST IMPORTANT CONSULTATIONS

The Commission has consulted stakeholders in many different ways. Below a list of the most important consultations:

- **Public consultation**, which was launched on 23 March 2016 and ended on 14 June 2016. It received more than 260 contributions from 27 MS and the country with the most overall contributions was Germany followed by UK, Belgium and Lithuania. Approximately 30% of replies were made on behalf of insolvency and legal practitioners, while the rest were mainly from companies and business support organisations, credit and financial institutions, debt collection and marketing information services, trade associations, consumer organisations, Trade Unions, academics and judges. In addition, replies were received from the public authorities of 18 Member States.
- **Dedicated meetings with Member States** (on 29 June 2016 and on 7 September 2016).
- **Dedicated meetings with stakeholders** (on 7 April 2016, 27 May 2016 and on 18 July 2016). An informal "Sounding Board" composed of selected stakeholders with particular interest in issues of debt restructuring and business failure was created. When creating this group of stakeholders we tried to identify the widest possible representation across EU or worldwide with a view to share their views on the initiative. The main participants were:
 - from the financial sector: AFME²⁰⁹, EBF²¹⁰, Invest Europe; EMF-ECBC²¹¹, EFIN²¹²;
 - from the business and trade sector: BusinessEurope, BDI²¹³, EuroChambers²¹⁴; specifically for SMEs: UEAPME²¹⁵, ESBA²¹⁶, Independent Retail Europe;
 - social or economic interest organisations:
 - for workers', employees: ETUC²¹⁷, UNI Europa
 - for consumers: BEUC

²⁰⁹ Association for Financial Markets in Europe

²¹⁰ European Banking Federation

²¹¹ European Mortgage Federation – European Covered Bond Council

²¹² European Financial Inclusion Network

²¹³ The Federation of German Industries

²¹⁴ The Association of European Chambers of Commerce and Industry

²¹⁵ Union Européenne de l'Artisanat et des Petites et Moyennes Entreprises

²¹⁶ European Small Business Alliance

²¹⁷ European Trade Union Confederation

- Practitioners with interest in the field of insolvency: ACCA²¹⁸, FEE²¹⁹, IBA²²⁰, CCBE²²¹, UIA²²², INSOL Europe;
- think-tanks: FDC²²³

In addition, bilateral meetings with specific stakeholders were held during the consultation period. These included among others meetings with the Nordic-Baltic Insolvency Network, Trans Europe Experts, with Verband Insolvenzverwalter Deutschlands (VID), with the National Bank of Austria, with Managed Funds Association (MFA), with INSOL International, with Droit et Croissance, with FENCA²²⁴, with the German Insurance Association.

- Expert group meetings (on 13 January 2016, 19 February 2016, 28-29 April 2016, 24-25 May 2016, 14-15 June 2016 and on 11 July 2016.) The expert group on restructuring and insolvency law was created in the end of November 2015 and the detailed list of experts could be found on the Register of Commission expert groups (<http://ec.europa.eu/transparency/regexpert/index.cfm?do=groupDetail.groupDetail&groupID=3362>).
- Conference on the convergence of insolvency frameworks within the European Union organised under the auspices of the Slovak Presidency on 12 July 2016. It was consisted of three main panels; on a new approach to business failure and insolvency and what can be improved following the 2014 Recommendation, how to create an appropriate insolvency framework beyond the scope of the 2014 Recommendation and on second chance for entrepreneurs and consumers.

2. MAIN FINDINGS

2.1. *General attitude towards the initiative*

Most of the stakeholders supported the adoption of preventive measures to enable the restructuring of viable businesses as well as measures to increase the recovery rates of debt in insolvency in order to achieve an appropriate insolvency framework within the EU. The provisions related to second chance were more controversial, but the majority considered that measures ensuring the discharge of debts for entrepreneurs (individuals) would be necessary for an appropriate insolvency framework within the EU. Moreover, although most of the stakeholders and Member States acknowledged the importance of discharge for consumers, many of them preferred that mandatory rules on consumer insolvency should not be included in this instrument.

The majority of those consulted were in favour of a minimum harmonisation entailing high-level principles that would help introducing a level playing field across the Europe for investors and entrepreneurs; they supported the objective to shift the focus of insolvency proceedings away from liquidation in such a way that viable businesses are encouraged to implement quick and cost-effective restructuring measures at an early stage.

²¹⁸ Association of Chartered Certified Accountants

²¹⁹ Federation of European Accountants

²²⁰ International Bar Association

²²¹ The Council of Bars and Law Societies of Europe

²²² Union Internationale des Avocats

²²³ Fondation pour le Droit Continental

²²⁴ Federation of European National Collection Associations

Other measures such as measures ensuring the enforcement of claims and measures governing employees' rights in insolvency did not gain much support as being appropriate for insolvency framework at EU level.

All the Member States agreed on the necessity of preventive measures enabling restructuring of viable businesses. While some of them were more open to a well targeted harmonisation, the majority of them were cautious about the harmonisation related to insolvency, restructuring and second chance, opting for high-level principles, where obstacles to the functioning of Internal Market are identified. In particular, some were more reluctant (FI, CZ, SE), while others either did not see the need (since introduced reforms – PL), or were afraid of many unintended interactions with other areas of law (DE) as well as with well-working systems and local cultures and policies. Wider diversity of views and reluctance was observed with regard to discharge periods and the conditions for discharge.

As to the stakeholders, business organisations, professionals' associations, financial institutions, consumer organisations, Trade Unions and academics were in general supportive of minimum harmonised rules on early restructuring and a second chance approach and welcomed the idea of an efficient and (cost)-effective EU insolvency framework for saving viable businesses. They believed that any intervention at EU level should be sensitive to national specificities, as well as existing Member State legislation and strike a right balance among the interests of different stakeholders. More particular, they gave attention to early warning mechanisms, early restructuring, court involvement and publicity requirements when rights of third parties are affected, protection of financing, short moratorium periods, reducing the cost and length of proceedings, protection of security and property rights, sufficient qualified and regulated professionals and enhanced judicial system. The banking industry also stressed the importance of protecting collateral and the cost of credit and financing. Consumer organisations underlined the need of early detection of financial difficulties, access to free or low-cost debt advice and discharge for natural persons. Trade Unions stressed that employees' interests, consultation and priority ranking rights should not be overruled. As to discharge, some stakeholders (mainly the banking sector) were of the view that consumer discharge should be dealt separately.

Also the experts advised the Commission to focus on business restructuring and make the Recommendation more workable. The opinions were divided as whether the future legal instrument should be more detailed or more principle based.

Views of main stakeholders

According to the position papers received during the public consultation, the position of the main European stakeholders is summarised below:

BUSINESSEUROPE is generally supportive of a second chance approach to insolvency in the EU by ensuring minimum standards for pre-insolvency (early restructuring) and recovery proceedings. It is essential to provide early warning systems, preserve the ability of the company going through a restructuring procedure to keep its business, protect new financing, promote specialisation of courts and training of judges and provide minimum standards for insolvency practitioners (e.g. Code of Ethics). In addition, consideration should be given to clarifying certain criteria for identifying 'honesty', promoting access to assistance and information tools as well as to alternative out-of-court means and digitalisation. However, **Businesseurope** is of the view that there should be no harmonisation of the classes of creditors and that consumer insolvency should be dealt separately.

Association of Chartered Certified Accountants (ACCA) welcomes the initiative of the European Commission to introduce minimum standards in the EU in relation to restructuring and insolvency, but underlines the dangers of changing well-working regimes. ACCA is in general in favour of introducing an effective and efficient framework for preventive restructuring measures in EU. Particularly, they opt for a framework entailing the possibility to file early, less court involvement and publicity, protection of secured creditors, protection of financing (no abusing) and sufficient qualified and regulated professionals. Finally, artificial distinctions between entrepreneurs and consumers in relation to discharge are not encouraged.

European Banking Federation (EBF) fully embraces the Commission's intention to introduce preventive measures developing a new approach to business restructuring in EU. It is however of key importance that the future legislative initiative would be well balanced in catering to the needs of both creditors as well as present and future debtors. In particular, EBF supports involvement of creditors in the restructuring plan and in the assessment of viability of the debtor, enhanced access to information for creditors, reasonable time limits for judicial restructuring procedures, super senior rank priority for new financing as long as is agreed in the restructuring plan and confirmed by the Court, EU common standards for claim statements' time limits, harmonisation of certain aspects on avoidance actions and strengthening the enforcement framework. Moreover, EBF welcomes the introduction of minimum standardized rules on the qualification of insolvency practitioners and measures laying down obligations for directors' of distressed companies. Concerns are expressed to a full discharge for entrepreneurs without the additional requirement of paying certain amount of the debt. Finally, they consider that consumers' insolvency should be dealt separately.

European Federation for the Factoring and Commercial Finance Industry (EUF) supports the idea of an efficient and (cost)-effective EU insolvency framework allowing for early restructuring, increasing the recovery rates and ensuring the enforcement of debts. Moreover, EUF underlines that the diversity of rules in several aspects related to insolvency and restructuring proceedings constitutes a barrier to the functioning of the Internal Market and increases the costs for creditors (e.g. costs for participating in cross-border insolvency proceedings, costs of assessing the risk of default) and for SMEs (e.g. they are disincentivised to start restructuring at an early stage). Harmonisation of measures related to claw-back, interim financing, and avoidance actions would increase legal certainty. Finally, EUF is of the view that there should not be a full discharge available for entrepreneurs.

European Financial Inclusion Network (EFIN) believes that preventive measures for enabling restructuring of viable businesses and measures to ensure the discharge of debts are key issues for an efficient insolvency framework in the EU and for achieving better recovery rates. Such framework should entail an early detection of financial difficulties, access to free debt advice, the possibility of a moratorium and of a cross-class cram down as well as discharge for entrepreneurs and consumers. The concept of 'honesty' is also essential and should not be abused and the principle of dignity should be central. Finally, they suggest the introduction of a calculation method for a minimum cost of living (e.g. reference budget) with the agreement of all stakeholders at a national level.

European Association of Certified Turnaround Professionals (EACTP) strongly supports Commission's Recommendation on a new approach to business failure and insolvency. They underline that the overall aim of a preventive restructuring framework should be to fully turnaround the business allowing for an operational restructuring. They are in favour of introducing incentives for business to take early action for restructuring, protecting 'bridge'

financing and granting a temporary stay (having also a designated court different from the insolvency court). They also support establishing professional standards for insolvency practitioners, mediators etc.

European Mortgage Federation-European Covered Bond Council (EMF-ECBC) supports the efforts to ensure the existence of effective insolvency frameworks for business in EU. However, any intervention at EU level should be sensitive to national specificities, as well as existing Member State legislation. EMF-ECBC stresses that differences between Member States' insolvency frameworks can act as an obstacle to the free movement of capital, goods and services and the functioning of Internal Market. They express concerns regarding limiting the enforcement of claims over the collateral underlining potential implications to capital bank requirements. Although they recognise that second chance entails benefits for the wider economy, they advocate that a debt discharge should be available only when a certain amount of a debt is repaid in order to avoid moral hazard and promote responsible entrepreneurship. Finally, they strongly believe that measures to ensure discharge of debt for consumers should not form part of the efforts of this consultation to create an efficient insolvency framework for businesses and it should be dealt separately.

Independent Retail Europe supports maximum harmonisation of EU insolvency rules, as this would provide businesses operating cross-border (and providing credit cross-border) with maximum levels of legal certainty, investor protection and cost savings. Independent Retail Europe particularly underlines the importance of protection (absolute priority ranking) of financing for SMEs under restructuring, in case of recovery proceedings, as well as protection of security and property rights. Harmonisation should also help with reducing the costs and the length of the cross-border proceedings and simplify the formal requirements. It would be also beneficial to introduce general principles for defining the viability of a debtor. Moreover, discharge periods should allow an entrepreneur to return to economic life in a reasonable timeframe; a set of objective criteria should be developed to determine when a facilitated discharge should be allowed in order to avoid moral hazard as well as fraudulent bankruptcies (taking also into account the risk of the chosen business). Finally, they stressed the knock-off effect that insolvencies of independent retailers have for the wider independent group (double punishment) and advocated that the group, with the agreement of the independent retailer should be able to intervene in a restructuring process, including, if necessary, the buy- out of the point of sale.

EUROCHAMBERS stresses that effective national insolvency systems are crucial for business and underlines the increasing risks for payment recovery in cross-border businesses. Insolvency frameworks that allow for early access to restructuring, strengthening the position of secured creditors and introducing flexible and less costly out-of-court procedures would reduce the overall default rates. However, EUROCHAMBERS is not convinced that there is a clear justification for EU competence for harmonisation in this area, but efficiency in insolvency laws should be rather achieved through guidance and pressure from the European semester process. EUROCHAMBERS supports the idea of introducing interconnected insolvency registers that would include information for creditors as well as sufficient information available online on all applicable legal frameworks. Finally, they encourage initiatives for professional support including mentoring, training and advising entrepreneurs in financial distress and believe that both consumers and entrepreneurs should have the possibility to restructure debts under certain conditions.

European Trade Union Confederation (ETUC) underlines the importance of protecting employees' rights in insolvency. They stress the severe direct and indirect effects of

insolvency for employment and for economy in general, due to the knock-off effect. They are generally in favour of preventative restructuring of viable businesses and a second chance approach as described in the Insolvency Recommendation, but they also express strong concerns regarding certain elements. Particularly, ETUC is concerned to ensure that there is no erosion of existing employee protections, as currently laid down in EU legislation, no alteration of the preferential creditor status of employees and no misuse about early filing or abuse of second chance with letter box practices. In addition, ETUC states that Member States should be encouraged to set up early warning and advice systems to businesses and also stresses the fundamental issue of consultation and information of workers. Moreover, they are in favour of establishing a common definition for insolvency, including a reasonable chance of viability test for entry in restructuring, enhancing the rights of employees to be heard and ensuring transparency and external supervision. Furthermore, ETUC fully supports the improvement of supervision of directors' duties and liability as well as the establishment of minimum standards for Insolvency Practitioners as an aid to increasing the efficiency and effectiveness of insolvency proceedings. Finally, ETUC is reluctant to a full discharge of debts after a relatively short period of time and is in favour of more stringent rules for dishonest entrepreneurs.

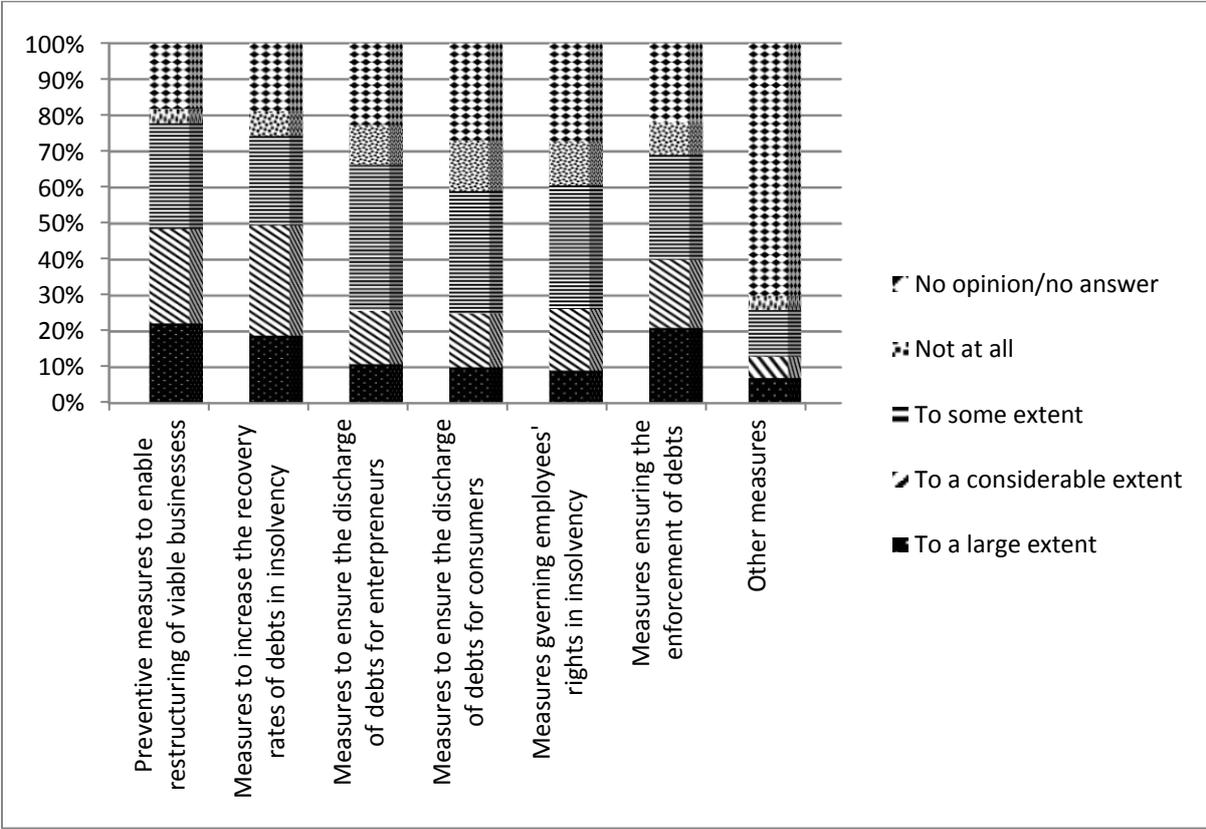
European Association of Craft, Small and Medium-Sized Enterprises (EUAPME) emphasises that preventive measures that enable viable business to restructure should be a primary consideration for an appropriate insolvency framework in the EU, taking though into account the coherence of the national legal systems and different policies. Particularly, measures ensuring the viability of a debtor, offering assistance for debtors in financial difficulties, raising the degree of recovery rates and improving the efficiency of procedures are crucial. A fair balance of debtors' and creditors' interests is needed and companies should be better directed to appropriate proceedings. Insolvency proceedings should be more efficient, quicker, fairer and more cost-effective, particularly for SMEs. In addition, restructuring proceedings should entail the involvement of the court and supervision when creditors' rights are affected, the possibility of a moratorium when it is absolute necessary and cram-down under conditions. However, no interference with ranking of creditors should be foreseen. Finally, with regard to discharge, indebted honest individuals should be offered a second chance and access to free or low cost advice, accompanied with adequate safeguards in order to prevent misuse.

INSOL Europe agrees that some level of harmonisation of preventive measures is desirable and particularly, issues such as rules on the opening of insolvency proceedings, reorganisation plans, avoidance actions, ipso facto clauses and directors liability are important topics apt for harmonisation. INSOL Europe also advocates for a European Rescue Plan that can be adopted of groups of companies which have opened insolvency proceedings in more than one EU jurisdictions. Moreover, they mention that both measures to protect new financing and measures to promote assistance to financially distressed debtors are important and they stress the necessity of introducing minimum standards on avoidance actions. In addition, the availability of debtor-in -possession proceedings is encouraged, but effective supervision when creditors are stayed from enforcing their rights is advisable. Furthermore, majorities of creditors should not be able to bind creditors with differing interests, but the court should decide about overruling such vote. They also advocate that a common definition of insolvency in the context of the opening of the proceedings is not necessary and they stress that the distinctive criterion between claims which predate the insolvency proceedings and claims which occur during insolvency proceedings should be harmonized. Nevertheless, they are not in favour of statutory rules on assessment of a debtors' viability or any minimum standards on IPs, judges, courts and ranking of claims. Finally, the opportunity for honest individuals to

obtain a discharge should be given to both consumers and entrepreneurs under the same conditions and access to cheap or low cost advice should be available for SMEs and individuals.

Federation of European Business Information Services (FEBIS) supports that minimum standards on preventive measures to enable the restructuring of viable business, measures to increase the recovery rates of debts in insolvency and measures ensuring the enforcement of debts should be taken to achieve an appropriate insolvency framework in the EU. They are in favour of early warning systems, publicity, court involvement, short stay provisions and discharge for all honest individuals with stricter conditions applicable for entrepreneurs. In addition, they stressed the important role of suppliers providing credit and the necessity to reduce cascade bankruptcies. Finally, they advocate for a better access to finance, enhancing information requirements for SMEs and introducing common accounting standards.

2.2. The affectation of internal Market by current rules



The vast majority of those consulted in the public consultation believed that existing differences between the laws of the Member States in all the areas mentioned in the chart above affect the functioning of the Internal Market. Particularly, almost half of them indicate that differences in the areas of preventive measures and measures increasing the recovery of debts affect to a large or a considerable extent the functioning of the Internal Market. Very few claimed that divergence in the laws of the Member States in those areas does not pose any barriers to the functioning of the Internal Market.

In the public consultation and the dedicated stakeholders meetings, all the stakeholders agreed that timely access to preventive (restructuring) proceedings is a key issue in order to avert the insolvency of economically viable business. The majority was in favour of a minimum broad

standards harmonisation, whilst allowing Member States flexibility as to how those standards are applied in practice, without affecting adversely any well-working regimes. In addition, they raised several points where more targeted harmonisation would be useful.

In the public consultation, the majority of respondents outlined that a minimum harmonisation of a preventive framework would be helpful providing for consistency, predictability and motivating investment and cross-border transactions. In particular, they argued that:

- The differences between Member States insolvency frameworks can affect exports, imports, investment, cross-border lending and cross-border company groupings.
- The unpredictability of insolvency proceedings makes it difficult for creditors to recover value from distressed debts, which contributes to high levels of non-performing loans. The latter weight on a bank's balance sheet and as a consequence may lead to constraints in its lending activities.²²⁵
- Divergences in the laws of the Member States raise the cost of financing leading to a fractured Internal Market.
- Harmonisation of business failures processing rules may help to encourage an environment in the EU where investors, funds, banks and other stakeholders will be motivated to support relevant European distressed companies and help them survive and thrive.
- Investors primarily want certainty of treatment and consistency of application in insolvency. Differences in insolvency regimes may increase uncertainty for investors as well as the cost of assessment of risks; it can become a deterrent to cross-border corporate investment, since the difficulties of establishing the value of distressed debt may increase the cost at which investors are willing to invest, or even it could discourage investors from establishing their business activities in other Member States.²²⁶
- Forum shopping and COMI shifts usually reflect the availability of preventive measures. SMEs are less able to do so.²²⁷ Costs from shifting of activities.²²⁸
- Approximation of preventive measures would reduce the regulatory arbitrage, preventing the debtors from relocating their center of interest to countries with a more favourable insolvency regime and file there for bankruptcy ("bankruptcy tourism").²²⁹
- National differences encourage rogue businesses to strategically establish their registered offices in Member States with "lax" legislation with a view to gain a competitive advantage over other national undertakings. The problem is particularly acute for letterbox companies.²³⁰
- It would allow for more efficient evaluation of the likely outcome of all affected parties, speeding the means for a solution as well as providing greater clarity around valuations at various layers of the capital structure, resulting in an efficient means of risk assessment and valuation.²³¹
- It would cut down on legal fees and other expenses, the need to forum shop and move corporate headquarters to enable a viable and speedy restructuring.

²²⁵ EBF

²²⁶ BBA, Loan Market Association,

²²⁷ Insolvency practitioners Association (UK)

²²⁸ IBA

²²⁹ EACB

²³⁰ ETUC

²³¹ Standard Life Capital Partners (UK)

- Debt discharge after a period will allow entrepreneurs second chances and provide a driver for growth. This should be tempered by ensuring disincentives for dishonest conduct.²³²
- Second time entrepreneurs are more successful and operate for longer than start-ups.
- Currently, there is a wide disparity within the EU Member States both as regards availability of appropriate rescue tools and, should rescue not be possible, effectiveness of the individual insolvency regimes and thus outcomes for stakeholders. There is anecdotal evidence of centre of main interests shift at the time of failure (for example from Germany or Spain to UK).²³³
- There are examples where one members of a group of companies has filed for insolvency because of strict legal requirements in the relevant Member State which has pushed the parent company into insolvency proceedings in another Member State when a restructuring might otherwise have been possible.²³⁴

However, some concerns were expressed whether a harmonisation in the above-mentioned areas is necessary and whether the above-mentioned differences have a direct effect on the Internal Market:

- A partial harmonisation may undermine the operation of the regime altogether as many aspects of a restructuring are interlinked with the formal insolvency processes or with other areas of law (company law, contract law, employment, labour law, tax law). This may have a limiting effect on the impact of any new measures.
- Some of the differences in approach to certain aspects of national insolvency are driven by national social and political considerations and therefore are not readily conducive to being harmonised across the EU socio-economic constructs and cultural differences make certainty and consistency difficult.
- An approach that might weaken the well-functioning approaches in some countries would not be welcome.
- Some insolvency practitioners mentioned that investment decisions of enterprises as well as decisions about cross-border transactions are not entirely depended on different features of insolvency law in a specific Member State. The level of risk depends mainly on the financial situation of the respective business partner and – if this risk is realised – the efficiency of the applicable insolvency law. The differences in insolvency laws will need to be taken into account when carrying out any risk analysis, but will not necessarily be a key focus or determining factor for investors, creditors or debtors.
- Certain measures notably those governing employees’ rights are likely to be rather political and polarising measures and therefore difficult to amend on EU level (e.g. In France, saving employment is the second priority of French insolvency law, after continuation of activity (first priority) but before settlement of liabilities (third priority)).
- Differences in the laws of the Member State may only affect the administration and the cost of the proceedings.²³⁵
- Differences in existing regimes are not necessarily problematic in practice, but can be seen as offering a greater variety of options for debtors who operate across borders. For example, English schemes of arrangement have been used as a solution for restructuring non-UK companies.²³⁶
-

²³² KPMG

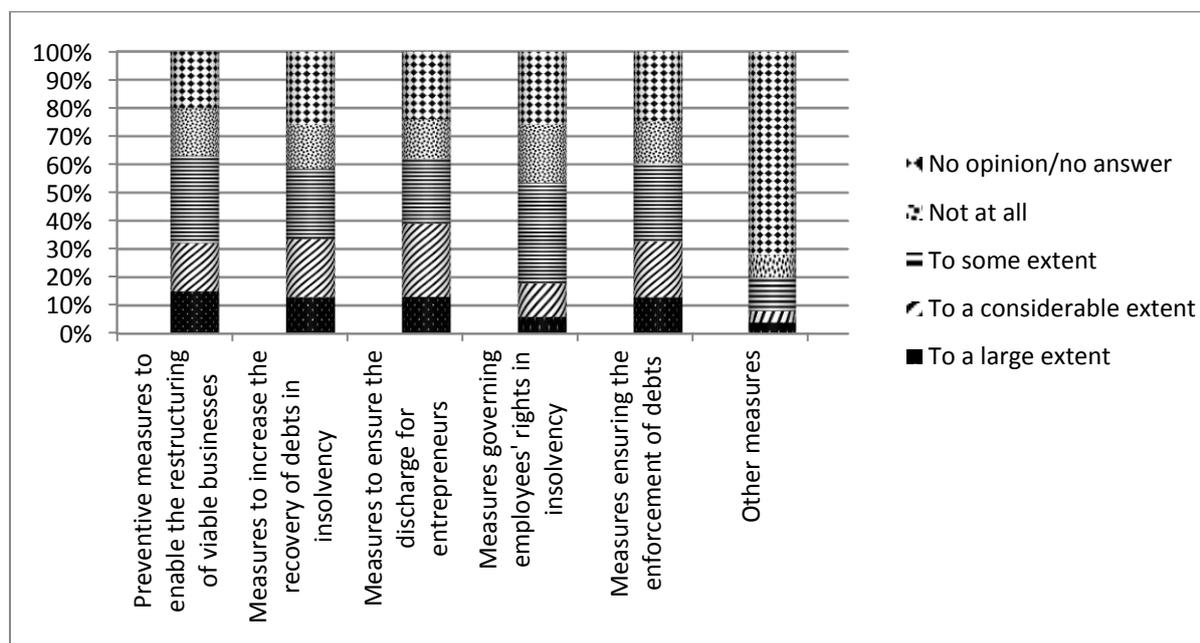
²³³ Deloitte

²³⁴ PwC

²³⁵ Finnish Bar Association

²³⁶ Invest Europe, R3

2.3. *Impact of the proposed measures on the creation of new companies*



The majority of those consulted in the public consultation, stressed that all the measures mentioned above have an impact on the creation and operations of newly established companies. Particularly, more than one third believed that preventive measures to enable restructuring of viable business, measures to increase the recovery of debts in insolvency and ensure enforcement of debts as well as measures to ensure discharge for entrepreneurs affect to a large or a considerable extent the creation and operations of newly established companies.

- On the one hand, the impact of the measures mentioned above was deemed considerable for start-ups since access to credit can be facilitated. Providers of equity and debt capital to new and growing businesses will be more willing to invest when their rights are clear and there is predictability and transparency of the process especially for measures that affect debt enforcement. At the same time, it may be easier for business to obtain funding where there is an effective regime across EU for creditor' rights and enforcement of debts.²³⁷
- On the other hand, although the possibility to restructure viable business may have an impact on new companies providing for incentives and confidence to entrepreneurs²³⁸, it was largely supported that, at the time of establishing a start-up, no significant focus is placed on insolvency regime (except maybe for certain considerations of personal liability or very strict discharge regimes), as the possibility of failure is not largely considered by entrepreneurs; newly formed businesses take into account a variety of different considerations (commercial, financial, operational, legal and regulatory) in order to decide in which jurisdiction operations should be located and operate from, but rarely in the areas mentioned above, apart from exceptional cases (e.g. where a

²³⁷ Standard life Capitals Partners (UK), ICAS, ICAEW, entrepreneur from Hungary, IBA

²³⁸ Unicredit, Barreau de Luxembourg

new company is used in a restructuring solution for an existing company/special purpose vehicles).²³⁹

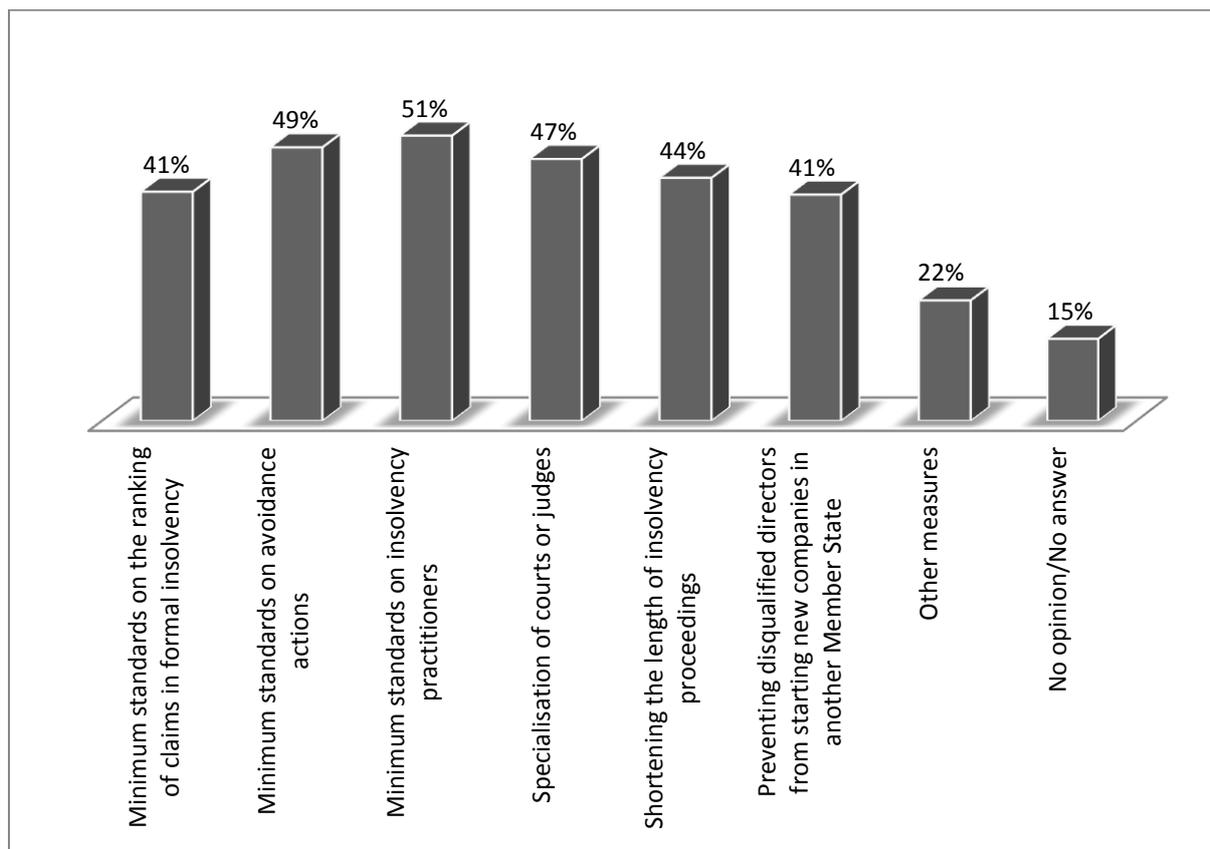
- Other stakeholders were of the view that all the measures mentioned above can have an impact on start-ups in the sense that due to their limited ‘financial buffer’ they are more vulnerable to knock-off effects.²⁴⁰

Other issues that according to the stakeholders may have an impact on saving viable businesses:

- The cost of restructuring
- The availability/range of recognised informal measures
- The court system in terms of speed, cost and specialisation
- The ability of qualified and regulated insolvency professionals to lead the restructure/business rescue
- The broader business environment and regulatory regime

2.4. *Impact of the proposed measures on the increase of recovery rates of debts*

When asked which measures would contribute to increasing the recovery rates of debts, the respondents to the public consultation replied as follows:



²³⁹ Clifford Chance LLP, academic from Germany, University of Bonn, ICAS, ICAEW, German banking industry committee, Loan Market Association, insolvency practitioners association (UK), ILA, Finnish bar association, Chamber of Trade for Munich and Upper Bavaria

²⁴⁰ Unizo, INSOL Europe

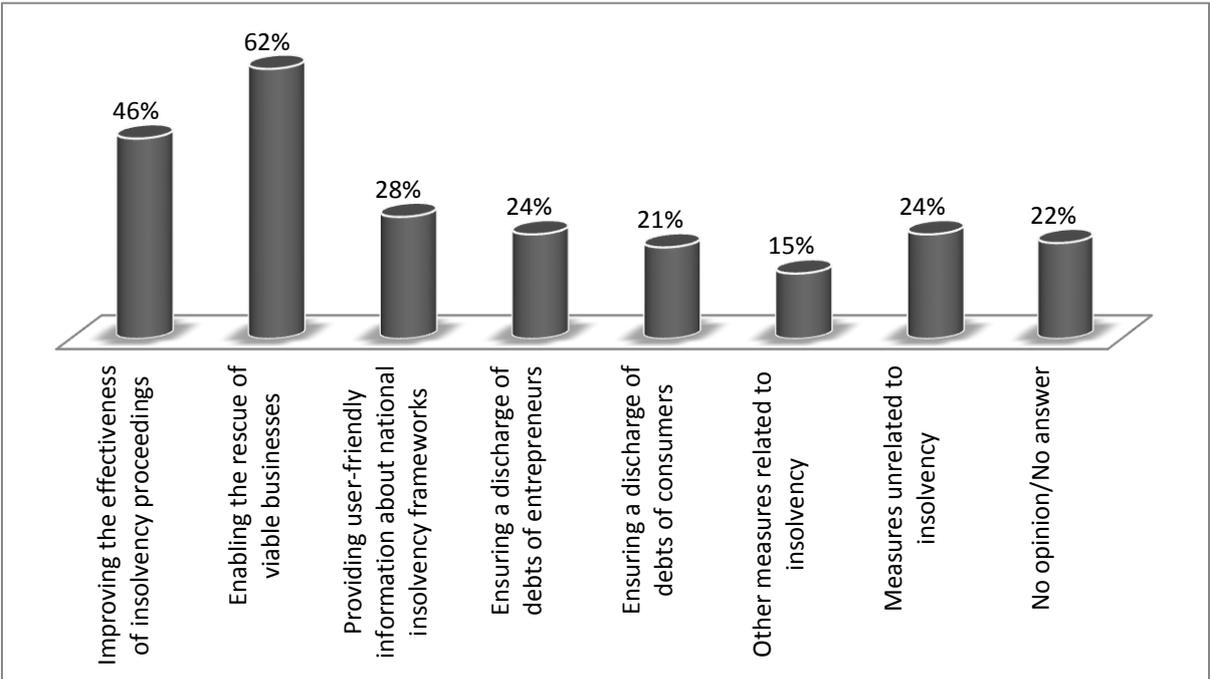
More than 40% of the respondents supported that all the measures mentioned above would contribute to increasing the recovery rates of debts. Minimum standards on insolvency practitioners/mediators/supervisors, minimum harmonized rules on avoidance actions, specializations of judges and the length of insolvency proceedings were deemed as more important.²⁴¹

It was also stated that:

- Other factors (such as the speed of access to the courts, the predictability of outcome in litigation and the expertise and innovation of insolvency practitioners) are more likely to have an impact on recovery.²⁴²
- Although several of the measures mentioned may be necessary to obtain a higher debt recovery rate, there is no need to set minimum standards under European law.²⁴³

2.5. The impact on the problem of non-performing loans

When asked about which measures would contribute to reducing the problem of non-performing loans, the respondents to the public consultation replied as follows:



The majority of those consulted agreed that measures enabling the rescue of viable companies are essential for mitigating the problem of non-performing loans, while less were of the view that measures to improve the effectiveness of insolvency proceedings can also contribute to reducing the problem of non-performing loans.

²⁴¹ EBF, IBA
²⁴² The City of London Law Society
²⁴³ German Banking Industry Committee

- It was in general stressed that the problem of NPLs can be dealt more effectively in a system providing for realistic possibilities of an effective restructuring and debt enforcement on the one hand and a prompt discharge of what is not realistically recoverable on the other hand.
- Effective insolvency legislation promotes efficient management of non-payments.²⁴⁴
- More particularly, it was supported that early restructuring measures result in better recovery for lenders since they can allow rescued companies to repay their loans (at least in part) and to continue to make a positive contribution to the economy.²⁴⁵
- Timely resort to restructuring well serves the objectives of recovery rates and NPLs.²⁴⁶
- Creditors and investors' certainty concerning legal outcomes particularly as to the enforceability of the loans and the effectiveness of the restructuring initiatives will lead to the efficient resolution of NPLs in Europe.²⁴⁷
- One of the primary factors for commencing enforcement action is the possibility of a quick enforcement and a degree of certainty on the process and outcome.²⁴⁸
- Consideration should be given not to impede efficient enforceability of the collateral, because in case a default the collateral backing the credit is deemed as a central element.²⁴⁹

Other measures mentioned:

- **Consumer and family organisations** supported limiting the cost of debt collection to reflect the 'real costs' and promote a non-profit model for debt collection and debt advice companies.
- The **European banking sector** would welcome strengthening the enforcement framework and protecting secured creditors. In particular, the adoption of harmonised enabling certain creditors' claims, at least those secured by a pledge, to be satisfied before the enforcement of contracts under insolvency proceedings would effectively enhance the lenders' recovery ratio or at least prevent excessive credit deterioration. Moreover, it was suggested that the context of ordinary enforcement procedures should allow the direct/automatic enforcement of the claims or part of the claims that have not been objected by the debtor, without any court preliminary consent. Finally, it was advocated to enlarge the scope of the Collateral Directive to include also unlisted financial instruments (e.g. shares of private companies).²⁵⁰

2.6. *Cross-border element and its impact on restructuring*

The majority of the participants to the public consultation recognised that, as opposed to a purely national situation, the restructuring of a business is very significantly or significantly affected when creditors are situated in a different Member State(s) than their debtors. On the contrary, very few stated that there is no impact at all.

Particularly, the majority of the stakeholders mentioned that:

²⁴⁴ EUAPME

²⁴⁵ INSOL Europe, Bar Council of England and Wales

²⁴⁶ BBA, IBA

²⁴⁷ Financial Markets Law Committee

²⁴⁸ Insolvency Practitioners Association (UK), KPMG

²⁴⁹ Danish Mortgage Banks' Federation

²⁵⁰ EBF

- There are higher costs and risks for creditors (especially unsophisticated and small ones) participating in cross-border restructuring process (language barrier, professional guidance, possible fees/costs) compared to a purely national situation.²⁵¹
- Where creditors are situated in a different Member State from the debtor, a restructuring will be more complex due to various legal uncertainties (such as specificities of the legal regime, including the different treatment of securities in rem, multiple and competing requirements, different time limits).²⁵²
- Variations in the requirements between jurisdictions mean that considerable extra costs would have to be incurred by creditors in order to fully understand the process and debtor and creditor rights; this would make it both slower and harder for an external creditor to effectively participate in supporting a debtor.²⁵³
- The difficulty to properly assess the consequences of a crisis, given the lack of harmonized minimum standards on debt enforcement and debt recovery procedures, makes it less secure for credit institutions and other investors to invest in other Member States.

Other stakeholders argued that:

- Creditor engagement is usually mainly driven by the likely outcome and individual effect on creditors.
- There can be problems in relation to proceedings which are outside of the scope of European Regulation on insolvency.
- The overall impact on the restructuring is likely to be low; other than the practical issues of locating and notifying creditors and assessing claims, there is little impact.
- It is more likely to have an impact on SMEs, where creditors are more likely to have relatively low stakes. For such creditors, the need to access advice on a restructuring in another Member State, to enable them to participate in that restructuring, may not be cost effective given the likely level of any recovery.²⁵⁴

2.7. The characteristics of an appropriate restructuring framework at EU level

2.7.1. Situation of debtors

In the performed public consultation, the majority of the respondents were in favour of having the possibility of **early restructuring** (before the debtor is insolvent, but where there is a likelihood of imminent insolvency),²⁵⁵ less stressed that restructuring should be available at any time²⁵⁶, while very few were of the view that only already insolvent debtors should be eligible for restructuring.²⁵⁷

In particular, the majority of stakeholders stressed that it is fundamental that both the failing viability of the debtor is identified in sufficient time before collapse, so that restructuring can be put in place, but also that its future viability can be assessed. Moreover, it was clearly

²⁵¹ EUF, ICAEW, Academic from Germany, insolvency practitioner from Germany

²⁵² EACB, German Institute for applied insolvency law (Hamburg University)

²⁵³ BBA

²⁵⁴ Insolvency lawyers association (UK)

²⁵⁵ UEAPME, PMT/PME/MN, Bundesverband der Deutschen Industrie e.V., EBF, ACCA, BV ESUG, Association of Insolvency Administrators (Germany), German Institute for applied insolvency law (Hamburg University)

²⁵⁶ Eurochambers, ACCA, Bar Council of England and Wales

²⁵⁷ INSOL Europe, German Federal Association of notaries

mentioned that adequate safeguards should be ensured in order to avoid abuses, such as delaying the onset of insolvency where there is no chance of a successful rescue.

In the public consultation and the dedicated stakeholders' meetings, the **business sector** (Eurochambers, Independent Retail Europe, EUAPME) was strongly in favour of early restructuring for viable businesses when there is a likelihood of insolvency and they underlined the importance for early warning tools. Some business organisations (Independent Retail Europe, EUAPME) also stressed that models for restructuring plans could be used as a starting point in order to reduce costs for SMEs, as long as they are optional and flexible.

Legal **practitioners**, insolvency practitioners and **academics** were in favour of early restructuring for viable debtors, when there is a likelihood of insolvency, including when the viability of the business is threatened due to over-indebtedness. They were also in favour of early warning mechanisms and facilitating access to advice. As for the model restructuring plans, although some professionals (ACCA) expressed feasibility concerns, others (CCBE, ELI) were in favour.

The **financial sector** supported the idea of and advocated for more efficient alert mechanisms, such as tax and social security authorities flagging a negative development of a business.

Trade Unions agreed that an early restructuring framework should be available to viable debtors in financial difficulties when there is a likelihood of insolvency. However, they reminded of abusive practices by which insolvency proceedings, and in particular restructuring, are deliberately used to evade responsibilities under labour law. An easier access to preventive restructuring framework should be counterbalanced by safeguards against 'tactical insolvencies', for the protection of employees' rights. Additionally, they advocated that the EU labour *acquis* should not be affected.

Most **Member States** supported the idea of early restructuring already at the time of the Recommendation on restructuring and second chance. In the performed public consultation over 50 % of respondents were in favour of early restructuring procedures while 20% believed that restructuring should be available at any time. Member States²⁵⁸ agreed on the necessity of preventive measures enabling early restructuring of viable businesses. During the dedicated meetings with the Member States, they were of the view that when the viability of the business is threatened due to over-indebtedness, the businesses should have a right to access an early restructuring framework. However, the majority, if not all ((AT, EE, FI, DE, IE, PL, PT, ES, SE) were opposed to harmonising the definition of insolvency or that of the likelihood of insolvency.

In addition, all the Member States advocated for early warning mechanisms and tools, but there was no consensus regarding the modalities how these systems should be established and operated (whether they should be funded and monitored by the State or by the private market). As for model restructuring plans, although the majority of Member States expressed concerns regarding the effectiveness, they were in favour as long as these checklists are optional and flexible.

Closely related to it was the question about a **harmonised definition of insolvency or likelihood of insolvency**. In the public consultation, two thirds of those consulted were in favour of introducing a common definition of insolvency at EU level, particularly with a view

²⁵⁸ 18 Member States replied (AT, DE, EL, CZ, EE, MT, PL, SK, SE, SI, LT, LV, HU, FR, IT, IE, FI and BE), but several asked for their contributions to remain confidential.

to enhance certainty and predictability for firms and investors across the EU and create a level-playing field for cross border insolvency proceedings.²⁵⁹ The majority of those consulted were of the view that such a definition should include elements of both a cash flow (liquidity) and a balance sheet test.

However, during the dedicated meetings with the stakeholders, it was highlighted by almost all of them that whilst some minimum standards might be helpful, it is unlikely to agree in practice on a common definition.²⁶⁰ In this context, some stakeholders argued that the consequences of a company meeting the insolvency definition/test are more important than the definition itself, in particular when there are strict requirements for mandatory filing for insolvency.²⁶¹ Additionally, in the public consultation and the informal meetings with the Member States, most of them were not in favour of harmonising these definitions at EU level.

Finally, the experts consulted did not reach a consensus on the need to a common definition of insolvency at EU level. The view expressed was that a definition would not be necessary to access early restructuring proceedings. Most of the experts expressed the view that the future initiative should focus more on trigger elements/criteria, especially for early restructuring procedures.

2.7.2. *Involvement of national courts*

Approximately 45% of the respondents to the public consultation supported that some sort of formal procedure (with the involvement of the court or other competent authority) should be opened when a moratorium is granted or in case of a confirmation of a restructuring plan,²⁶² while 18% were in favour of a rather flexible process without having the involvement of a court as an absolute requirement²⁶³. In addition, during the ‘Sounding Board’ meetings, the majority of stakeholders in **business and financial sector** as well as **professionals in the field of restructuring** confirmed that less court-driven procedures may make the restructuring process less rigid, costly and time-consuming.

Particularly, the majority argued that as soon as rights of third parties are affected, (e.g. cram-down or moratorium), court involvement should be required to avoid an abuse of process by the debtor (and consenting creditors).²⁶⁴

The majority of the stakeholders indicated that restructuring measures in which the courts are involved to a lesser degree or not at all should equally be available to all forms of enterprises²⁶⁵, with many of them stressing that they should be particularly available to SMEs.

Other stakeholders argued that:

- In purely consensual restructurings court involvement is not necessary.

²⁵⁹ BBA, Bundesverband der Deutschen Industrie e.V., EBF, law firm from Germany, German Bar Association, BV ESUG, Association of Insolvency Administrators, Association of Insolvency Administrators (Germany), German Institute for applied insolvency law (Hamburg University)

²⁶⁰ BusinessEurope

²⁶¹ AIMA, KPMG

²⁶² Bundesverband der Deutschen Industrie e.V., German Bar Association, Association of Insolvency Administrators (Germany), German Institute for applied insolvency law (Hamburg University)

²⁶³ Bar Council of England and Wales, ACCA, BV ESUG

²⁶⁴ UEAPME, EACTP

²⁶⁵ Eurochambers, INSOL Europe, German Bar Association

- Flexible out-of-court procedures would be an efficient and viable solution both in terms of success rate and duration.²⁶⁶

Additionally, in the public consultation, the majority of the stakeholders indicated that restructuring measures in which the courts are involved to a lesser degree or not at all should equally be available to all forms of enterprises²⁶⁷, with many of them stressing that they should be particularly available to SMEs.

2.7.3. *Publicity related to proceedings*

Some stakeholders were of the view that publicity is only required in case of a moratorium or a confirmation of the plan, while others stated that publicity should not be an absolute requirement.²⁶⁸ Fewer were of the view that publicity is required as from the beginning of the negotiations on a restructuring plan.

In the public consultation, it was particularly stated that:

- Publicity should be required when the restructuring measures affect all or the majority of the creditors.²⁶⁹
- Notification should be given to all affected stakeholders, but this may be only a limited group of creditors.²⁷⁰
- For entirely consensual restructurings, which do not rely on stays or court approval, publicity is not required.²⁷¹
- Especially for cross-border cases, access to information about restructuring/insolvency proceedings on a timely manner, is crucial for creditors.
- A European register of insolvencies based on existing national registers would be beneficial particularly for cross-border cases, as creditors could be informed about the opening of an insolvency proceedings against their debtor in another Member State.²⁷²

In light of these, the **Trade Unions** underlined the importance of consultation and information rights of the employees at an early stage.

Finally, during the dedicated meetings with the Member States, while some **Member States** (UK, DE, IT, FI) mostly favoured transparent procedures and certain publicity, others (NL, BE, ES, FR) stressed the importance of confidential procedures.

2.7.4. *'Debtor-in-possession arrangements'*

In the public consultation, the vast majority of stakeholders were of the view that debtors in the context of restructuring measures should be allowed to keep control over the day-to-day

²⁶⁶ Eurochambers

²⁶⁷ Eurochambers, INSOL Europe, German Bar Association

²⁶⁸ Eurochambers, Bar Council of England and Wales, Bundesverband der Deutschen Industrie e.V., ACCA, BV ESUG, Association of Insolvency Administrators (Germany), German Institute for applied insolvency law (Hamburg University)

²⁶⁹ UEAPME

²⁷⁰ GDV

²⁷¹ ILA

²⁷² Eurochambers

operations of their business ('debtor-in-possession arrangements') with almost two thirds supporting that there should be supervision from a suitably qualified mediator/supervisor/court.²⁷³

Main comments:

- The debtor-in-possession arrangements prove to be very often the best solution in order for a debtor to preserve the productive capacity of a company; they promote operational efficiencies and realize significant cost savings.
- Some form of supervision by a suitably qualified and independent professional would reduce the risk of abuse and provide a transparent and trustful process for creditors.²⁷⁴
- The level of oversight may depend on the nature of restructuring and on the measures requested (e.g. where the rights of creditors are limited).²⁷⁵
- A range of restructuring measures should be available with options for a debtor to remain in possession or where appropriate have an independent supervisor or the court to assist.²⁷⁶
- In principle, the intervention/supervision of a mediator/supervisor/court should not be mandatory.²⁷⁷
- Once a moratorium is ordered, supervision is necessary.²⁷⁸
- The debtor-in-possession arrangements are especially needed for SMEs, since it would be very difficult to find proper management for the company. However, it is highly unlikely that the restructuring would succeed without any supervision or control.²⁷⁹

During the 'Sounding Board' meetings, **business sector and business support organisations** were strongly in favour of debtor-in-possession arrangements. They particularly underlined that if the appointment of a supervisor/mediator is optional, this could reduce costs for SMEs. Some of them were also of the view that when rights of third parties are not affected, the decision of the appointment of a supervisor should be confidential.

Practitioners were in favour of debtor-in-possession principle with the possibility for appointing a supervisor. They were though reluctant to harmonising the conditions for appointing an insolvency practitioner.

Credit and financial institutions were of the view that the debtor should in principle remain in possession and they fully shared the principle according to which the appointment of a mediator in a preventive restructuring framework should not be mandatory, but made by the court on a case by-case basis. They also underlined the importance of transparency of information for creditors.

Trade Unions supported the debtor-in-possession principle, but underlined that the employees' rights to information and consultation should not be affected.

²⁷³ Eurochambers, EACTP, INSOL Europe, EBF, PMT/PME/MN, Bundesverband der Deutschen Industrie e.V., Buchalik Brömmekamp Rechtsanwälte | Steuerberater, German Bar Association, German Federal Association of notaries, Association of Insolvency Administrators, Association of Insolvency Administrators (Germany), German Institute for applied insolvency law (Hamburg University)

²⁷⁴ KPMG, University of Palermo, Barreau de Luxembourg, Academic from Germany, GDV, ICAS

²⁷⁵ KPMG, Insolvency practitioners association (UK), Martin Luther University Halle-Wittenberg, Unizo, UEAPME

²⁷⁶ Loan Market Association

²⁷⁷ BBA, EACTP, Academic from Spain

²⁷⁸ University of Bonn, IBA

²⁷⁹ Finnish Bar Association, German Bar Association

From the public consultation and the dedicated meetings with the **Member States**, almost all of them (AT, BE, EE, DE, EL, HU, IE, FR, FI, IT, LV, LT, PL, SK, SI) were in favour of the debtor remaining in possession, but subject to supervision by a suitably qualified mediator/supervisor/ court. They also agreed that the appointment of a mediator or supervisor (insolvency practitioner) should remain optional, but were not in favour of harmonising the conditions for appointment.

2.7.5. *Enforcement actions – stay and its duration*

In the public consultation, the majority of those consulted supported that **a stay of individual enforcement actions should be available both in formal insolvency proceedings and in preventive/pre-insolvency restructuring procedures.**²⁸⁰

The majority underlined that:

- A stay of individual enforcement actions gives the viable businesses in temporary financial distress a necessary amount of time ('breathing space') to define a restructuring plan and to avoid precipitate creditor action, thus significantly increasing their chances for a successful restructuring.²⁸¹
- It should be ensured that creditors whose rights are stayed are adequately protected; a balance must be found between depriving creditors (especially secured creditors) of their contractual or proprietary rights, and allowing the debtor breathing space to restructure; adequate safeguards should be put in place (e.g. limited conditions and supervision, possibility for creditors to lift the stay).²⁸²
- A stay should be limited to prevent individual creditor claims (no general stay).

The majority was also in favour of allowing an individual creditor to **lift the stay** granted to the debtor, under certain conditions.²⁸³

They specifically argued that:

- An individual creditor should be allowed to ask the court to lift the stay in order to reduce the risk connected with commencement of preventive/pre-insolvency procedures in bad faith (e.g. in order to harm creditors' interests, delay enforcement actions).
- The creditor should be able to request the stay to be lifted if it can show that it leads to unfair prejudice or abuse against the creditor, or if the creditor would be able to block the restructuring proceedings (i.e. it represents a blocking minority).²⁸⁴

Others were of the view that an individual creditor should not be sufficient, but a qualified or a large majority of creditors should be allowed to ask the court to lift the moratorium (e.g. if they prove that the debtor is not negotiating or there are not any realistic chances of success).²⁸⁵

²⁸⁰ UEAPME, BusinessEurope, INSOL Europe, Bar Council of England and Wales, PM/PME/MN, Bundesverband der Deutschen Industrie e.V., EBF, ACCA, Association of Insolvency Administrators (Germany), German Institute for applied insolvency law (Hamburg University)

²⁸¹ University of Palermo, University of Bonn, barrister from UK, BBA, Barreau de Luxembourg

²⁸² ICAS, AIMA, GDV, IBA, Financial Markets Law Committee

²⁸³ UEAPME, EBF, Bar Council of England and Wales, German Federal Association of notaries, Association of Insolvency Administrators (Germany), German Institute for applied insolvency law (Hamburg University)

²⁸⁴ Academic from Germany, Barreau de Luxembourg, ICAEW, Insolvency practitioners Association (UK), Unizo (BE)

²⁸⁵ Academic from Spain, Grow your business East Anglia Ltd (UK), business advisor from UK, EUF

As for its duration, the majority of the stakeholders were of the view that a stay should be granted for a **maximum of 2-3 months with a possibility of renewal in certain circumstances**, while others were of the view that the time limit should be set by the court subject to the fulfillment of certain conditions.

The majority stated that:

- There should be a fair balance between the debtors' and creditors' rights. Thus, a stay should not be granted for a very long period, but for a proportionate and appropriate timeframe in order to contribute to the efficiency of the negotiations.
- Only a fast restructuring ensures the survival of the business operation and longer periods may not lead to better results, but have a negative impact on the recovery of debt.²⁸⁶
- There should be the possibility of renewal or extension, under certain circumstances, (e.g. depending on the level of the complexity of the restructuring or in the event that there are prospects of success).

According to the experience of the majority of insolvency practitioners and legal professionals consulted:

- 2-3 months is a reasonable and sufficient time, but there should be the option to extend if there is a reasonable basis (i.e. complexity). Longer stays without a review mechanism would unfairly prejudice the rights of creditors. It is often the case that preliminary negotiations are conducted without requiring a stay. The longer the period of the process, the lower the chances of a successful restructuring.

Others were of the view that:

- Since there is no one-size-fits-all approach, flexibility is needed as to the time limit.²⁸⁷
- The period of a stay should depend upon the level of oversight of the debtor's continuing activities by suitably qualified and regulated professional and be subject to appeal to a Court.²⁸⁸

During the 'Sounding Board' meetings, **businesses sector** was in favour of a short limited stay (2-3 months) for individual enforcement actions, while some of them (UEAPME) underlined that a stay should be granted for a period set by the court.

Financial institutions were of the view that a short stay (2-3 months) should not be automatically provided by the court, but only ordered in specific situations, with the possibility to be lifted by the creditors.

Legal and insolvency practitioners were in favour of a short stay of 3-4 months with the possibility of renewal under certain circumstances and be lifted by the creditors. Some of them (INSOL Europe) underlined that where creditors are stayed from enforcing their rights it is advisable to institute effective supervision.

²⁸⁶ GDV, German banking industry committee, BBA

²⁸⁷ Finnish Bar Association, Academic from Germany, Barreau de Luxemburg, Bar Council of England and Wales

²⁸⁸ Insolvency Practitioners Association (UK)

Trade Unions underlined that employees should not be treated worse in preventive restructuring scenarios than in case of insolvency proceedings.

From the public consultation and the dedicated meetings with the **Member States**, the majority of them (PL, PT, ES, SE, IT, AT) supported the view that a stay should be granted without any conditions (automatically) with the possibility to be lifted by the creditor, while others preferred that a stay should be granted only if the debtor shows that it is likely that negotiations have a reasonable prospect of leading to a successful restructuring. Some Member States (FI, SE) were in favour of a general stay, while others (NL) supported only a stay on individual enforcement actions. As for the duration, Member States in general supported a short stay (4 months) with the possibility of its prolongation under certain circumstances, while others opted for longer periods (LU, FR) and others (FI) were of the opinion that the duration of a stay should be set by the Courts. Diverse views were expressed as to the maximum period envisaged.

2.7.6. *Creditors' rights - 'cross-class cram down' (i.e. the confirmation of the restructuring plan supported by some classes of creditors in spite of the objections of some other classes of creditors)*

In the public consultation, almost 60% of those consulted were of the view that a 'cross-class cram down' should be possible, subject to certain conditions and safeguards.²⁸⁹ It was mentioned that, in particular circumstances, a cross class cram down is beneficial, but mitigations should be taken into account (e.g. appropriate court supervision, worse-off principle, separate classes for creditors with different interests etc.).

It was in general supported that:

- In principle, a restructuring plan adopted by an appropriate majority of classes of creditors and with any necessary court confirmation should be binding on all creditors.
- Creditors with different interests should be treated in separate classes, which reflect those interests.²⁹⁰
- As a minimum, there should be separate classes for secured and unsecured creditors.
- A class of creditors which is out of the money should not be able to veto a restructuring plan so long as they are not being unfairly prejudiced. However, the assessment of valuation should be independently supervised by the Court or an appropriately regulated person and subject to mechanism for challenge.²⁹¹
- The plan should be fair and reasonable and leave no creditor worse off than they would be in the most likely alternative scenario, e.g. liquidation.²⁹²

In the public consultation and the 'Sounding Board' meetings, **business organisations and insolvency practitioners** supported in general that the plan should be adopted if the required majority in every class is in favour provided that the minority creditors are not unfairly prejudiced and that all classes of creditors should be affected by the plan. They were strongly of the view that secured and unsecured creditors should be treated in separate classes. The majority supported minimum standards on cross-class cram-down accompanied by adequate

²⁸⁹ UEAPME, EBF, ACCA, Bar Council of England and Wales, PMT/PME/MN, Bundesverband der Deutschen Industrie e.V., BV ESUG, Association of Insolvency Administrators (Germany)

²⁹⁰ Loan Market Association

²⁹¹ Insolvency practitioners association (UK), ICAS

²⁹² Loan Market Association, University of Bonn, Judge from Germany

safeguards. As for shareholders' position, various views were expressed; some of them were more reluctant to introducing mandatory provisions regarding shareholders in preventive restructuring, while others were of the view that although shareholders should be involved in the negotiations, they should not have a hold out position if they are out of the money.

Financial institutions were not opposed to cram down mechanisms, but they underlined that adequate safeguards should exist for secured creditors, because the write off of claims of a secured creditor without individual consent could generate the type of uncertainty that may result in higher costs of financing. They particularly stressed the importance of the protection of the enforceability of the collateral and the implications to the cost of credit and financing. They were also of the view that shareholders' rights might need to be limited in certain circumstances, i.e when they prevent the plan from being adopted although this plan is likely to ensure the continuation of the company's activity and the recovery of the debts.

Trade Unions stressed that employees' interests should not be overruled; where there is a preventative restructuring of a business or undertaking then the employer must be obliged to inform, consult and engage with the employees with a view to reaching agreement. Any subsequent agreement reached on restructuring in as far as employment and industrial relations is concerned should not be subject to veto by other creditors.

From the public consultation and the informal meetings with the Member States, the majority of the **Member States** were in favour of cram-down on all creditors, as long as appropriate safeguards are put in place. However, views were diverging with regard to majorities required, exceptions and safeguards. As for the position of shareholders in early restructuring, despite the fact that all the Member States supported the rationale, some of them were concerned about the idea of introducing mandatory detailed rules, because of potential implications on company law and constitutional protection of property rights.

2.7.7. *Protection of new financing*

The vast majority of the participants to the public consultation underlined the significant importance of interim/new financing for a successful restructuring and the continuity of a business and agreed that there should be appropriate incentives and safeguards to encourage the provision of financing to enable restructuring to take place. Almost 70% were of the view that financing ensuring current operations should be protected in case of insolvency in the future²⁹³ and only 5% were opposed to any kind of protection. In particular, the majority of those in favour stressed that financing necessary for the implementation of a restructuring plan should be protected only if agreed in the restructuring plan and confirmed by the court.²⁹⁴ More specifically, 50% of the business sector was of the view that financing should be protected if agreed in the restructuring plan and confirmed by the court, while additional 20% believed that new financing should always be protected.

The majority agreed that:

- If there is not any protection (e.g. protection from avoidance rules or higher priority) of interim and new financing, then potentially interested investors will be discouraged

²⁹³ Independent Retail Europe, BusinessEurope, Bundesverband der Deutschen Industrie e.V., EBF, ACCA, BV ESUG

²⁹⁴ German Bar Association, Association of Insolvency Administrators (Germany)

and companies in need of working capital could be left without the possibility to finance their day to day operations, to the detriment of the real economy.²⁹⁵

- Creditors that decide to inject liquidity in a distressed company should be given a sufficient degree of predictability on the recovery of their claims.
- In general, such a financing should be protected, if there are reasonable prospects for the plan to be successful and subject to a confirmation by the court and there is potential benefit to the creditors.²⁹⁶

It was also argued that:

- Statutory super priority is best left to each Member State to decide as any such proposals will need to be consistent with existing national laws regarding property rights and security interests.

During the ‘Sounding Board’ meetings, **business organisations** such as UEAPME, Independent Retail Europe and BusinessEurope mentioned that adequate protection of new financing will provide incentives for early restructuring.

Legal and insolvency practitioners were in favour of providing protection for new financing and, for the sake of greater certainty, they supported the idea of a safe harbour provision equipped with adequate safeguards.

Financial institutions were in favour of adequate protection for new financing if that is agreed in the plan and confirmed by the court.

The majority of the **Member States** (NL, AT, SI, RO, PT, IE, PL, EL) were in favour of general principles for the protection of new and interim financing, provided that there are appropriate safeguard against bad faith behaviour and fraud. Member States were, nevertheless, opposed to mandatory provisions granting super priority for new money or to any rules, which would affect domestic systems of ranking of claims and securities.

Regarding the **priority of claims in insolvency**, almost 45% of respondents in the public consultation supported that differences in the areas of ranking of claims affect to a large or to a considerable extent the operation of the internal market. 41% also believed that harmonisation in this area would increase recovery rates for creditors. However, discussions in the **Commission Expert Group** revealed that this area is fraught with difficulty especially because of Member States approaches to giving preferences to employees and state creditors (tax, social security etc.). Competing values are at stake and harmonisation is not at this stage feasible. In addition, in the public consultation and during the dedicated meetings with the **Member States**, most of them were opposed to any harmonisation of ranking of claims.

2.7.8. Role of directors in preventing insolvencies

More than half of those responded in the public consultation were of the view that directors of companies should be incentivised to take appropriate preventive measures if companies are in distress but not yet insolvent²⁹⁷, while 18% were against.

²⁹⁵ EUF

²⁹⁶ German Banking Industry Committee

²⁹⁷ UEAPME, EACTP, BusinessEurope, EBF, German Bar Association

It was particularly stressed that:

- Directors should be incentivised and encouraged to take professional advice and appropriate preventive measures at an early stage and this could be a mitigating factor in any subsequent assessment of the conduct of the director.
- Mandatory filing periods which penalise directors can have a negative effect on directors taking preventative measures and precipitate (in some cases) premature filings for formal insolvency.²⁹⁸
- There should be a flexible “safe harbour” protecting against potential liability directors who, in good faith, attempt to restructure a financially distressed company with a view to the long term best interests of the company and its constituencies. This should not protect abusive practices, such as shareholder-directors delaying formal restructurings.²⁹⁹
- Instituting preventative proceedings should not protect directors from earlier misbehaviour, nor should they be protected from actions relating to their conduct during the moratorium where that conduct involves fraud, negligence or wilful misfeasance.³⁰⁰

However, during the dedicated meetings with the **Member States**, although they acknowledged the need to incentivise directors for early restructuring, most of them were reluctant to mandatory detailed provisions on directors’ duties, due to the implications on company law.

2.7.9. Role of Member States in preventing insolvencies

In the public consultation, the majority of stakeholders were in favour of encouraging Member States to take specific action to help debtors in financial distress. Approximately 30% supported specific action only for SMEs and individuals, while 22% for all the debtors.

During the ‘Sounding board’ meetings, **business sector and practitioners** in restructuring underlined the importance for early warning tools and facilitating access to advice. However, while some stakeholders were of the view that some kind of government-backed measures (i.e. funds, assistance schemes) could be introduced to support viable businesses in their attempt to restructure, others supported that the financial and administrative burden should be borne by each debtor.

The **financial sector** supported the idea of and advocated for more efficient alert mechanisms, such as tax and social security authorities flagging a negative development of a business.

Additionally, during the dedicated meetings, all the Member States advocated for **early warning mechanisms and tools**, but there was no consensus regarding the modalities how these systems should be established and operated (whether they should be funded and monitored by the State or by the private market).

2.7.10. Avoidance actions

²⁹⁸ Barreau de Luxembourg, ILA, Unizo, Invest Europe

²⁹⁹ IBA, academic from Spain

³⁰⁰ KPMG

The majority of those consulted in the public consultation believed that certain aspects of avoidance actions should be harmonised at EU level, such as setting up common rules on the types of transactions subject to annulment and a common time period that corresponds to "suspect periods", with a view to enhance predictability and legal certainty for investors and business for the risks faced across EU Member States.³⁰¹ Others believed that harmonisation on avoidance actions is not necessary at this point.³⁰²

The majority particularly argued that:

- Investors, companies and entrepreneurs would be more willing to invest or do business outside their Member States if they were provided with the assurance that certain types of transactions, entered into within a certain period of time, are prescribed throughout the EU. This is especially the case when dealing with foreign counterparts in financial distress and there is an impact on regular business transactions, in particular lending.

During the Sounding Board meetings, **legal and insolvency practitioners** were reluctant to harmonising substantive definitions of avoidance actions and look back periods, because of the existing divergence in national systems. Additionally, discussions in the **Commission Expert group** revealed that while avoidance actions could in principle be harmonised across the board, it would be disproportionate to do so at this stage.

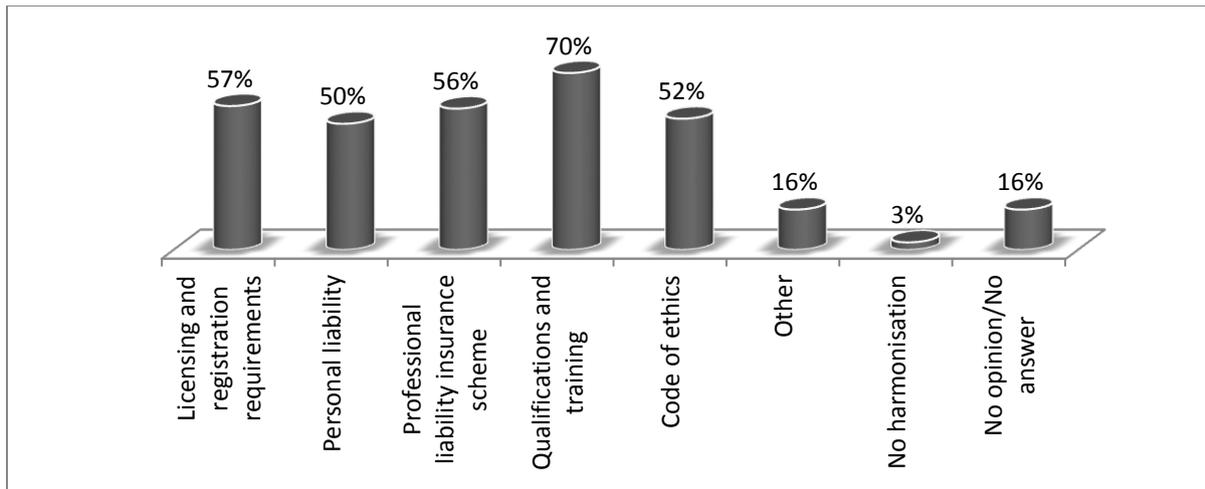
The majority of the **Member States** (RO, PT, ES, DE, PL, IT, BE) were in favour of providing a safe harbour for transactions which are closely connected with the negotiation of a restructuring plan and which are adopted by the creditors and confirmed by the court, as long as European legislation remains at the level of principles and there are no too detailed provisions. A few Member States (DE, FI, AT) expressed concerns with regard to legal certainty and the danger of abuse.

2.7.11. Insolvency practitioners

When asked in what areas minimum standards for insolvency practitioners would help to increase the efficiency and effectiveness of insolvency proceedings, the respondents to the public consultation replied as follows:

³⁰¹ AIMA, EUF, EACB, Insolvency Practitioners Association (UK), EBF, Academic from Germany, Martin Luther University Halle-Wittenberg, German bar Association, German Institute for applied insolvency law (Hamburg university)

³⁰² German Banking Industry Committee, ICAEW, KPMG, ILA, University of Bonn



As for any additional standards needed for insolvency practitioners specifically dealing with cross-border cases, some professionals' associations were reluctant.³⁰³ On the other hand, 50% of the respondents to the public consultation would welcome the introduction of minimum standardised rules on relevant foreign language knowledge, 46% on sufficient human and financial resources and 33% on a pre-defined period of experience for insolvency practitioners specifically dealing in a cross-border context.

Particularly, INSOL Europe stressed that, although harmonisation would be in general desirable, only common principles in cooperation matters, independence and continuous education are advisable at this stage, due to the great diversity of national rules with regard to all aspects related to insolvency office holders (types, nature of employment, size, qualification, training, appointment, remuneration and liability issues).

It was particularly stated that improving the efficiency of insolvency practitioners will increase confidence to the whole system and improve the efficiency of the procedures.

During the 'Sounding board' meetings, **business organisations** welcomed minimum standards for practitioners in the field of restructuring and insolvency. Many of them advocated the introduction of a code of conduct for insolvency practitioners. **Financial institutions** in general would welcome the introduction of minimum standardised rules on the role of mediators and supervisors, which should include among others: (i) professional qualification standards; and (ii) general principles covering their remuneration.

Insolvency practitioners were reluctant to detailed provisions regarding insolvency office holders due to the existing divergence of rules and specificities. They rather favoured general principles on independence and adequate qualification.

The majority of the **Member States** (PT, DE, ES, FR, NL, FI, IE) supported the objectives of adequate qualification and training of insolvency practitioners. Many Member States voiced that EU intervention should remain at the level of general objectives and provide a rather flexible approach, especially regarding the appointment and remuneration of practitioners.

2.8. Second chance – debt discharge for natural persons

³⁰³ IBA, ICAEW, ICAS, ILA, Insolvency practitioners Association (UK)

2.8.1. General considerations

The vast majority of the respondents to the public consultation (74%) agreed that both entrepreneurs and consumers as long as they are honest should be given the chance to restructuring their debt³⁰⁴, while only 1% was opposed and 8% considered that the chance to restructuring should be offered only to entrepreneurs for debts related to their professional activity.

A general consensus was that the prospect of debt rehabilitation for natural persons (entrepreneurs and consumers) is vital both from an economic and social policy perspective. However, this should be subject to adequate checks and balances to ensure that culpable behavior is recognised and sanctioned.³⁰⁵

The majority of those consulted supported that a second chance approach for over-indebted natural persons should be promoted because:

- It will stifle trade, strengthen real economy and be a driver for growth, since it will encourage entrepreneurship and stimulate consumer spending.³⁰⁶
- It will address the issue of bankruptcy tourism.
- It will reduce the problem of black labour.
- It is counterproductive for honest bankrupts (consumer or entrepreneur) to labour under the shadow of undischarged debt for extended periods.
- Restrictions on bankrupts may significantly impact their daily lives.
- Extended bankruptcies may also contribute to overburdening the financial and judicial system.

However, the **banking sector** and some business organisations³⁰⁷ supported that entrepreneurs and consumers should be dealt separately and that consumers should not form part of the future initiative on business restructuring and second chance.

Trade Unions stressed that attention should be given whether some rules on “second chance” are so lax to facilitate the so-called “phoenix syndrome”.³⁰⁸

In the public consultation, the majority of the Member States agreed in principle with a second chance approach providing the possibility for natural persons to restructure their debt and be offered a discharge, but there was a diversity of views with regard to the conditions and the duration of discharge. Moreover, during the informal Member States meetings, most of the Member States were reluctant to including mandatory provisions on consumers discharge.

³⁰⁴ Eurochambers, UEAPME, INSOL Europe, ACCA, Bar Council of England and Wales, debt counseling companies Association (Germany), German Bar Association, BV ESUG, Association of Insolvency Administrators (Germany)

³⁰⁵ ICAS

³⁰⁶ Academic from Spain, Martin Luther University Halle-Wittenberg, Insolvency practitioners Association (UK), IBA, EFIN

³⁰⁷ BUSINESSEUROPE, European Banking Federation (EBF) and European Mortgage Federation-European Covered Bond Council (EMF-ECBC).

³⁰⁸ This is defined as a situation where controllers of a company that becomes insolvent by reason of their acts or omissions are enabled to be relieved of their failure and debts and immediately re-establish themselves in a new enterprise effectively carrying on the same business and still availing of the privilege of limited liability.

However, many stakeholders' organisations, including practitioners in the field of restructuring were in favour of **consolidation or coordination of procedures** (business and personal debts) for the purposes of discharge. Finally, many Member States were in favour of consolidation of economic and private debts (BE, FI, FR, NL, ES).

Family and consumer protection stakeholders on the contrary strongly endorsed minimum standards on consumer insolvency and discharge and stress that there are no convincing arguments for differentiating between entrepreneurs and consumers with regard to the applicable conditions.

2.8.2. *Affectation of the Internal Market*

The majority of the respondents of the public consultation considered that existing differences between the laws of Member States in the area of second chance affect the functioning of the Internal Market to some extent (34% to some extent, 19% to considerable extent, 14% to large extent). Only 6% held the view that it had no impact.

Consumer and household organisations supported that differences in this area have led to bankruptcy tourism, with debtors seeking to move, or claim to have moved, their centre of main interests to Member States where they are able to take advantage of favourable discharge periods.

However, a few stakeholders stated that the problem is not sufficiently severe or pervasive as to require an EU-wide minimum standards approach; it is materially different from corporate insolvency, where one distressed group can have operations and legal entities in several Member States and a consistent approach across the EU can have real and immediate benefits for the restructuring or insolvency of the distressed group as a whole.

2.8.3. *Advice to debtors*

The vast majority of the respondents to the public consultation were of the view that both over-indebted entrepreneurs and consumers, possible to certain conditions, should have access to free or low cost advice³⁰⁹, while only 2% were opposed.

Some stakeholders argued that the details of debt counseling should be addressed according to the national policy of each Member State and different views were expressed as to whether such advice should be publicly funded or market-driven or operated within the relevant bodies of the industry and consumer organisations.

Consumer organisations supported that a key tool to gain efficiency would be to elaborate on a method setting minimum cost of living (reference budget) agreed by all the stakeholders at a national level.³¹⁰

³⁰⁹ Finnish Bar Association, IBA, EFIN, ACCA, Bundesverband der Deutschen Industrie e.V., Eurochambers, UEAPME, INSOL Europe, Barreau de Luxembourg, BBA, Loan Market Association, German Banking Industry Committee, Martin Luther University Halle-Wittenberg, Bar Council of England and Wales, debt counseling companies Association (Germany), Association of Insolvency Administrators (Germany)

³¹⁰ EFIN

In the public consultation and the discussions in the informal meetings with the **Member States**, while all of them recognised the importance of offering free or low cost advice to the debtors, there was a diversity of views with regard whether this should be coordinated by the State (courts, administrators) or by localized chambers of commerce and industry organizations.

2.8.4. *Discharge of debts*

In the performed public consultation, almost two thirds of the respondents, were of the view that a full discharge of debts, possibly subject to certain conditions, should be offered to both entrepreneurs and consumers provided that they are 'honest' debtors,³¹¹ while very few were opposed to any discharge of debt for natural persons. In addition, very few argued that only entrepreneurs should be entitled to a full discharge. The majority of the stakeholders and Member States underlined that discharge should be tempered by ensuring disincentives for dishonest conduct and adequate control for abuses.

In the 'Sounding Board' meetings, stakeholders in the business sector as well as professional associations strongly supported the objective of offering honest bankrupt entrepreneurs a second chance reducing the stigma of insolvency and allowing them to return to economic life in a reasonable timeframe.

EU banking sector argued that a full debt discharge may ultimately result in a counterproductive measure, providing wrong signals for entrepreneurs and consumers; thus, a discharge should be given provided that a certain amount of debt is repaid or that the individuals used all their efforts and financial means to repay the debt. Moreover, a limitation on the period after which a second discharge may be provided should be envisaged in order to prevent abuses.

Other stakeholders were of the view that a case-by case approach is needed and each debtor situation should be evaluated before. The amount and time tolerance given should be specified by the court taking into consideration various elements, including the aggregated value of debt.

Moreover, less than half of the respondents to the public consultation supported that the conditions for the discharge of debts should be the same for entrepreneurs and consumers³¹², while only 28% were of the opposite view (that the conditions applicable to entrepreneurs should be stricter than those applicable to consumers).³¹³ Most of stakeholders shared that viewed and considered that, if this matter is to be regulated, the conditions for discharge should be the same for all natural persons, because there is not any public policy rationale for consumers and small-scale entrepreneurs to be treated differently or any reason to have stricter conditions for discharge applied depending on the purpose of the debt.³¹⁴

³¹¹ BBA, ICAS, Eurochambers, Insol Europe, EFIN, ACCA, Barreau de Luxembourg, Bar Council of England and Wales, Bundesverband der Deutschen Industrie e.V., debt counseling companies Association (Germany), German Bar Association, German Federal Association of notaries, BV ESUG, Association of Insolvency Administrators (Germany), German Institute for applied insolvency law (Hamburg University)

³¹² UEAPME, INSOL Europe, Bundesverband der Deutschen Industrie e.V., EFIN, ACCA, debt counseling companies Association (Germany), German Bar Association, German Federal Association of notaries, Association of Insolvency Administrators (Germany), German Institute for applied insolvency law (Hamburg University)

³¹³ Eurochambers, BV ESUG

³¹⁴ ICAS, ILA, IBA, German Institute for applied insolvency law (Hamburg University)

Additionally, during the stakeholder meetings, **business organisations as well as legal professionals and accountants** voiced that, where the entrepreneur has personal debts, both generated by his/her business activity and by his/her non-business activity, the proceedings should be consolidated for the purposes of the discharge.

- Moreover, it was strongly outlined that many such insolvent individuals will have a mixture of consumer and business liabilities, therefore potentially giving rise to a costly, time consuming, unnecessary process to determine whether they are to be treated as consumers or as entrepreneurs if a distinction is to be made; it will be often difficult to adequately distinguish between a purely consumer debtor and self-employed persons who may also have incurred consumer credit, potentially in supporting their trading activities.³¹⁵
- Apart from that, some participants mentioned that, if the conditions vary, there is room for discrimination (constitutional issues) or for potential risks of gaming the system.³¹⁶

Although all **Member States** supported, in principle, the idea of a second chance for entrepreneurs, providing for a reduced discharge period, various views were expressed with regard to the conditions and exemptions.

2.8.4.1. Entry conditions for the discharge procedure

Despite the fact that many stakeholders supported that a full discharge of debt should be offered without the condition of repayment of a certain amount of debt³¹⁷, there was a strong minority (mainly composed of the banking industry) that opposed to this view.³¹⁸ In addition, some MS (DE) pointed out that a full discharge of debt should be possible after the repayment of certain amount of debt.

In the public consultation:

On the one hand, it was stated that:

- The condition of repayment of a certain amount of debt would weaken the objective of discharge, since it would deprive many over-indebted debtors that they would not be in a position of repaying the exact amount of debt from the possibility of a second chance and the potential benefits for the wider economy.

On the other hand, it was stressed that:

- Discharge should be a case-by-case outcome and be subject to the adoption of ex ante conditional measures. On the basis of the assessment of the economic performance of the insolvent debtor the payment of a certain amount of the debt should be made a condition and this can constitute a balance so as not to disincentivise lending.³¹⁹

Moreover, in the public consultation and the 'Sounding Board' meetings, the majority of stakeholders agreed that there is a need for harmonisation of **the test of 'honesty'** at EU

³¹⁵ ICAS, Insolvency practitioners Association (UK), EFIN

³¹⁶ ICAEW, Association of Insolvency Administrators (Germany)

³¹⁷ Bar Council of England and Wales, Bundesverband der Deutschen Industrie e.V., EFIN, Debt counseling companies association (Germany), BV ESUG, German Institute for applied insolvency law (Hamburg University)

³¹⁸ Eurochambers, EBF, German banks, law firm from Germany

³¹⁹ Finnish Bar Association, banking sector and debt collection companies, Bar Council of England and Wales

level.³²⁰ A lot of stakeholders agreed that there could be a **presumption of honesty** or a negative definition (i.e. certain minimum criteria that would exclude 'honesty').³²¹ Nevertheless, many stakeholders expressed concerns with regard to the level of difficulty and complexity of establishing a harmonised test of honesty across all EU Member States. During the dedicated meetings with the Member States, most of them were reluctant to harmonising the test of honesty, but agreed that certain general non-mandatory principles could be envisaged. In addition, some Member States were in favour of introducing a presumption of honesty, while others spoke against.

Trade unions made reference to directors that act not just honestly but also responsibly; for example, criteria such as the extent to which there is compliance with obligations of company law or employment law, the extent to which there is certain responsibility for the insolvency of company or any responsibility for net deficiencies in the assets of a company etc.

2.8.4.2. Discharge period

The majority of those consulted supported short discharge periods. In the public consultation, almost one third stated that a maximum discharge period of 3 years is a reasonable balance³²² for honest debtors, while less were in favour of a 5-year discharge period.

It was specifically argued that:

- A too short period encourages frivolous use, while a too long period discourages entrepreneurship and risk taking.
- Variations should exist or extension should be possible in exceptional cases (e.g. when the debtor has hidden assets or has not co-operated with the trustee or bankruptcy court).
- If the debtor is insolvent and no assets or income are available there is no valid point in delaying the discharge.
- Honesty should be considered and dishonest conduct may be subject to a longer period.
- Convictions for fraud or financial misfeasance may be taken into account.
- There may be causes which could revoke a debt discharged, for example, if the debtor receives a heritage or it breaches the out of court payment agreement.

The **banking sector** was of the view that honest bankrupt entrepreneurs should be discharged from debts after a relatively short period of time (3 years) only if a certain amount of the debt is repaid (threshold should not necessarily be statutory, but may also be determined by the courts on a case-by-case basis). The banking sector and some other stakeholders supported that limitations with regard to the period after which a second discharge may be available should exist.

³²⁰ Academic from Germany, University of Bonn, Bundesverband der Deutschen Industrie e.V., EBF, EFIN, debt counseling companies Association (Germany), BV ESUG, Association of Insolvency Administrators (Germany), German Institute for applied insolvency law (Hamburg University)

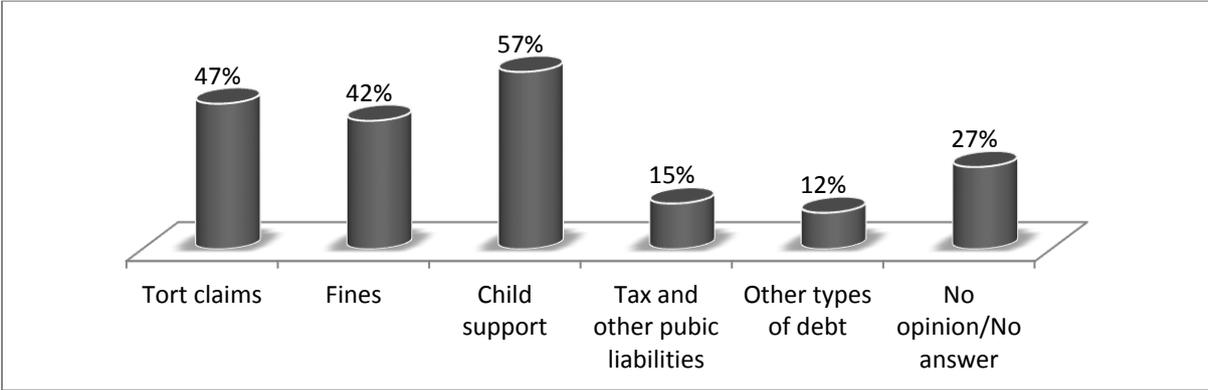
³²¹ EFIN, EBF, banks from Germany

³²² ICAS, Martin Luther University Halle-Wittenberg, Loan Market Association, ILA, KPMG, EFIN, debt counseling companies Association (Germany), Association of Insolvency Administrators (Germany), German Institute for applied insolvency law (Hamburg University), consumer organisations

Consumer organisations strongly supported a three-year discharge period for all honest debtors.

2.8.4.3. Exclusion from discharge

When asked which special types of debt should be excluded from discharge, the respondents to the public consultation replied as follows:



2.9. Outside restructuring framework and second chance

When asked what the causes are for the excessive length of insolvency proceedings, the respondents to the public consultation replied as follows:

Causes	Results
Judicial activities concerning the supervision or administration of insolvency proceedings	48%
Delays in the liquidation of the debtor's assets	58%
The time taken to obtain final decisions on cases concerning the rights and duties of the debtor (e.g. claims, debts, disputed property in goods)	46%
A lack of promptness in exercising creditors' rights	19%
Lack of electronic means of communication between the creditors and relevant national authorities, such as for the purposes of filing of claims, distance voting etc.	24%
Other	21%
No opinion/No answer	19%

However, it was also mentioned that although all the causes mentioned above may affect at a greater or lesser extent the length of the insolvency proceedings, the duration of insolvency proceedings in itself is not a matter which can sensibly be considered for harmonisation.³²³

³²³ ILA, IBA

2.9.1. Duration of insolvency proceedings

When asked whether a target maximum duration of insolvency proceedings — either at first instance or including appeals — would be appropriate, 30% of the respondents to the public consultation were of the view that a target maximum duration for insolvency proceedings would be useful³²⁴, a larger part of them were of the opinion that it would not be appropriate.³²⁵

The European **banking sector** was in favour of introducing certain maximum periods/time limits (e.g. to come up with the restructuring plan or for claim statements).

However, discussions in the Expert Group as well as in dedicated meetings with stakeholders, revealed that deadlines or maximum period for insolvency proceedings would not be feasible to regulate now at EU level, due to the divergence for rules. Most of the stakeholders and experts advocated that other measures (e.g. enhancing efficiency of practitioners, specialization of judges) could reduce the length of insolvency procedures and maximizing the efficiency of insolvency frameworks.

When asked what **incentives** could be put in place to reduce the length of insolvency proceedings, the respondents to the public consultation replied as follows:

- Digitalisation; facilitating electronic communication between practitioners, creditors and national authorities;
- Specialisation of courts;³²⁶
- Supporting the courts' resources;³²⁷
- Less court involvement;
- Informal and out-of-court proceedings;
- Clear requirements for entering to insolvency proceedings;
- Ensuring that the thresholds are triggered early enough for restructuring;
- Deadlines/time-limits for court proceedings;³²⁸
- Publicly accessible information as a (general) prevention;
- Remuneration of insolvency practitioner or liquidator upon success of restructuring or percentage on liquidation; 'sprinter bonus' for administrators;³²⁹ payment benefits to enhance fast proceedings³³⁰
- Providing incentives for speeding up auctions, e.g. reducing tax for those participating in judicial auctions;³³¹
- Cut-off periods for creditors presenting their claims;
- A common online EU portal for companies requiring restructuring or declared insolvent in order to facilitate access to take-overs and credit;
- Public insolvency claim register, where any creditor can file its claim publicly, in order to allow efficient claims trading;³³²

³²⁴ EU Banking sector, Unizo vzw(BE), EACB, AIMA, Eurochambers, EBF, PMT/PME/MN

³²⁵ INSOL Europe, ACCA, Bar Council of England and Wales, German Bar Association, German Federal Association of notaries, Association of Insolvency Administrators (Germany), German Institute for applied insolvency law (Hamburg university)

³²⁶ Martin Luther University Halle-Wittenberg

³²⁷ Insolvency practitioner from Spain

³²⁸ Standard life Capital Partners (UK)

³²⁹ Barreau de Luxembourg, German Banking Industry Committee

³³⁰ German lawyers association, German Institute for applied insolvency law (Hamburg university)

³³¹ Judge from Italy

- Specific fast process in order to deal with insolvency cases, where there are no assets to liquidate;

2.9.2. Directors' disqualification

The majority of the respondents to the public consultation supported that directors' disqualification orders should be made available for information purposes through interconnected insolvency registers³³³, while more than one third were of the view that when disqualification orders for directors are issued in one Member State, they should automatically prevent disqualified directors from managing companies in other Member States.³³⁴ The majority of the respondents was also of the view that disqualified directors in one Member State (home State) should be prevented from managing companies in other Member States only for the duration applicable to equivalent disqualification orders in the host State.

However, although the majority of the stakeholders agreed with the principle that disqualified directors in one Member State should not be involved in the management of companies in another Member State, they stressed that an automatic effect of disqualification orders should not be feasible or appropriate at this stage due to divergence of the rules on disqualification across EU. In addition, with regard to interconnection of registers, many participants expressed their concerns with regard to data protection issues and the interlinkage with certain aspects of criminal and company law.³³⁵

During the dedicated stakeholder meetings, business organisations underlined that any potential action in this area should not lead to disincentivising entrepreneurship. During informal meetings with the Member States, although some of them welcomed EU action in this area, the majority was reluctant.

³³² Insolvency practitioner from Germany

³³³ ICAEW, Insolvency Practitioners Association (UK), BBA, PMT/PME/MN, ACCA, German Bar Association, Association of Insolvency Administrators

³³⁴ ICAS, AIMA, ETUC, Eurochambers, Bar Council of England and Wales, German Federal Association of notaries, German Institute for applied insolvency law (Hamburg university)

³³⁵ UEAPME

2.10. Stakeholder suggestions which were not taken on board by the initiative

	Suggestion	Sector where the position is coming from	Justification why it was not integrated by the proposal
Preventive restructuring	The stay may be lifted only upon the request of a majority of creditors, individual request from creditors should not be taken into account.	certain business stakeholders	The stay is a strong limitation of creditors' rights the impact of which should be limited to the necessary minimum. Among others, the possibility of individual requests for lifting the stay is considered as one guarantee to ensure this objective.
	Initial stay should be granted only if the debtor shows that it is likely that negotiations have a reasonable prospect of success.	some Member States	Since the "breathing space" obtained by the debtor by the moratorium can be vital on several occasions in terms of the chances of restructuring, it was decided to provide an easy entry counterbalanced by the possibility of lifting it. Evidence on prospects of success is, nevertheless, required for the exceptional prolongation of the initial stay period.
	It should be allowed that courts grant stay periods longer than 4 months, on a case by case basis.	certain Member States	There was a general impression that a short period of the stay is sufficient for a viable company, and that with time passing by the real chances for restructuring are fading. Anyway the stay may be exceptionally prolonged.
	Secured creditors should not be crammed down by another class, or write off claims without their consent.	Financial institutions	On the one hand, restructuring plan that does not bind secured creditors has less prospects of success. On the other hand, adequate safeguards will exist for dissenting creditors: creditors with different interests should vote separately (at least secured and unsecured creditors should be in different classes), the plan should be reasonable and leave no creditor worse-off than they would be in the most likely alternative scenario, i.e. liquidation.

	Shareholders' position should not be touched by the harmonised rules on restructuring because of potential implications on company law and constitutional protection of property rights	certain Member States	A preventive restructuring framework should prevent hold-out of shareholders who are out of the money. The proposal of the initiative in this respect remains at the level of principle, though, giving Member States large flexibility in how they transform this principle to the level of detailed rules.
Second chance	Debt discharge for consumers should be treated by the initiative equally with those of entrepreneurs (second chance provisions should extend also to consumers).	Consumer organisations	Many Member States have in recent years adopted or reformed (ES, RO, HU, HR, LU, CY, SI) national laws on consumer insolvency. At the same time, the cross-border lending market appears to be very small at the moment. The Commission will continue to assess the recent national reforms of insolvency laws on consumer aspects and collect data to assess the relevance of a future possible EU contribution in the area of consumer insolvency. Also to be noted that some other sectors were strongly opposed of including rules on consumer insolvency (e.g. financial institutions).
	The possibility of a "full discharge" is gives wrong signals for entrepreneurs; discharge should be given provided a certain percentage of the debt is repaid.	Financial institutions	Empirical evidence shows that repayment of a statutory rate of the amount makes discharge in most of the cases impossible. The initiative accepts a repayment condition if it is based on an individual assessment of the circumstances of the case.
	Harmonisation of the test of "honesty" in context of discharge is necessary	certain stakeholders from the business sector and practitioners	Substantive harmonisation of concepts embedded in national legal systems is an inappropriate approach. The initiative shall tackle the practical problems instead. The initiative gives some guidance with examples in this respect, though, in accordance with the Member States shall interpret the concept.

ANNEX 3

THE IMPACT OF THE INITIATIVE AND ADDITIONAL DATA ON INSOLEVENCY AND RESTRUCTURING PROCEEDINGS

Table of Contents

1. IMPACT ON CREDIT AVAILABILITY.....	155
2. IMPACT ON COMPETITIVENESS.....	161
3. IMPACT ON COMPETITION AND STATE AID RULES	163
4. IMPACT ON FUNDAMENTAL RIGHTS.....	164
4.1. Right to property	164
4.2. Right to an effective remedy and to a fair trial.....	165
4.3. Right to conduct a business and to engage in work.....	166
4.4. Workers' right to information and consultation within the undertaking	
5. IMPACT ON SOCIAL ENVIRONMENT.....	167
6. IMPACT ON TAX REVENUES.....	170
7. IMPACT ON SMEs.....	171
8. ADDITIONAL DATA.....	178

1. IMPACT ON CREDIT AVAILABILITY

High levels of NPLs have negative consequence for the economy. They discourage investment by over-indebted businesses and also consumption and entrepreneurship by over-indebted households³³⁶.

While non-performing loans (NPLs) have been recently decreasing, they still constituted 6,4% of all loans in June 2015. They are much higher with respect to loans granted to SMEs (18,6% of loans granted to them are non performing) and they are also substantial in loans granted to households (5,1%) mostly for loans for residential purposes.³³⁷

High level of NPL has obviously a negative impact on the functioning of banks. It limits their capacity of lending and thus restrains access to credit to the potential borrowers. The tendency to deleverage and reduced possibility to better allocate credit may have additional negative impact on growth of the economy³³⁸.

For the banks, resolving the problem of NPL by debt restructuring is in principle preferable to liquidation of assets of the debtor.³³⁹ To respect the interests of creditors there is a need to distinguish viable debtors, who should be given possibility to restructure, and those who are not viable and whose assets should be liquidated fast. The process of assessment of viability and preference conditions (stay) granted during this process should be sufficiently fast to avoid losing assets of the debtor. There should be also incentives to viable borrowers to create value to repay outstanding debt. Efficient insolvency procedures would limit reticence of banks to start proceedings because of expected high cost and uncertain prospects of recovery.

Quality of insolvency framework may impact on the costs of credit. Creditors may hesitate to offer more cross-border credits because they do not have sufficient knowledge about the applicable insolvency regimes in other Member States. There are still substantial divergences in relation to insolvency regimes across the EU. If lenders are unable to assess and quantify the outcome of insolvency proceedings and repossession laws, they will not feel confident lending to individuals.³⁴⁰ The AFME study found that a significant, negative correlation between corporate bond yields and expected recovery rate for bonds can be observed. A 10 percentage point increase in expected recovery rate is associated with a 37 basis point fall in bond spread. This suggests that countries with strong insolvency regimes have lower borrowing costs. Alternative estimations that take into account the effect of unobservable country level characteristics (i.e. “country dummies”), a 10 percentage point improvement in recovery rates is associated with a 0.18 percentage point reduction in bond spread³⁴¹.

³³⁶ C. Cuerpo, I. Drumond, J. Lendvai, P. Pontuch, R. Raciborski, *Indebtedness, Deleveraging Dynamics and Macroeconomic Adjustment*, European Economy – Economic Papers 477, April 2013

³³⁷ Risk Assessment of the European Banking System, EBA December 2015, p.28. It should be kept in mind that those figures cover only banking sector, while loans granted by other financial providers may reveal other levels of NPL

³³⁸ Ibid, p.36 – 38.

³³⁹ IMF: Euro Area Policies – Selected Issues, IMF Country Report No. 15/205, July 2015, Euro Area Policies, IMF Country Report No. 15/2014, July 2015.

³⁴⁰ Action Plan on Building a Capital Markets Union, COM (2015) 468 final, p.25

³⁴¹ Potential economic gains from reforming insolvency law in Europe, AFME, Frontier economics, Weil, February 2016, p. 34.

The AFME report finds a statistically significant effect of changes to the recovery rate on the cost of borrowing i.e. as the recovery rate improves, it can be observed that the cost of borrowing declines, even once other factors (notably country fixed-effects) are controlled for. The results can be paired with previous empirical research, notably the work undertaken by the World Bank and the Commission, linking changes in the recovery rate to reforms to the insolvency regime, and notably reforms that include pre-insolvency restructuring options. The results can also be paired with the qualitative evidence reported in that report, which documents improvements to the recovery rate in many Member States following accession. The AFME report also documents that balanced and effective insolvency regimes can have a beneficial effect on the costs of borrowing via changes to credit ratings. It also documents that recovery rates remain a significant factor affecting the cost of borrowing, even when other institutional variables, beyond insolvency-related factors, are shown to have explanatory power³⁴².

³⁴² Potential economic gains from reforming insolvency law in Europe, AFME, Frontier economics, Weil, February 2016, p. 40.

Table 1: Results of bond estimation model – impact on corporate bonds yield spread (% points)

	(1) Basic model	(2) With recovery rate	(3) With recovery and country dummies	(4) With Strength of Insolvency Framework
Time trend (days)	0.000307***	0.000428***	0.000380***	0.000836***
Time to maturity (days)	0.000187***	0.000197***	0.000189***	0.000326***
Credit rating (notch)	-0.253***	-0.222***	-0.184***	-0.249***
Missing beta [§]	0.260***	-0.0313	0.0285	-0.439**
Beta	11.40***	7.934***	6.996***	0.386
Missing bid-ask [§]	0.899***	1.235***	1.274***	1.374***
Bid-ask (% point)	0.101***	0.0766***	0.0676***	0.00301
Recovery rate (% point)		-0.0366***	-0.0178***	
Strength of Insolvency Framework (0-16)				-0.270***
AUT [¶]			0.712	
CHE [¶]			-0.691	
DEU [¶]			0.103	
FRA [¶]			1.121*	
GBR [¶]			(omitted - base case)	
IRL [¶]			1.574**	
ITA [¶]			0.941	
LUX [¶]			0.0111	
NLD [¶]			1.498**	
PRT [¶]			1.346*	
SWE [¶]			-0.643	
TUR [¶]			-0.298	
Constant	4.034***	5.295***	2.761***	4.633***
Observations	22,982	22,982	22,982	6,462
R-squared	0.302	0.368	0.398	0.310

Robust standard errors in parentheses *** p<0.01, ** p<0.05, * p<0.1, [§] dichotomous variables (or "dummies"): 1= for bonds with missing beta or missing bid-ask spreads; 0= otherwise, [¶] dichotomous variables (or "dummies"): 1= for bonds issued in the country; 0= otherwise.

Source: Frontier analysis of Datastream and World Bank data

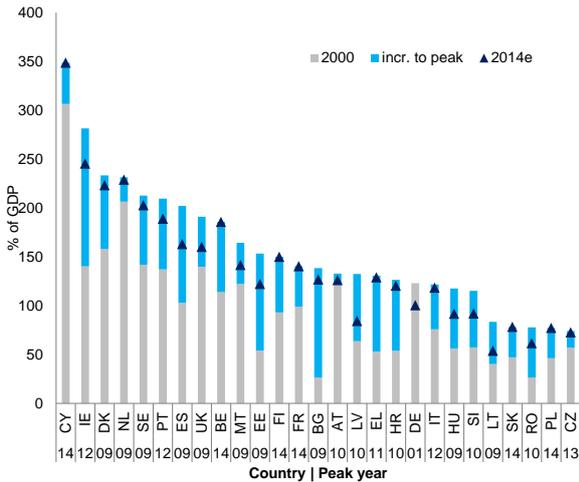
If these results are combined with those from bond pricing model, it is possible to simulate the macroeconomic impact of insolvency reform at EU level. If all EU member states were to reach a recovery rate of 85 percent, this would imply a permanent increase in GDP of €41bn to €78bn (or between 0.3% and 0.55% of EU28 GDP). Additional employment in the EU28 would increase by between 600,000 jobs in the low scenario and 1.2 million jobs in the high scenario. The distribution of macroeconomic effects suggests that much of the absolute gains from insolvency reform could flow to Italy, Spain and France, as well as some central European member states such as Poland, Hungary and Romania³⁴³.

Downward adjustment of indebtedness from peak has been mixed so far, with only a handful of countries having managed to significantly revert to lower levels (graph 1). In parallel, high

³⁴³ Potential economic gains from reforming insolvency law in Europe, AFME, Frontier economics, Weil, February 2016, p. 5.

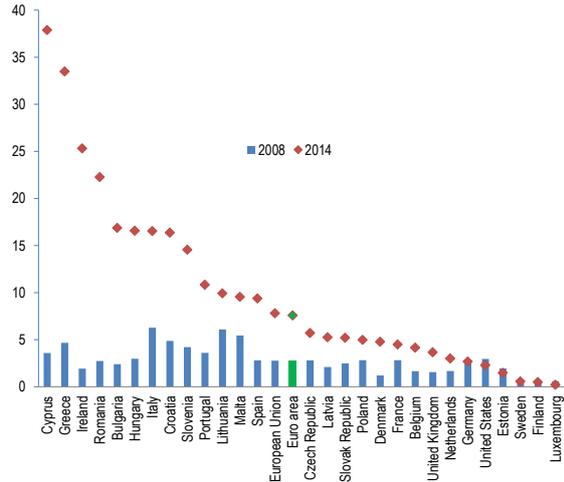
indebtedness has led to a considerable deterioration of banks' balance sheets, as reflected in very high NPLs levels (graph 2). The weight of existing debt held by corporations and households prevents them from undertaking new investments and holds back their consumption (known as the debt overhang problem)³⁴⁴. By implication, as long as private debts remain at high levels, economic activity may struggle to pick up.

Graph 1: Private sector debt adjustment



Source: Eurostat

Graph 2: Extent of the non-performing loans problem

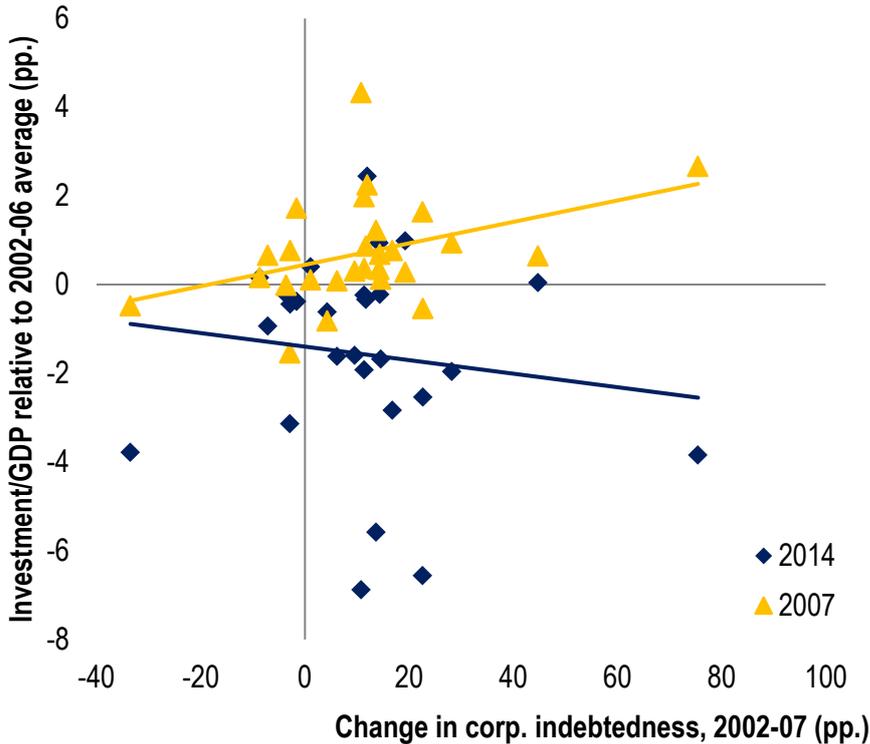


Source: IMF

While booming indebtedness was associated with high investment prior to the crisis, it was followed by an even stronger contraction in investment thereafter (graph 3). The countries where the corporate sector has accumulated more debt over the debt boom period are not necessarily the same exhibiting higher insolvency rates in 2013. The occurrence of insolvency is indeed highly country-specific, and differences may be linked to other factors than just the magnitude of deleveraging needs. The data however indicate that the evolution of bad debt is linked to that of insolvencies. Such link is highly country-specific. Cross-country correlations suggest that countries with more effective insolvency frameworks are characterised by a lower stock of NPLs and have implications for business dynamics.

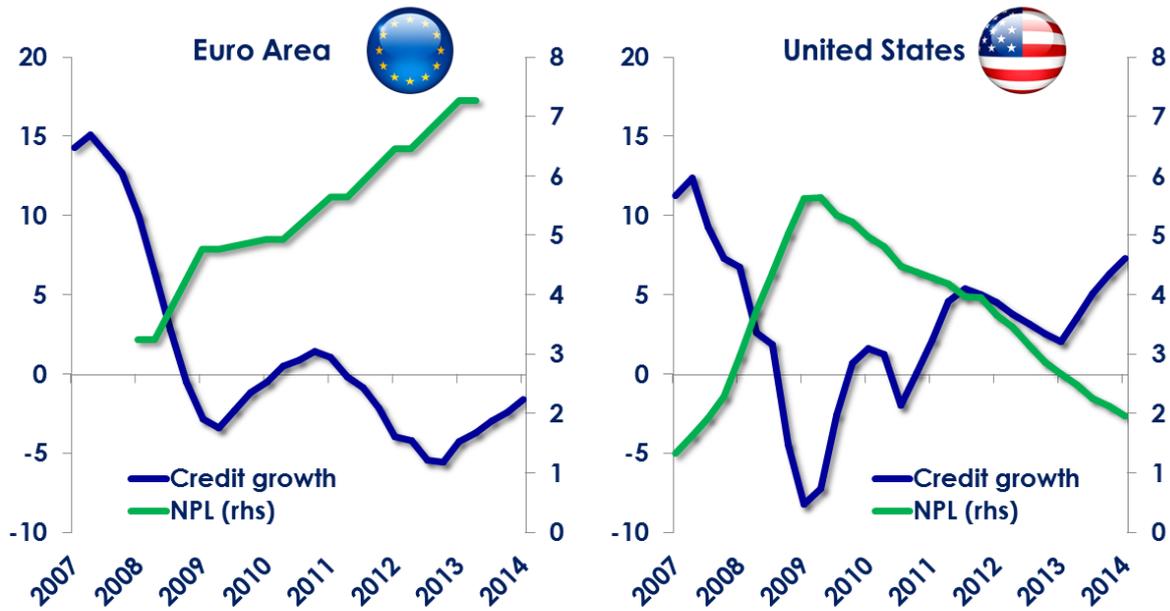
³⁴⁴ Debt overhang is defined as a situation where a firm's high levels of debt act as a disincentive to new investment (Myers, 1977). Consequences of household debt overhang and deleveraging are presented in C.Cuerpo, I. Drumond, J. Lendvai, P. Pontuch, R. Raciborski, *Indebtedness, Deleveraging Dynamics and Macroeconomic Adjustment*, European Economy, Economic Papers 477, April 2013

Graph 3: Corporate non-residential investment and debt overhang in the EU



Source: Eurostat

An additional problem which emerged after the financial crisis and recession in some Member States is a problem of financing viable borrowers, in particular SMEs in the countries in recession; where access to credit is very difficult. High levels of non-performing loans undermine the capacity of banks to lend in recovery. The banks' reduced lending capacity is likely to disproportionately affect SMEs that are more dependent on bank finance. Studies and data from the International Monetary Fund suggest that high indebtedness of EU companies and the problem of non-performing loans represent an investment barrier and prevent economic growth. To encourage cross-border lending to them it is necessary to provide more certainty to the lenders in what manner they can recover debt in case of insolvency of the borrower. Beyond that, progress has been slow in resolving impaired loans, as manifested in high non-performing loan (NPL) ratios in banks' balance sheets, which could act as a constraint on the supply of credit and has implications for the allocation of financial resources. Hence, there is less credit available to the economy since markets are unable or unwilling to lend to firms having non-performing loans or charge high or prohibitive rates.



Source: Haver Analytics, ECB, FRED, and IMF staff calculations.

Effective insolvency frameworks contribute to the reduction of adverse effects of high private debt on economic activity by freeing up resources caught in unproductive activities. Moreover, they can mitigate deadweight costs linked to bankruptcies by providing a transparent and speedy process to resolving non-viable debt.

2. IMPACT ON COMPETITIVENESS

According to the Commission's competitiveness proofing tool, competitiveness consists of three aspects:

- o Cost competitiveness (i.e. the extent to which a proposal affects competitiveness by raising costs for some companies but not for others)
- o Innovation competitiveness (i.e. the extent to which a proposal affects the propensity of likelihood of success of innovation among some companies but not others)
- o International competitiveness (i.e. the extent to which a proposal affects the ability of European companies to compete with non-European companies).

As to the aspect of costs, the proposal on restructuring and second chance will have a positive impact for companies with high cross-border volumes. This will be due to reduction of costs of assessment of cross-border investment and of different types of costs of proceedings, of costs of relocation falling on debtors and creditors. The impact on costs of companies operating only domestically will depend on the type of jurisdictions. For the companies operating in jurisdictions where efficient restructuring is already available, the effect would be neutral; For the companies operating in jurisdictions with less efficient restructuring framework the effect would be positive.

As to the impact on innovation, the proposal will have a significant positive impact by encouraging entrepreneurship and creation of small businesses. Thus it will have some positive impact on innovation (to the degree start-ups are favourable environment for innovation).

Excessive liquidations and excessively long discharge periods cause small firms and entrepreneurs to shy away from innovation as their financial resources are tied to the repayment of past bad debts often resulting from investments to non-viable business models which cannot be redirected to more viable and innovative investments. Moreover, such entrepreneurs are often stigmatised and do not want to experiment one more time. In contrast, a restructuring and second chance framework encourages greater innovation and a start-up culture. The insolvency of a large company has significant effects on the European economy because large companies, although only representing 0.2% of European companies, provide 30% of jobs in the EU and produce 41% of gross added value. According to the April 2011 report of the Reflection Group on the Future of EU Company Law, the international group of companies has become *the* prevailing form of European large-sized enterprises, in which business activity is typically organised and conducted through a multinational network of subsidiaries. About 20% of large enterprises (ca. 8,500) have foreign subsidiaries or joint ventures³⁴⁵. There are more than one million SMEs in Europe which have subsidiaries or joint ventures abroad³⁴⁶.

³⁴⁵ 2007 Eurobarometer survey.

³⁴⁶ Internationalisation of European SMEs, EIM, report for DG Enterprise and Industry.

Incentives not only to invest but also to supply labour are reduced if a large part of income is used to repay debt. When the overhang problem affects many economic actors at the same time, the whole economy may have little incentives to repay external debt (e.g., Krugman, 1988). Empirical evidence shows that the impact of the debt overhang on aggregate investment can be quite sizable. Lagging debt restructuring leads to lower investments since highly indebted companies have to use all profits created for repayment of old debts instead for new investment. Debt deleveraging currently weighs on economic activity and competitiveness of EU industry compared to U.S. or Japan.

As to international competitiveness, the proposal will have positive impact for companies that compete in global markets (i.e. against non-EU imports) due to both effects described above (lowering costs in some situations and providing better environment for innovation).

3. IMPACT ON COMPETITION AND STATE AID RULES

Easier access to restructuring and preferential conditions awarded in restructuring plan (as stay, moratorium) may enhance competitive position of businesses participating in those proceedings. It should be however underlined that those measures are not directed to any predefined sectors of activity, but available to all businesses. However, to limit potential asymmetries as to competition position it would be necessary to strictly limit the conditions of access to restructuring to viable businesses and impose control of creditors and courts on the manner stay and restructuring plan as such are being used.

Discharge creates asymmetry with respect to competition between discharged and not discharged businesses. However, the impact on competition is limited because discharged entrepreneurs are by definition unable to continue business or unable to continue it in previous size and scope (if obliged to repay a substantial part of debt, while being constrained in income capabilities).

The proposal will not impact state aid, except very small expenditures of horizontal type (potential financing of debt advice and similar services).

4. IMPACT ON FUNDAMENTAL RIGHTS

When assessing the impact of the envisaged initiative to improve substantive insolvency regimes, the final impact assessment report pays a particular attention to fundamental rights in order to ensure that the proposed schemes fully respect the rights and principles set out in the Charter, in particular those in Article 17 (right to property), Article 16 (freedom to conduct a business), Article 15 (freedom to choose an occupation and right to engage in work), Article 47 (2) (right to a fair trial), Article 27 (Workers' right to information and consultation within the undertaking) as well as Article 8 (protection of personal data) and Article 7 (respect for private and a family life). The basic rights and freedoms protected by the Treaties in particular the free movement of persons, services and establishment, are also relevant for this measure.

4.1. Right to property

Where creditors' and shareholders' rights can be suspended or curtailed, the fundamental right to property comes into question. Article 17 of the European Charter of Fundamental Rights, hereafter ECFR (see also Article 1 of Protocol 1 to the European Convention on Human Rights, hereafter ECHR) enshrines a right to property, as being the right to peaceful enjoyment of one's property or possessions, not to be deprived of possessions unless certain conditions are met and to have the use of property controlled only in accordance with the general interest. The right applies irrespective of whether the subject is a natural or legal person.

The concept of property, or "possessions", is very broadly interpreted. It covers a range of economic interests, including 'movable or immovable property, tangible or intangible interests, such as shares, patents, an arbitration award, the entitlement to a pension, a landlord's entitlement to rent, the economic interests connected with the running of a business, the right to exercise a profession, a legitimate expectation that a certain state of affairs will apply and a legal claim. The rights of shareholders to equity and those of creditors entitled to a legal claim are therefore both protected under this provision. The right to property is not absolute, but must be applied on balance with other values. Interferences with the enjoyment of property as well as deprivations of possessions can be justified by a legitimate objective in the public or general interest, provided that the measures are proportionate.

In preventive procedures, several measures have been considered from the perspective of compliance with the right to property:

- where certain creditors' rights to enforce a claim are suspended during a moratorium, proportionality is ensured by the fact that the duration of the moratorium is short and safeguards have been put in place so that creditors can ask for the moratorium to be lifted when their rights are unfairly prejudiced;
- where minority creditors are over-ruled in a majority vote or in a cross-class cram-down plan, they should be guaranteed the liquidation value (best interest of creditors test);

- where shareholders' equity is diluted or, exceptionally, wiped off following a restructuring plan, they shall be guaranteed the enterprise value (fairness test).

This impact on the right to property is considered to be proportionate to the objective of rescuing businesses and saving jobs, not the least since it has been shown that the median recovery rate for creditors may be significantly higher in case of restructuring as compared to liquidation.

In second chance provisions:

- full discharge of debt for natural persons is justified by competing values such as that of ensuring the dignity of the person; a maximum period of 3 years is thought to strike the balance between the creditors' interest to be repaid, the debtor's right to dignity and to restart work and the societal value of bringing people in to the productive economy back from poverty and exclusion.

4.2. Right to an effective remedy and to a fair trial

Article 47 (2) ECFR of the Charter enshrines the right to an effective remedy and to fair trial for anyone engaged in a civil law dispute (see also Article 13 and 6 of the ECHR).

In preventive procedures, several measures have been considered from the perspective of compliance with the right to an effective remedy and to a fair trial and safeguards were designed to address potential concerns:

- where certain creditors' rights to enforce a claim are suspended during a moratorium, they have the right to ask the court to lift the moratorium if their rights are unfairly affected; a court must approve any prolongation of the short moratorium period after being satisfied that appropriate progress in being made in the negotiations;
- where minority creditors are over-ruled in a majority vote or in a cross-class cram-down plan, they have the right to challenge the restructuring plan before a court and/or to appeal the court order confirming the plan; a court must confirm such a plan and also ensure that dissenting creditors are not unfairly prejudiced (according to the best interest of creditors test);
- where shareholders' equity is diluted or, exceptionally, wiped off following a restructuring plan, there again they have the right to challenge the plan and/or appeal against it; a court must confirm such a plan after being satisfied that the plan complies with the fairness test;
- where new finance which might affect the rights of third party creditors is agreed in the plan, a court must confirm the plan to ensure that the rights of creditors are not unfairly prejudiced.

In second chance provisions:

- where creditor's rights are affected by a discharge in favour of a natural person, they shall be protected against dishonest behaviour.

4.3. Right to conduct a business and to engage in works

A greater convergence in early restructuring possibilities within the EU would have a positive impact in terms of the freedom to conduct a business and right to engage in work as it will generate a greater level of rescuing businesses and will contribute to saving jobs. The fact that efficient preventive restructuring proceedings with similar core features will be available in all Member States will raise legal certainty for entrepreneurs and investors and will raise cross-border business activities.

Similarly, the second chance provisions in the initiative providing a debt-discharge for honest entrepreneurs within a reasonable period of time will facilitate the possibility of a second chance for those entrepreneurs concerned and (where relevant) for natural persons, thereby ensuring their return to the internal market as economically active persons .

4.4. Workers' right to information and consultation within the undertaking

Article 27 of the ECFR stipulates that workers or their representatives must, at the appropriate levels, be guaranteed information and consultation in good time in the cases and under the conditions provided for by Union law and national laws and practices.

The proposal on an early restructuring framework will not change the current rules which provide for information and consultation of workers under EU law: the present Directive is without prejudice to the EU labour law Directives such as Directives 98/59/EC, 2001/23/EC, 2002/14/EC, 2008/94/EC, 2009/38/EC. Nor does the forthcoming proposal prescribe how such consultation and information should be effected (i.e. on-line or otherwise).

Where employees will be affected under a restructuring plan, they will also have the right to vote on it and, if they are dissenting, a court will need to confirm the plan and guarantee the legality of the process. The vote could be organised by distance means of communication, which will facilitate the participation of creditors.

5. IMPACT ON SOCIAL ENVIRONMENT

Effective rescue and second chance provisions may have a positive influence upon employment and entrepreneurship. Rescuing viable companies rather than liquidating them can reduce the amount of jobs lost and unemployment in general. Second chance for honest but bankrupt entrepreneurs is an important incentive for individuals to re-enter the jobs market and the productive economy. Several respondents to the CMU Green Paper consultation highlighted the resulting complexity involved in approximating substantive laws in the area of insolvency which may touch upon the functioning of tax and social security systems of Member States.³⁴⁷ This suggests the necessity of adopting a pragmatic line identifying on the basis of a thorough impact assessment specific areas where common principles/minimum standards would be appropriate in order to achieve CMU objectives, whilst leaving the details of implementation to Member States to fit in with their national frameworks.

Households are a key source of funds to finance investment, but also remain under debt overhang pressure. EU-SILC survey data shows that, in 2011 and across the EU area as a whole, one in almost nine of those surveyed (11.4%) had been in arrears with payments over the previous 12 months on rent/mortgage, utility bills and/or hire-purchase/loan agreements due to financial difficulties. However, more than three in ten of those surveyed in Bulgaria, Greece and Romania were in this situation.³⁴⁸ The situation in the EU shows high cross-country heterogeneity³⁴⁹ with the household sector effectively deleveraging only in a subset of countries. In other countries, this sector is likely to be caught in a debt trap. Households with lower income or wealth appear to be affected by the debt overhang which has a negative impact on household spending and hence aggregate demand. Remaining in a debt trap has detrimental consequences both for the indebted person and for the society. The person is under financial strain, reduces his/her consumption, may lose apartment. Indirect consequences may be on one's health and willingness to participate in active economic life – find a job or start business. The over-indebted person will be most probably refused any further credit and may be excluded totally from using financial products, even having a bank account. Consequences to the society may be increased demand for social help, but also deteriorating social climate, even expansion of crime if more people are becoming homeless and without resources.

Workers

Workers are also a key group. They are first needed in order to ensure that the business in financial difficulties continues operating as usual. Second, after the restructuring plan is confirmed, they are needed to implement the measures required to bring the company back to viability.

³⁴⁷ Feedback Statement on the Green Paper "Building a Capital Markets Union" (Question 29), SWD(2015) 184 final, 30.9.2015, p. 59 and foll.

³⁴⁸ The over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact, Civic Consulting for the European Commission, 2014, p. 32, http://ec.europa.eu/consumers/financial_services/reference_studies_documents/docs/part_1_synthesis_of_findings_en.pdf

³⁴⁹ Also a high within country heterogeneity can be observed.

The proposal enshrines work-related rights provided by the Charter of Fundamental Rights of the European Union³⁵⁰. In particular, the Freedom to choose an occupation and right to engage in work (Article 15) is reinforced through the protection of existing jobs, as a direct consequence of encouraging efficient restructuring instead of their extinction as a normal consequence of liquidation. Furthermore, since debtors in financial difficulties will be able to continue operating during restructuring negotiations having full or at least partial control of their assets and affairs, and over indebted entrepreneurs would be able to have a second start after a full discharge of debt, the Freedom to conduct a business (Article 16) will be strengthened under the proposal's framework.

In respect to rights of workers, the proposal does not entail any restriction. EU law guarantees a number of essential rights to workers in insolvency and, to a certain extent, in early restructuring procedures. A framework on early restructuring does not upset the existing set of rights which workers enjoy and full labour law protection should be guaranteed to employees during such procedures.

In particular, this Directive should be without prejudice to employees' rights guaranteed by Directives 98/59/EC³⁵¹, 2001/23/EC³⁵², 2002/14/EC³⁵³, 2008/94/EC³⁵⁴ and 2009/38/EC³⁵⁵.

The rights concerning the information and consultation of employees under national law implementing the above-mentioned-Directives remain fully intact.

Where a partial transfer of undertaking is agreed in the restructuring plan, Directive 2001/23/EC puts in place safeguards for workers. Some limitations to this basic principle are possible under insolvency proceedings. For proceedings not targeted at liquidation, which is the case for preventive restructuring by definition, Art. 5 (2) mentions two possible limitations: (i) the transferee can be relieved of previous liabilities if workers receive a compensation at least equivalent to the one they would receive from the existing guarantee fund for workers (ii) working conditions can be downsized in agreement with employees. These limitations are only possible where "proceedings are under the supervision of a competent public authority (which may be an insolvency practitioner determined by national law)".

³⁵⁰ Charter of Fundamental Rights of the European Union, 2010 O.J. C 83/02.

³⁵¹ Council Directive 98/59/EC of 20 July 1998 on the approximation of the laws of the Member States relating to collective redundancies, OJ L 225, 12.08.1998, p. 16.

³⁵² Council Directive 2001/23/EC of 12 March 2001 on the approximation of the laws of the Member States relating to the safeguarding of employees' rights in the event of transfers of undertakings, businesses or parts of undertakings or businesses, OJ L 82, 22.03.2001, p. 16.

³⁵³ Directive 2002/14/EC of the European Parliament and of the Council of 11 March 2002 establishing a general framework for informing and consulting employees in the European Community, OJ L 80, 23.3.2002, p. 29.

³⁵⁴ Directive 2008/94/EC of the European Parliament and of the Council of 22 October 2008 on the protection of employees in the event of the insolvency of their employer, OJ L 283, 28.10.2008, p. 36.

³⁵⁵ Directive 2009/38/EC of the European Parliament and of the Council of 6 May 2009 on the establishment of a European Works council or a procedure in Community-scale undertakings and community-scale groups of undertakings for the purpose of informing and consulting employees, OJ L 122, 16.5.2009, p.28.

On the other hand, Directive 2008/94 imposes an obligation on Member States to put in place guarantee institutions to guarantee the payment of employees' outstanding claims resulting from contracts of employment or employment relationships in the event of the employer's formal insolvency proceedings in relation to the employer. Member States have the possibility to extend the coverage of such guarantee institutions also to other types of procedures. The current proposal will not have an impact on the application of Directive 2008/94. The proposal aims at putting in place in each Member State preventive procedures which aim at helping the debtor avoid a state of insolvency. However, if restructuring efforts fail and the debtor becomes insolvent according to national law, the provisions of Directive 2008/94 will apply accordingly.

Moreover, the right to information and consultation before restructuring and/or collective redundancies, guaranteed by Directives 98/59/EC, 2001/23/EC, 2002/14/EC, 2008/94/EC and 2009/38/EC, remain intact.

As creditors, employees also enjoy certain safeguards under the preferred option to ensure that their legitimate interests are protected. For example:

- ask for the stay of enforcement to be lifted or to not be granted if they are unfairly prejudiced;
- if they are affected by the plan, they will have the right to be involved and to vote; if they are not involved, they will not be affected by the plan;
- a court needs to confirm a plan, and at that stage the court needs to be satisfied that employees receive under the plan at least as much as they would receive in liquidation proceedings;
- salaries will need to be paid during the stay period. Salaries will also be protected under the 'safe harbour' provision;
- employees may challenge and appeal a restructuring plan.

6. IMPACT ON TAX REVENUES

The proposal may have some impact on tax revenues. The assessment would be different for short term and for longer term perspective.

In longer term the impact on tax revenues would be positive. This is due to availability of early restructuring which would increase the proportion of saved businesses (taxpayers if longer period is taken into account). As to leaving debtor in possession of business, in principle the outcome in terms of saved assets (and thus higher taxable base in the future) could be positive, but detrimental decisions of debtor with respect to the prospects of business as a whole can not be excluded. Involvement of the court in allowing debtor to stay in possession would counter-act such tendencies.

Another reason of increase of tax revenues would be reduction of costs and of length of proceedings. To the degree costs of restructuring are treated as costs reducing the base of taxation, the outcome of reducing those costs would imply higher tax revenue.

There may be however reasons for reduced tax revenue, in particular in short term. It could be due to including taxes due in the moratorium and by giving priority to new financing over previous, also fiscal, debts. This negative impact of taxation should be short term and underpinned by the necessities of the success of restructuring.

7. IMPACT ON SMEs

Capital Markets Union is about improving the funding of the EU economy, especially for equity and SMEs. Tackling insolvency laws, to ensure creditors, debtors and courts have sufficient incentives to resolve NPLs, is important to improve the funding of the EU economy. It is through an effective insolvency regime that the current high level of debt can be transformed into equity, and it is through an effective personal insolvency regime that the funding of SMEs can be improved. Both personal and corporate insolvency laws are relevant for SMEs, but it is the first that is most restrictive. The focus here is on households and small companies, because insolvency for large companies is less disputed. Concerning large companies, the EU's approach is not dissimilar to that of the US, a less recourse regime, captured in Chapter 11. This is not the case for households and small companies. All Member States have different insolvency regimes, and do not, in principle, follow the US approach reflected in Chapter 7. This is also consistent with the DG GROW report of giving a second chance to facilitate risk-taking activities of households and small companies. If we want small companies to take risks and to ask for funding in order to grow, we have to introduce a less recourse regime that shares risk between banks and them. Furthermore, in order to grow they need space i.e. they need labour and capital, factors of production that can be released through insolvency, from unproductive companies.

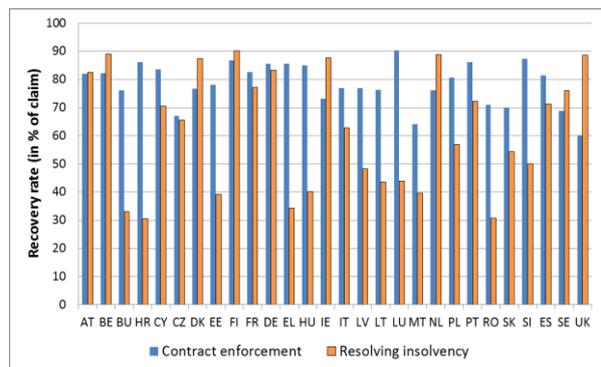
As can be seen in Charts 1 and 2 below, insolvency frameworks and the effectiveness and enforcement of contract law continue to differ significantly across EU Member States, despite ongoing efforts to improve the efficiency of European insolvency and restructuring procedures.

Chart 1: **The number of years required to enforce a contract or resolve an insolvency**



Source: World Bank Doing Business 2014

Chart 2: **The recovery rate in enforcing a contract or resolving an insolvency**

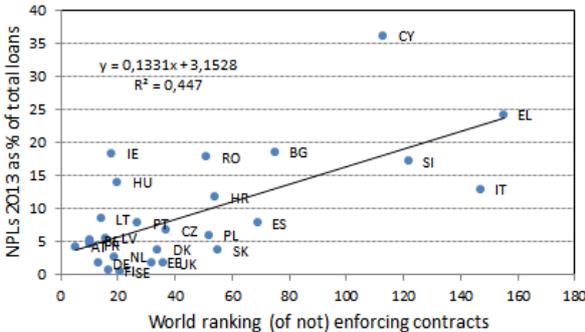


Source: World Bank Doing Business 2014

The considerable differences in and the inter-action between the insolvency laws of Member States create additional costs for foreign investors to assess the risk and work-out the insolvency proceedings, and thus hamper the emergence of pan-European credit markets. In particular, the lack or inadequacy of rules enabling early debt restructuring in many Member

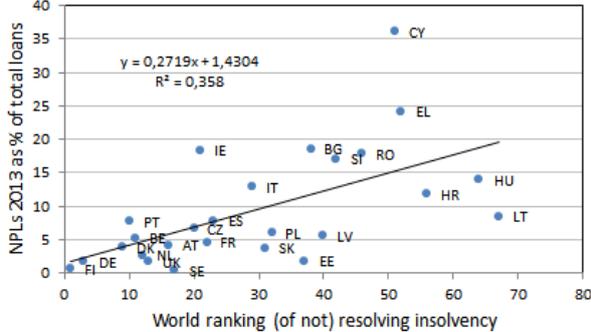
States, the absence of provisions to give a second chance for persons and entrepreneurs and the length and costs of formal insolvency proceedings in many Member States lead to high NPLs (Chart 3 and 4) and discourage investors who either hold back from investing or do so only at a higher premium.³⁵⁶

Chart 3: NPLs versus payment enforcement



Source: World Bank Doing Business 2014, ECB

Chart 4: NPLs versus insolvency



Source: World Bank Doing Business 2014, ECB

Another point relating to different type of insolvency or preventive procedures that emerges from the comparative study is that a substantial majority of EU countries do not have such small business rescue procedures. The results of the study are set out in the following table³⁵⁷. The absence of small business rescue procedures includes countries with mature, sophisticated economics such as Germany, Austria, Netherlands and the Scandinavian countries (Denmark, Sweden, Finland the comparator, Norway)³⁵⁸. More countries however, have simplified liquidation procedures for small enterprises or at least special provisions of Insolvency Law that apply to the liquidation of debtors with relatively small liabilities e.g. France, Greece and Hungary. The threshold for the application of the special provisions varies however ranging from liabilities €100,000 in Greece, €750,000 in France to €5m in Spain³⁵⁹. However, the US experience demonstrates that designing an appropriate small business restructuring regime is not likely to be easy.³⁶⁰

³⁵⁶ Commission Staff Working Document "Impact Assessment accompanying the Commission Recommendation on a new approach to business failure and insolvency", SWD (2014) 61 final.
³⁵⁷ Study on a new approach to business failure and insolvency, University of Leeds, January 2016, p. 209.
³⁵⁸ Study on a new approach to business failure and insolvency, University of Leeds, January 2016, p. 211.
³⁵⁹ Study on a new approach to business failure and insolvency, University of Leeds, January 2016, p. 212.
³⁶⁰ See generally G McCormack, "Rescuing Small Businesses: Designing an "Efficient" Legal Regime" [2009] Journal of Business Law 299-330.

Table 1: *Special insolvency arrangements for SMEs*³⁶¹

Country	Special insolvency arrangements for SMEs and their effectiveness
Austria	No. But Austrian Insolvency law dates from 1914 when most businesses were small. Entire procedure is well-suited for SMEs – proceedings are considered big if the claims total more than 10m EUR. Current procedures considered sufficient.
Belgium	No
Bulgaria	No
Croatia	No
Cyprus	No
Czech Republic	Streamlined liquidation proceedings are available for small business debtors. Indeed, the majority of business insolvencies seem to take this form.
Denmark	No
Estonia	No – about 95% of existing companies in Estonia are SMEs
Finland	No but the Restructuring Act enables simplified restructuring proceedings that are, in practice, more suitable for SMEs.
France	Yes – for companies and individual debtors submitted to rescue proceedings – court appoints only IP for checking of claims and representing the collective interests of creditors – limits no more than 20m Euros turnover or less than 20 employees. Simplified liquidation procedure for SMEs - no more than 750,000 euros turnover, 5 employees and no immovable assets. Procedures considered to be a convenient tool for many debtors i.e. individuals with few assets, by giving them a very efficient tool for a rescue through discharge.
Germany	No. Germany Insolvency Law provides for one single and unitary insolvency procedure, no matter whether it pursues restructuring or liquidation and no matter whether the debtor is a natural or legal person or large or small company. No special forms or templates.
Greece	Simplified liquidation procedure for SMEs but only for companies with assets of less than 100,000 euros.
Hungary	Some special rules for small businesses but no special procedures. Standard forms and templates. The rules were introduced not for encouraging the quick rescue of small businesses but rather to minimise the opportunities for committing fraud.
Ireland	Special procedure in that a small company is enabled to apply to the Circuit Court rather than the High Court to access the recovery procedure – promoted as a more cost efficient process but questionable since the working capital required to fund the company during the process and the dividends for creditors will not change and High Court continues to hear cases that could have been heard in the Circuit Court. Changes not having a visible effect in practice.
Italy	No special insolvency arrangements applicable only to SMEs but simplified insolvency procedures, including liquidation and composition procedures that may be applied to SMEs. No special forms or templates and as yet no evidence to suggest that the simplified procedures are

³⁶¹ Study on a new approach to business failure and insolvency, University of Leeds, January 2016, p. 209 -211

Country	Special insolvency arrangements for SMEs and their effectiveness
	particularly successful.
Latvia	No
Lithuania	Simplified and more expeditious bankruptcy procedure available when the court or IP established during the case that the enterprise has no assets or that its assets are insufficient to cover the legal and administrative expenses. Considered useful generally to have provisions specifically tailored for SMEs.
Luxembourg	No
Malta	No and the provisions on corporate recovery do not expressly apply to small companies as such term is defined in the Act. Considered that provisions allowing for a more expeditious and cost effective mode of insolvency for small and often family run enterprises would be a welcome development.
Netherlands	No. But a characteristic feature of insolvency proceedings under Dutch law is the expedient and flexible manner in which proceedings can be conducted. Examples include prompt commencement of the proceedings following a basic insolvency test and the short periods applicable to certain formal processes. Limited court supervision and extensive powers of the IP to manage and realise the insolvent estate have further minimised procedural delays whilst maintaining a sufficient degree of checks and balances.
Norway	No
Poland	No special procedures though size and nature of debtor's enterprise is recognised as important factor in certain provisions of the Insolvency law.
Portugal	No
Romania	Simplified liquidation with special forms and templates but the procedure is not designed at all for business rescue.
Slovakia	Simplified liquidation procedure with modified rules but no special templates. A special restructuring procedure for SMEs not considered to be realistic since the "restructuring process requires experienced experts with strong integrity, who are generally very few and the costs of their services are high."
Slovenia	Simplified composition rather than liquidation procedures but a greater role for creditors in the procedure considered to be useful.
Spain	Speedy insolvency procedure for debtors with liabilities of less than 5m euros. Also procedure with standard forms for an out-of-court restructuring plan specifically tailored for debtors with liabilities of less than 5m euros. But the fact the State claimants have a privileged position in the procedure appears to militate against their effectiveness.
Sweden	No
United Kingdom	Special arrangement introduced for SMEs but not widely used and not considered to be a great success.
US	Chapter 11 process is streamlined for 'small business debtors', which are defined as persons engaged in commercial or business activities that have aggregate noncontingent liquidated secured and unsecured debts as of the date of the filing of the bankruptcy petition in an amount not more than (currently) \$2,490,925. The requirement for an official creditors' committee can be relaxed by the court in small business cases. Other onerous disclosure requirements are

Country	Special insolvency arrangements for SMEs and their effectiveness
	<p>substantially reduced. Otherwise, small business cases are subject to usual chapter 11 procedures.</p> <p>The small business provisions are not thought to work well in practice because of their inflexibility and associated process costs. As a consequence, small businesses often seek recourse to alternative procedures outside of the bankruptcy system.</p> <p>At present, it appears that the small business provisions of the Bankruptcy Code are not effective for encouraging quick rescues. However, US experience suggests that it can be very difficult to strike a balance between streamlined process and effective protection for creditors. One concern that led to the tightening of the small business provisions in 2005 was that too many nonviable small businesses were using them to delay their inevitable failure, thus prolonging their demise at increased administrative cost, when an immediate orderly liquidation would have provided a better return to creditors.</p>

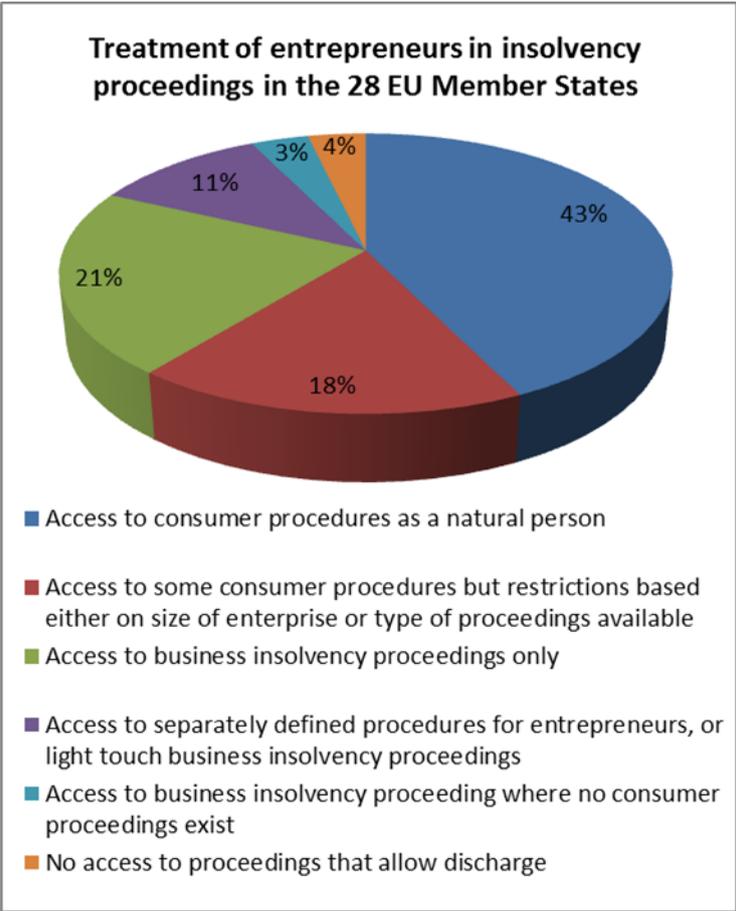
Table 2. Trends in number of business bankruptcies and other forms of involuntary business cessations selected Member States 2007 to 2014 – 2009=100.

Member State	2007	2008	2009	2010	2011	2012	2013	2014
AT	91.2	91.5	100.0	92.4	85.0	87.5	79.1	78.6
BE	81.5	90.0	100.0	101.6	108.5	112.4	124.6	114.0
BG			100.0	125.2	145.1	177.6	193.8	170.6
CY	88.7	84.9	100.0	107.5	114.5	83.6	118.9	102.5
CZ	67.3	72.3	100.0	109.1	119.7	131.0	151.1	144.3
DK	42.0	65.0	100.0	113.2	95.8	95.6	87.4	70.6
EE	19.1	40.1	100.0	97.4	59.1	46.9	43.5	40.6
EL	144.5	101.1	100.0	100.0	125.4	116.9	110.4	93.0
ES	19.9	55.6	100.0	94.5	109.5	148.9	167.2	114.0
FI	68.8	79.8	100.0	87.5	90.0	90.4	95.6	91.2
FR	81.2	87.9	100.0	95.5	94.1	96.7	99.0	98.9
HU		84.7	100.0	104.4	83.0	68.7	93.1	149.1
IR	53.6	66.0	100.0	100.8	113.0	109.0	95.6	
IT	65.6	80.0	100.0	119.7	129.5	130.6	150.6	167.5
LT	32.9	51.9	100.0	88.8	69.0	76.0	84.2	91.4
LU	95.1	82.8	100.0	132.5	141.1	151.5	151.4	122.7
LV	0.0	56.4	100.0	121.9	41.2	40.0	36.5	42.9
NL			100.0	88.8	88.1	105.9	120.7	95.7
PT	68.5	92.5	100.0	107.2	124.4	175.3	158.1	105.3
SE	75.8	82.5	100.0	95.2	91.1	97.8	100.8	93.7
SK	61.2	90.9	100.0	124.6	135.9	130.4	142.8	148.6
UK	62.8	86.2	100.0	85.8	89.7	85.5	75.9	69.7



Sources: London Economics based on data from AT: Kreditschutzverband; BE: Statistics of the Belgium Federal Public Service Economy; BG: provided by official of Ministry of Economy; CY: Department of Registrar of Companies and Official Receiver; CZ: CRIF from Insolvency Register of Ministry of Justice; DK: Statistics Denmark; EE: Kreditiinfo SA; ES: OECD; Statistics Finland; FR: Insee; EL: OECD; HU: Hungarian Central Statistical Office; IR: Dpt of Jobs, Enterprise and Innovation; IT: Cerved; LT: Statistics Lithuania; LU: Statec; LV: Lursoft; NL: Statistics Netherlands; PT: COSEC SA; Swedish Agency for Growth Policy Analysis; SE: SK: Ministry of Justice Slovakia; UK: Insolvency Service³⁶²

Table quoted from Annual Report on European SMEs 2015/2016 p. 53



A recent study looked into the impact of different features of bankruptcy regime on entrepreneurship³⁶³. The features of bankruptcy that were taken into account contain:

- availability of discharge
- time to discharge
- generosity of exemptions
- impact on the bankruptees civil and economic rights
- level of difficulty a debtor faces in achieving discharge by agreement with creditors
- the minimum capital requirements for creating a limited liability company.

³⁶² Annual Report on European SMEs 2015 / 2016, p. 53-54.

³⁶³ Annual Report on European SMEs 2015/2016, Special Study

The impact of those variables on entrepreneurship (measured by self-employment and by business birth rate) was analysed in the context of control variables such as GDP growth, stock market growth and income taxes on wages.

It was found that high number of years to discharge is a key deterrent of entrepreneurship.

8. ADDITIONAL DATA

Since 2004, the World Bank Doing Business initiative has scored countries on various aspects of institutional quality, including rule of law, creditor protection, and quality of the insolvency framework.

In relation to resolving insolvency, the following types of data are available:

- Quantitative data on insolvency outcomes. This covers the cost of insolvency proceedings, the time for creditors to recover credit, and recovery rates. These data are available back to 2004.
- Qualitative data on strength of insolvency framework. This composite measure is based on four sub-indices covering: (i) a reorganisation index; (ii) a commencement of proceedings index (to gauge whether debtors and/or creditors can initiate liquidation and/or reorganisation); (iii) a management of debtor's assets index; and (iv) a creditors' rights index. Each sub-index is given a rating of 0-4, and these are added to give a score of 0-16. This dataset starts in 2014.
- Overall 'distance to frontier' score. The DTF is an overall score showing how a country is performing in relation to insolvency, drawing on the available measures. For each variable included, a country's performance is measured relative to the worst and best performers, expressed as a number from 0 to 100. These scores are then averaged to give the DTF score. This approach is used to summarise each aspect of institutional quality in Doing Business. Note that this measure was not used in earlier years, so any analysis of this variable over time would need to use a consistently derived measure³⁶⁴.

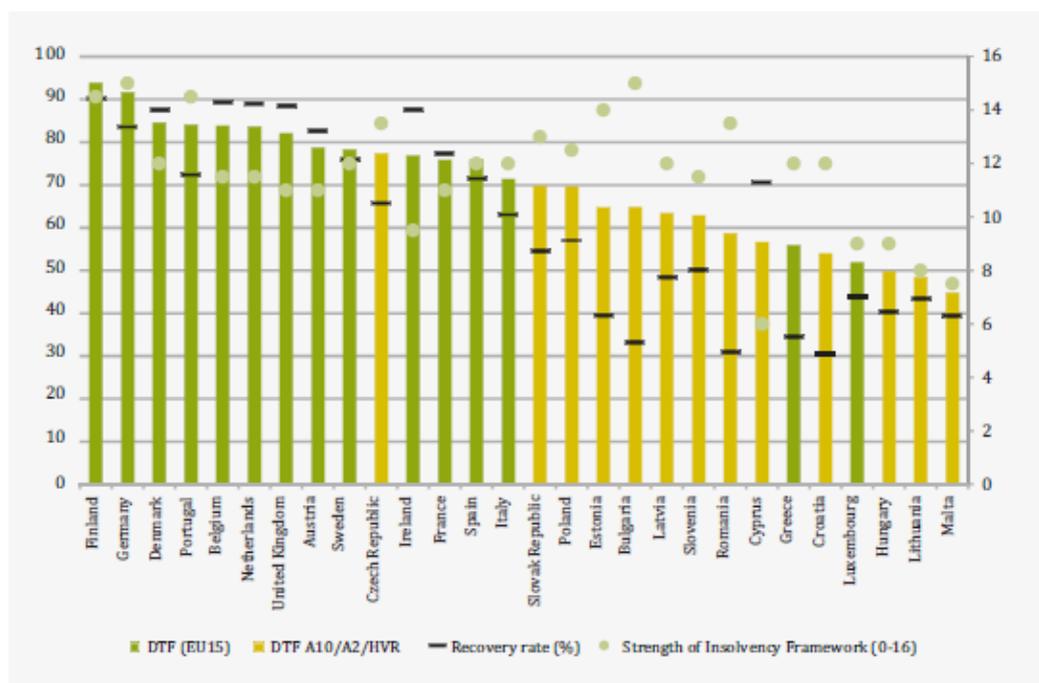
Figure 2 shows the EU28 countries ranked by insolvency DTF score in 2015. The bars show the 2015 DTF score. This ranking tends to place established EU members higher, with the EU15 clustered to the upper end of the distribution and the accession countries clustered to the lower end. The only exceptions to this pattern are that the Czech Republic appears in 10th place amongst the EU15, and that Luxembourg and Greece are ranked much lower than other EU15 countries³⁶⁵.

The two measures on which the 2015 DTF score is calculated – estimated recovery rate and strength of insolvency framework – are also shown. In general we see that the EU15 countries perform relatively better in terms of estimated recovery rate, but not so well in terms of strength of framework, whereas the 13 Member States (EU13) which have joined since 2004 are rated better on strength of insolvency framework than on recovery rate.

³⁶⁴ The range of indicators and method of aggregating scores in Doing Business has changed over time. In 2004 the quantitative measures of cost of proceedings and time of proceedings were used, alongside qualitative measures of priority of claims and efficiency of outcomes. In 2005 the qualitative measures were dropped, and a recovery rate was introduced, itself reflecting the time and cost of proceedings. From 2007, the recovery rate was used to rank countries. From 2012 a distance to frontier approach was used to treat each aspect of institutional quality – in relation to insolvency this used only the recovery rate. In 2014 the strength of insolvency framework index was introduced and used alongside recovery rate in 50:50 proportion to calculate DTF.

³⁶⁵ Potential economic gains from reforming insolvency law in Europe, AFME, Frontier economics, Weil, February 2016, p. 26.

Figure 2: Distance to frontier, recovery rate and strength of insolvency framework in EU28



Source: Doing Business 2015

The DTF scores of EU28 Member States range from 93.5 (Finland) to 44.78 (Malta), while recovery rates range from 90.2 (Finland) to 30.5 (Croatia). The large differences between countries highlight the potential benefits of harmonising insolvency regimes with adequate minimum standards. Likewise, the scope of each EU 28 member state to vary the manner in which it implements those standards should be limited; otherwise the DTF scores and recovery rates would preserve similar ranges of variation between countries, limiting in turn the ‘single market’ benefits of harmonisation³⁶⁶.

Clearly, in the context of 28 divergent insolvency regimes in the EU, foreign investors are facing higher costs of assessing risks resulting from different insolvency regimes than in a jurisdiction with a single rule book on insolvency. Those individual differences can translate into differing strength on insolvency frameworks of individual Member States. Although the below mentioned table of the World Bank does not take into account all the aspects indicated under letters (a) to (h) above in the subsection on drivers, it can serve as a valuable comparator of the key differences between Member State restructuring frameworks taking into account most of the abovementioned aspects.

The strength of insolvency framework index is the sum of the scores on the commencement of proceedings index, management of debtor’s assets index, reorganization proceedings index and creditor participation index. The index ranges from 0 to 16, with higher values indicating insolvency legislation that is better designed for rehabilitating viable firms and liquidating nonviable ones (table 2). This methodology was developed by Djankov, Hart and others

³⁶⁶ Potential economic gains from reforming insolvency law in Europe, AFME, Frontier economics, Weil, February 2016, p. 27.

(2008) and is adopted here with several changes. The strength of insolvency framework index was introduced in Doing Business 2015.³⁶⁷

Member State	Strength of insolvency framework index (0-16)	Commencement of proceedings index (0-3)	Management of debtor's assets index (0-6)	Reorganization proceedings index (0-3)	Creditor participation index (0-4)
Netherlands	15.0	2.5	6.0	1.0	2.0
Slovenia	14.5	2.5	6.0	2.0	1.0
Croatia	14.5	3.0	4.0	3.0	2.0
Denmark	14.0	3.0	6.0	1.0	2.0
Greece	13.5	2.5	5.5	3.0	1.0
Latvia	13.5	2.5	5.0	2.5	2.0
Spain	13.5	3.0	6.0	2.0	1.0
Sweden	13.0	3.0	6.0	1.0	2.0
Poland	13.0	3.0	6.0	2.5	1.0
Bulgaria	13.0	2.5	4.0	2.5	4.0
Cyprus	12.5	3.0	4.5	2.5	3.0
Slovak Republic	12.0	3.0	4.0	3.0	3.0
Czech Republic	12.0	3.0	5.5	3.0	2.0
Italy	12.0	3.0	5.5	3.0	2.0
Romania	12.0	3.0	6.0	2.5	2.0
Estonia	12.0	2.5	5.5	2.0	4.0
Finland	12.0	3.0	6.0	2.5	3.0
Portugal	11.5	3.0	5.5	3.0	3.0
Germany	11.5	3.0	6.0	3.0	3.0
Luxembourg	11.5	2.5	3.0	0.5	1.0
Malta	11.0	2.5	2.0	0.0	3.0
Lithuania	11.0	2.5	4.0	0.5	1.0
Hungary	11.0	2.5	5.0	0.5	1.0
Ireland	10.0	3.0	4.5	1.5	1.0
Austria	9.0	2.5	5.5	1.0	2.0
France	8.0	3.0	6.0	1.0	1.0
United Kingdom	7.5	3.0	5.0	1.0	2.0
Belgium	7.0	2.5	6.0	1.0	2.0

The efficacy of the legal mechanisms and system that serve to protect creditors and provide recovery in the event of a default can increase or decrease the risk to the lender of investors. If one concludes that the enforcement or insolvency procedures will yield little or no return, than the chance of non-performance carries a higher risk of loss that must be factored into the cost of the credit at the front end of the transaction. This is typically reflected in higher interest rates and higher lending cost, which restrict access to credit by making it less accessible or accessible only at a greater cost to the maker.³⁶⁸

³⁶⁷

<http://www.doingbusiness.org/data/exploretopics/resolving-insolvency>

³⁶⁸

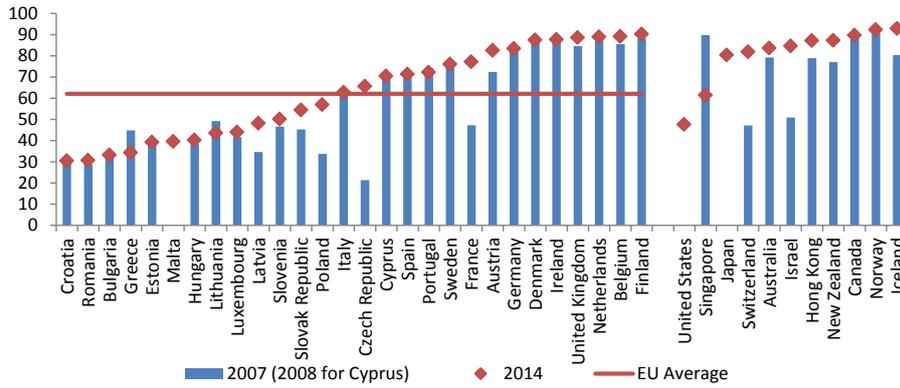
"Corporate restructuring. Lessons from experience" by World Bank, Chapter 15 "Developing effective framework for insolvency and credit rights", by Gordon W. Johnson".

In Doing Business database recovery rates are reported as the percentage of the initial value of the loan recovered by secured creditors. The costs of proceedings are deducted from the value recovered and depreciation of physical assets and actualisation of financial flows are taken into account. By this means duration of the procedure negatively impacts the value recovered.

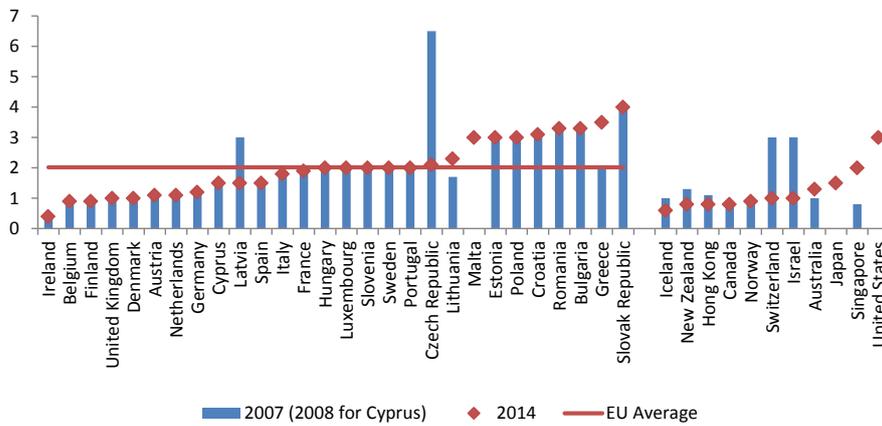
The recovery rates calculated according to this definition, for the EU Member States, are presented in the table below, together with the data on time, cost of proceedings and its outcome.

Country	Recovery rate (cents on the euro)	Time (years)	Costs (% of estate)	Outcome (0 – piecemeal sale, 1 – going concern)
FI	90,1	0,9	3,5	1
DE	83,7	1,2	8	1
PT	73,4	2,0	9	1
BE	89,3	0,9	3,5	1
NL	88,9	1,1	3,5	1
SI	88,2	0,8	4	1
CY	71,4	1,5	14,5	1
AT	82,7	1,1	10	1
IE	87,7	0,4	9	1
IT	63,1	1,8	22	1
FR	77,5	1,9	9	1
ES	71,2	1,5	11	1
SK	54,7	4,0	18	1
EE	40,0	3,0	9	0
LV	48,1	1,5	10	0
EL	34,9	3,5	9	0
LT	42,8	2,3	10	0
LU	43,8	2,0	14,5	0
MT	39,6	3,0	10	0
EU average	63,8	2,0	10,3	0
EA average	66,9	1,8	9,9	0
World average	43,7	36,1	2,6	0

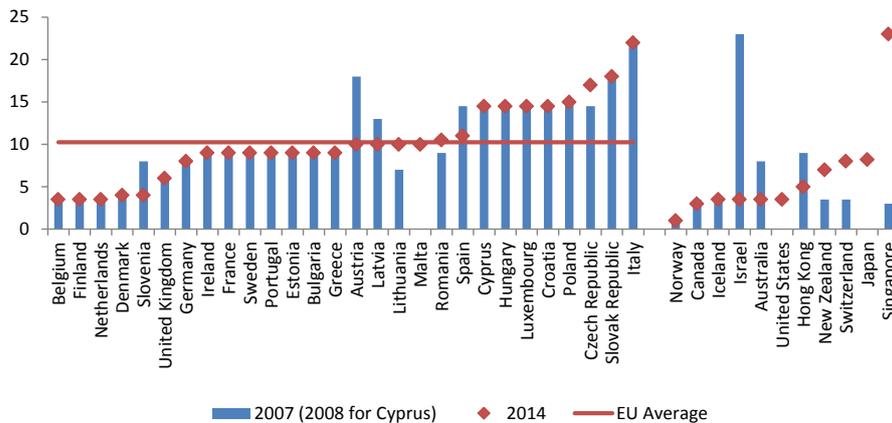
Recovery rate (cents on the dollar)



Time to resolve debt (years)



Cost for resolving debt (% of estate value)

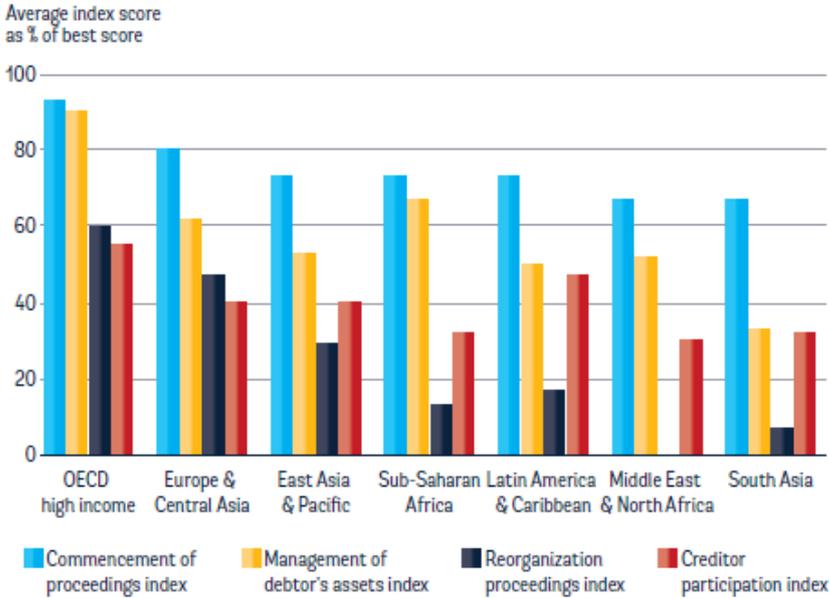


Source: Doing Business, World Bank, authors' calculations.

Note: there has been a recent change in methodology in Doing Business.

The following figure indicates the areas where improvement of reorganisation proceedings is needed.

FIGURE 12.2 Two areas where many economies can improve are reorganization proceedings and creditor participation



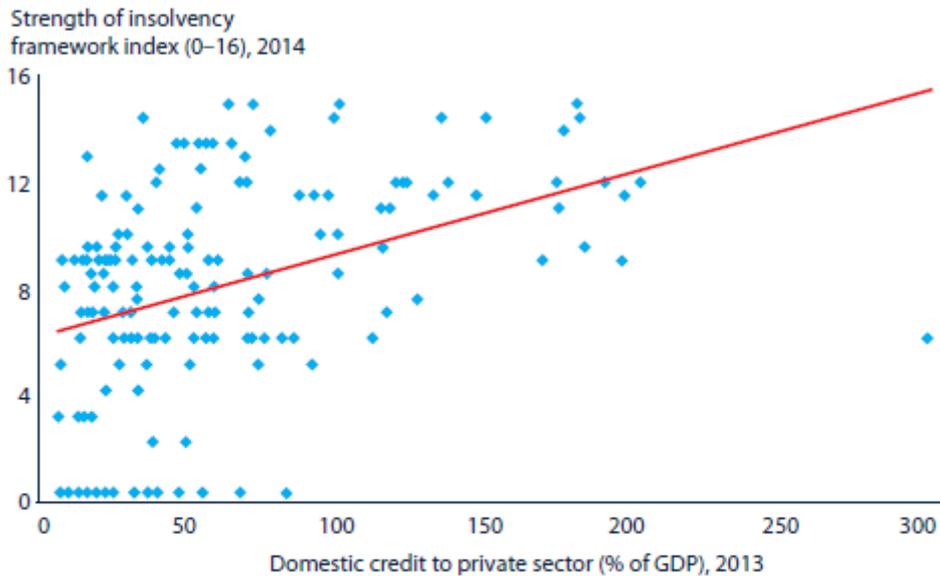
Source: Doing Business database.

Analysis of the data collected for the strength of insolvency framework index confirms the connection many researchers have made between insolvency laws and credit market development. Economies that score well on the index have higher levels of credit provided to the private sector by domestic financial institutions (figure 12.3). These results suggest that the quality of bankruptcy laws is important not for its own sake but as an indication of and perhaps a step toward a better developed financial system. Where credit institutions and entrepreneurs can anticipate the outcome of the worst-case scenario—when a business fails to pay its loans and several creditors must compete for the best return—more banks will be willing to lend and more entrepreneurs will be willing to take on the challenge of starting a business³⁶⁹.

There is also evidence on the relationship between the general score of Doing Business quality and FDI stock in a country.

³⁶⁹ World Bank Doing Business Report, p.

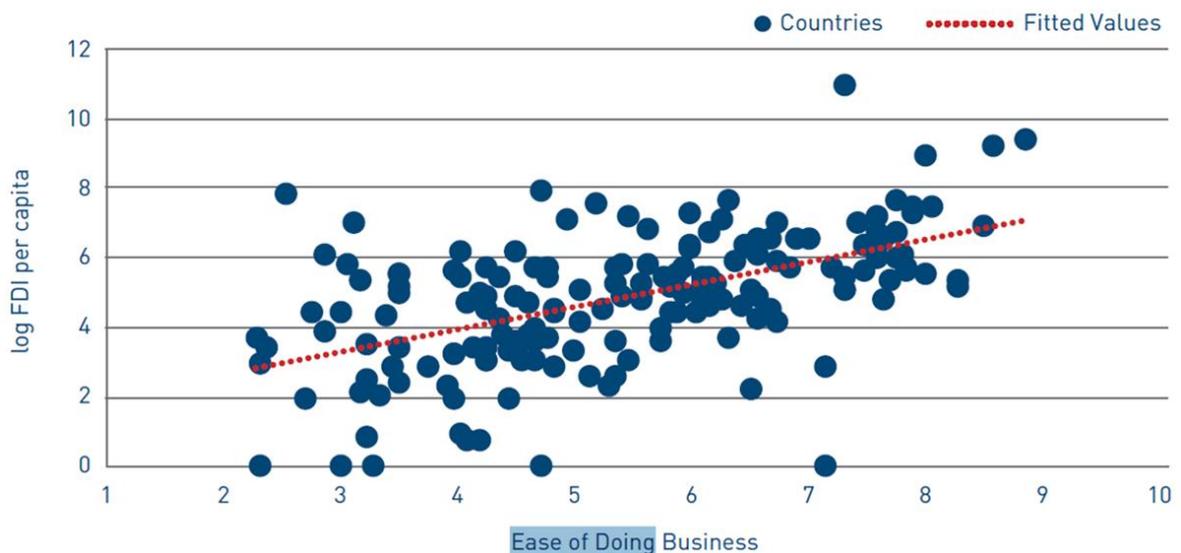
FIGURE 12.3 Economies with strong insolvency frameworks have higher levels of domestic credit provided to the private sector



Note: Domestic credit to private sector refers to financial resources provided to the private sector by financial corporations, such as through loans, purchases of nonequity securities, and trade credits and other accounts receivable, that establish a claim for repayment. The correlation between the strength of insolvency framework index and domestic credit to private sector as a percentage of GDP is 0.40. The relationship is significant at the 1% level after controlling for income per capita.

Source: Doing Business database; World Bank, World Development Indicators database.

Ease of Doing Business vs. FDI Per Capita



SOURCE: <http://www.globalopportunityindex.org/pdf/2015-Global-Opportunity-Index.pdf>

There is also evidence on the relationship between facilitation of continuation of operations and debt sustainability in a country.

Figure 2. Composite indicators of preventive procedures: Easiness vs. Direct and Indirect Costs.

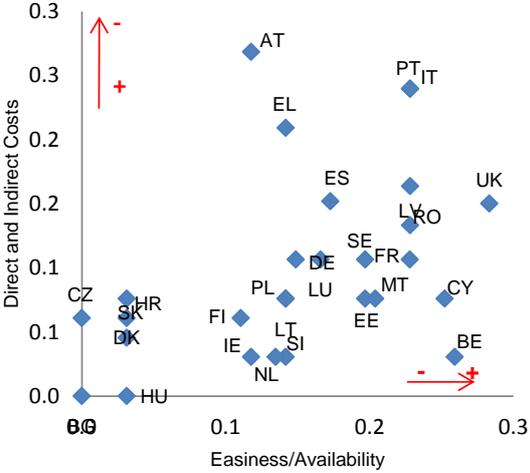
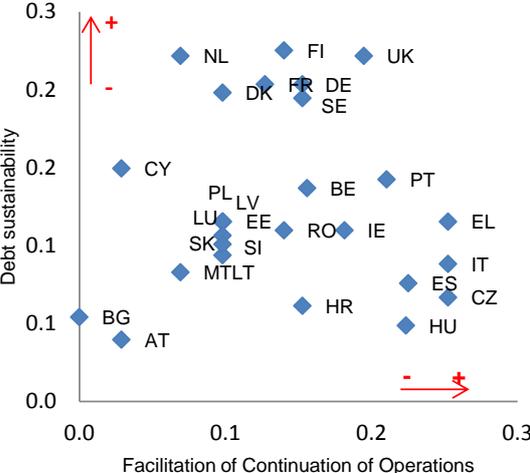


Figure 3. Composite indicators of preventive procedures and discharge periods: Debt sustainability vs. Continuation of Operations.

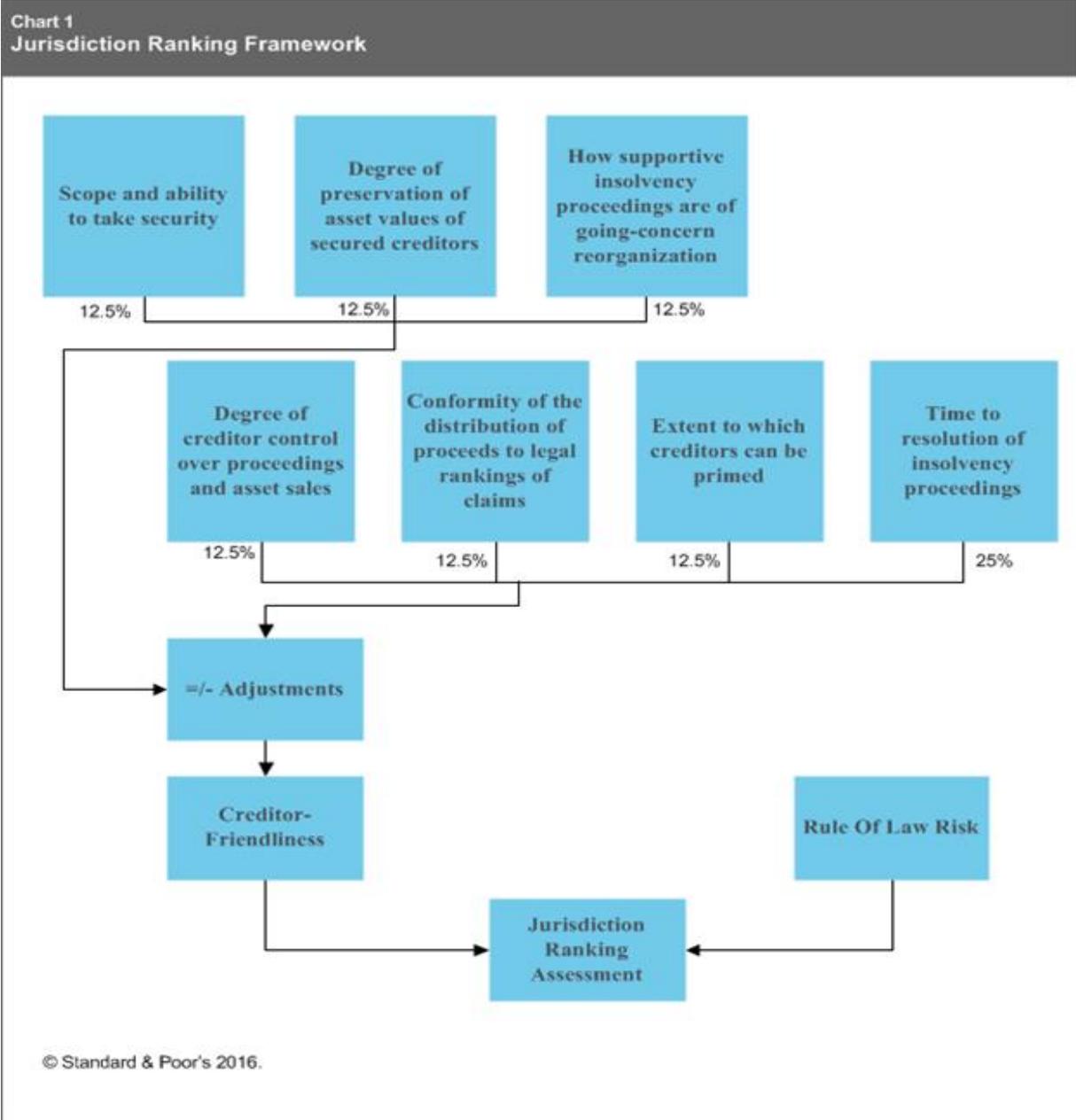


Source: Staff calculations³⁷⁰

Annex 6 of this Report provides comparative elements of reorganisation and discharge in the member States of the European Union.

³⁷⁰ The information conveyed by the indicators describes the situation of Member States as of end-2012.

The graph below illustrates the methodology of assessing quality of insolvency frameworks from creditors risk perspective (Standard&Poors). It illustrates how complex the process is. ³⁷¹



³⁷¹https://www.standardandpoors.com/ja_JP/delegate/getPDF?articleId=1565219&type=COMMENTS&subType=CRITERIA

ANNEX 4

LEGAL BACKGROUND

Reforming insolvency law in Europe is driven by the objective of promoting economic recovery after the years of crisis. It is pursued to the benefit of the citizens of the European Union, since higher investment rate and reinforced businesses bring more jobs and prosperity. Growth in Europe cannot be achieved without a new insolvency culture, which looks at business failure as an opportunity rather than a loss, or which helps viable businesses in financial distress instead of punishing them. Modern insolvency law should ensure that procedures are speedy and efficient, in the interest of both debtors and creditors, including investors, and should help safeguard jobs, help suppliers to keep their customers, and owners to retain value in viable companies.

Modernizing insolvency rules in Europe has been identified since many years as an important tool for achieving the key priority of growth and investment of the European Union. Already the 2009 Stockholm Programme for the European area of justice³⁷² highlighted the importance of insolvency rules in supporting economic activity. In the Single Market Act II³⁷³ of 3 October 2012, the Commission undertook as a key action to modernise the Union insolvency rules in order to facilitate the survival of businesses and present a second chance to entrepreneurs. Furthermore, the "Five Presidents' report" of 22 June 2015 on "Completing Europe's Economic and Monetary Union"³⁷⁴ listed the area of insolvency law among the most important bottlenecks preventing the integration of capital markets.

1. THE EU-LAW CONTEXT

1.1. Contribution of the revision of the Insolvency Regulation to the insolvency reform in Europe

Both the original European Insolvency Regulation³⁷⁵ and its recently adopted recast³⁷⁶ deal with the private international law dimension of issues related to insolvency. The regulations aim at facilitating the treatment of cross-border insolvencies by creating uniform rules on conflicts of laws and jurisdictions and on the recognition and enforcement of foreign decisions arising from insolvency proceedings opened in another Member States or of judgments which are directly linked to these proceedings. They also contain rules on the coordination between various proceedings commenced in different Member States on the same insolvency estate.

³⁷² OJ C 115, 4.5.2010, p. 1.

³⁷³ Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on a Single Market Act II: Together for new growth, COM(2012) 573 final, Brussels, 3.10.2012, p. 11-12.

³⁷⁴ Completing Europe's Economic and Monetary Union, Report by Jean-Claude Juncker (in close cooperation with Donald Tusk, Jeroen Dijsselbloem, Mario Draghi and Martin Schulz, 22 June 2015 (http://ec.europa.eu/priorities/economic-monetary-union/docs/5-presidents-report_en.pdf))

³⁷⁵ Council regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings

³⁷⁶ Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings

The modernised rules of the Regulation will make it easier for businesses to restructure and for creditors to get their money back, while ensuring that procedures for cross-border insolvencies are effective and efficient. The recast Regulation has a broadened scope which encompasses also less formal restructuring schemes of national laws, which are speedier, less costly and are carried out partly out-of-court. The renewed Regulation will increase legal certainty by establishing clearer conditions in determining the State having jurisdiction for insolvency proceedings and by introducing additional safeguards against so called "bankruptcy tourism". The Regulation will increase chances to rescue a company in a cross-border context, by avoiding the unnecessary opening of secondary proceedings in other Member States. It also addresses for the first time the insolvency of groups of companies. Finally, it creates transparency about on-going insolvency proceedings by the establishment of the EU-wide interconnection of national insolvency registers through the European e-Justice Portal.

While the existing Insolvency Regulation and its recast have substantially improved legal certainty and have succeeded in minimizing parallel insolvency proceedings, the existing instruments cannot prevent debtors from taking advantage of more favourable insolvency regimes in other Member States, possibly to the detriment of creditors and investors.

Also, the existing instruments cannot ensure a coherent substantive treatment of cross-border insolvencies. Indeed, the existing Regulations follow the so called "principle of mitigated universality" and are based on the approach of a system of satellite secondary bankruptcies which revolve around and give assistance to a main core proceeding. This system acknowledges, based on economic necessity and political feasibility, the legitimacy of the opening of secondary or other local proceedings in parallel to the main insolvency proceedings. In such a system, it is accepted that the insolvency laws of several States may be applied to various questions of the insolvency estate.

It is to be noted that the uncompromised "universality principle" for cross-border insolvencies would imply that the court having jurisdiction to the insolvency proceedings encompasses all assets and creditors of the debtors' estate, and that the law applied by this court (the "*lex fori concursus*") applies to all questions emerging during the proceedings. However, a fully-fledged application of the universality principle proved not to be realistic in the EU. The rationale for this decision is explained by the Virgos-Schmit Report prepared to the 1995 Convention on insolvency proceedings which was the direct predecessor of the old Regulation. The Report states that "the idea of a single exclusive universal form of insolvency proceedings for the whole of the Community is difficult to implement without modifying, by the application of the law of the State of the opening of proceedings, pre-existing rights created before insolvency under the different national laws of other Contracting States. The reason for this lies in the absence of a uniform system of security rights in Europe, and in the great diversity of national insolvency laws as regards criteria for the priority to be given to the different classes of creditors. In this legal context, the Convention seeks to reconcile the advantages of the principle of universality and the necessary protection of local interests. This explains why a combined model has been adopted which permits local proceedings to coexist with the main universal proceedings".³⁷⁷

Consequently, even the recently adopted Insolvency Regulation keeps wide ranging possibilities of opening secondary or other local proceedings in parallel to the main insolvency proceedings in other Member States, thus resulting in the parallel application of insolvency laws of different Member States to a single economic unit operating in several

³⁷⁷ M. Virgos, E. Schmit: Report on the Convention on Insolvency Proceedings, paragraphs 12-13.

Member States. Therefore, the handling of cross-border insolvencies requires not only the handling of competing rights and interests, but also the handling of competing jurisdictions and competing laws. The diverging national insolvency regimes provide for incentives for forum shopping and undue economically measurable differences in outcomes for creditors, investors, and debtors in financial distress.

In a situation where in case of insolvency with cross-border elements parallel national proceedings may exist, complementary action is therefore needed to ensure legal certainty for and appropriate protection of creditors and investors throughout Europe and to ensure a coherent treatment of cross-border insolvencies. Such action may consist of a harmonisation of certain substantive law aspects of the national proceedings. The more similar national insolvency or restructuring proceedings are in their substantive aspects, the smoother they will be running and the better their outcome will be, in particular if they run in parallel in respect of an insolvent corporate entity with assets, liabilities or participations spread over several Member States.

1.2. Steps taken in the EU towards a greater convergence of selected aspects of domestic insolvency laws

In its conclusions of 30 May 2011, the Competitiveness Council invited the Member States to promote a second chance for entrepreneurs by limiting, when possible, the discharge time and debt settlement for an honest entrepreneur after bankruptcy to a maximum of three years by 2013.

In November 2011, the European Parliament adopted a Resolution³⁷⁸ on insolvency proceedings which, in addition to recommendations regarding the revision of Council Regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings, included recommendations for harmonising specific aspects of national insolvency law. A study commissioned by the European Parliament³⁷⁹ in this context had shown that disparities between national insolvency laws can create obstacles, competitive advantages and/or disadvantages and difficulties for companies with cross-border activities or ownership within the EU. That study concluded that 'there are certain areas of insolvency law where harmonisation is worthwhile and achievable', which would increase the efficiency of restructuring procedures and the returns to creditors.

Based on these recommendations, the Commission Communication of December 2012³⁸⁰ identified certain areas where differences between domestic insolvency laws may hamper the establishment of an efficient internal market, which included among others discharge periods for honest entrepreneurs, chances of restructuring of businesses due to rules relating to opening of insolvency proceedings and rules promoting the acceptance of restructuring plans.

Under an economic recovery programme, the Commission has identified the key role of judicial reforms, including reforms of national insolvency laws, as a means to promote economic recovery. A number of Member States received country-specific recommendations relating to conditions for rescuing and restructuring of firms in difficulties as part of the

³⁷⁸ European Parliament Resolution of 15 November 2011 with recommendations to the Commission on insolvency proceedings in the context of EU company law, P7_TA (2011) 0484.

³⁷⁹ Harmonisation of Insolvency Law at EU level, Directorate General for Internal Policies of the European Parliament, PE 419.633.

³⁸⁰ European Commission: Communication "A new European approach to business failure and insolvency" COM(2012) 742.

European Semester in 2013.³⁸¹ On 9 January 2013 the Commission adopted the Entrepreneurship 2020 Action Plan³⁸² where the Member States are invited, among others, to reduce when possible, the discharge time and debt settlement for an honest entrepreneur after bankruptcy to a maximum of three years by 2013 and to offer support services to businesses for early restructuring, advice to prevent bankruptcies and support for SMEs to restructure and re-launch.

On 12 March 2014 the Commission adopted a Recommendation on a new approach to business failure and insolvency addressed to the Member States.³⁸³ This Recommendation aims at establishing minimum standards for: (i) preventive restructuring procedures enabling debtors in financial difficulty to restructure at an early stage with the objective of averting insolvency, and (ii) debt discharge, within prescribed periods, for honest bankrupt entrepreneurs as one of the steps necessary to provide them with a second chance.

The Member States were invited to implement the Recommendation by 14 March 2015. An evaluation carried out on the basis of this information by the Commission concluded that the Recommendation has been only partially taken up by some Member States, including by those receiving insolvency-related recommendations in the context of the European Semester exercise addressing macro-economic imbalances. Even those Member States which have taken up the Recommendation did so in a selective manner, meaning that differences remain.³⁸⁴

The public consultation on the Capital Markets Union³⁸⁵ asked for stakeholders' views as to what specific aspects of insolvency laws would need to be harmonised in order to support the EU capital market. A number of investors advocated an approach aiming at least at the identification of common principles in the area of insolvency at the EU level.

On 30 September 2015 the Commission published the Capital Markets Union Action Plan³⁸⁶ which indicated, amongst other things, that the Commission would consult on the key insolvency barriers and take forward a legislative initiative on business insolvency, including early restructuring and second chance, drawing on the experience of the Recommendation. It was announced that the initiative will address the most important barriers to the free flow of capital and building on national regimes that work well.

Also the Single Market Strategy³⁸⁷ indicated that the Commission would support bona fide entrepreneurs and propose legislation to ensure that Member States provide a regulatory environment that is able to accommodate failure without dissuading entrepreneurs from trying new ideas.

More recently, the Council highlighted, in its Conclusions on the Commission Action Plan on building a Capital Markets Union³⁸⁸, the insolvency initiative and invited the Commission to consult the Member States in order to identify business insolvency law-related barriers to the development of a single market for capital. Furthermore, the Eurogroup stated, on 22 April

³⁸¹ Available at <http://ec.europa.eu/europe2020/making-it-happen/country-specific-recommendations/>.

³⁸² COM(2012) 795 final

³⁸³ C(2014) 1500 final

³⁸⁴ For more details please see the evaluation of the implementation of the Commission Recommendation on a new approach to business failure and insolvency, 30 September 2015:

http://ec.europa.eu/justice/civil/files/evaluation_recommendation_final.pdf.

³⁸⁵ COM/2015/063 final of 18 February 2015.

³⁸⁶ Action Plan on Building a Capital Markets Union, COM(2015) 468 final, 30.9.2015

³⁸⁷ COM (2015) 550 final, 28.10.2015

³⁸⁸ 10 December 2015.

2016, that 'early restructuring procedures with limited court involvement – in particular out-of-court settlement – should be developed further as a priority and resorted to where appropriate. Insolvency procedures should be easily accessible and affordable for both debtors and creditors. Honest distressed debtors should also be given a second chance after a certain period of time.' Finally, the Council Conclusions on a roadmap to complete the Banking Union adopted on 17 June 2016 underline the work being carried out by the Commission on 'a legislative proposal for minimum harmonisation in the field of insolvency law in the context of the Capital Markets Union (CMU), which may also support efforts to reduce future levels of non-performing loans'.

2. THE INTERNATIONAL CONTEXT

2.1. *UNCITRAL*

UNCITRAL has been working on insolvency law for a number of years. UNCITRAL first focussed on cross-border insolvency and adopted a Model Law on this issue in 1997. The material scope of the Model Law broadly corresponds to that of the Insolvency Regulation. Work then concentrated on substantive insolvency law. A Legislative Guide on insolvency law was adopted in 2004 (Part I and II); this was supplemented more recently by a part three on the treatment of enterprise groups (2010) and a part four on directors' obligations in the period approaching insolvency (2014).

Although these instruments have a long record of shaping national insolvency reforms throughout the world, they are not appropriate to serve the objectives set by the current EU legislative initiative:

On the one hand, the subject matter scope of the UNCITRAL instruments does not have its focus on the preventive restructuring mechanisms. The Legislative Guide addresses insolvency law in an overarching manner and provides a comprehensive statement of the key objectives, structures and principles that should be reflected in a State's insolvency laws. Although the Guide contains some pieces of information about existing models of voluntary restructuring or (in the context of insolvency proceedings) about pre-insolvency schemes of certain legal systems³⁸⁹, it does not contain specific recommendations on this issue.

On the other hand, the type of the instrument of the Legislative Guide is not a tool specifically designed for the approximation of laws. "The Legislative Guide does not provide a single set of model solutions to address the issues central to an effective and efficient insolvency law, but assists the reader to evaluate different approaches available and to choose the one most suitable in the national or local context."³⁹⁰

2.2. *United States*

In this context it appears worthwhile to underpin the differences which the preferred option of this Impact Assessment has compared to the procedure in Chapter 11 of the US bankruptcy code.

³⁸⁹ UNCITRAL Legislative Guide on Insolvency Law, pp. 25, 29-30.

³⁹⁰ UNCITRAL Legislative Guide on Insolvency Law, p. 2.

Chapter 11 deals with the restructuring of ailing businesses. It is generally filed by corporations that require time to restructure their debts, and it gives the debtor a fresh start, subject to the debtor's fulfilment of his obligations under the plan of reorganization. In most cases, Chapter 11 is run as a "debtor in possession" procedure, however, under the protection of the procedure the business is banned from making certain decisions without the permission of the courts. Entry into Chapter 11 bankruptcy in the US is also permitted when a company is not insolvent. But if a company is not insolvent then entry into Chapter 11 proceedings is often tactical and to allow the directors to renegotiate pre-existing contracts, particularly with employees.³⁹¹ Chapter 11 is available to every types of business and to individuals, although it is most prominently used by corporate entities.

The main difference between Chapter 11 and the preferred option of this report is the formal and complex nature of the US proceeding. Chapter 11 is a fully judicial procedure, while the EU initiative provides a flexible framework which combines out-of-court elements with judicial intervention at key moments in the procedure, where the rights of creditors may be unduly affected (stay of enforcement actions, cram down). From this complexity of the procedure and from the costs involved follows that protection under Chapter 11 is mainly required by large companies. Although the US legislator made several steps to streamline the procedure to the needs of SMEs, these small business provisions are not thought to work well in practice however. Certainly, they have not met with universal support and small businesses often seek recourse to alternative procedures outside of the bankruptcy system. The detailed record keeping required by the procedure increases the cost for small businesses seeking bankruptcy protection.³⁹²

³⁹¹ Study on a new approach to business failure and insolvency, University of Leeds, January 2016, p.52.

³⁹² Study on a new approach to business failure and insolvency, University of Leeds, January 2016, p.214.

ANNEX 5

Glossary³⁹³

Avoidance actions – An avoidance action provides for setting aside transfers of property that are made to defeat or delay the claims of creditors or to put the property beyond the reach of creditors.

Bankruptcy – A legal process in which the debtors' assets are liquidated and the proceeds of sale are distributed to creditors.

'Best interests' test – This is a test which requires that creditors should receive at least as much under a restructuring plan as they would receive in a liquidation of the business.

Centre of Main Interests (COMI) – The place where main insolvency proceedings commenced under the European Regulation on Insolvency Proceedings must be opened.

Consumer – Natural person who is not an entrepreneur.

Co-obligor – A person bound with other(s) by an obligation.

Cram down – The judicial power to confirm or modify a plan against the wishes of certain classes of interest or claim holders.

Cross-class cram down – A situation where not all creditor groups have approved a restructuring plan but it is proposed to approve the plan regardless.

Debt discharge – Permanent release from a debt obligation. This may be straight discharge (unconditional freedom from debt) or conditional discharge (dependent upon some payment of debt).

Debtor-in-possession – A debtor in financial difficulties or in the state of over-indebtedness who as a fiduciary of the creditors keeps control over his estate and, as a result, has an obligation to refrain from acting in a manner which could damage the estate, or hinder a successful reorganization.

Discharge period – A period after which the debtor is released from his/her debt obligations.

Disqualification – A process that leads to a director being unable to act as a director and, in some jurisdictions, act in other capacities.

Dissenting (creditor, class) – Creditors or group of creditors who object to the terms of a restructuring plan.

Enforcement – A procedure under the control of a court for collecting debt in respect of which there has been a court order, which may include seizing assets.

³⁹³ Unless specified otherwise the definitions are taken from: (i) Study on a new approach to business failure and insolvency, University of Leeds, January 2016, and (ii) Impact assessment study on policy options for a new initiative on minimum standards in insolvency and restructuring law, Second Progress Report, VVA/ JIIP/ DTI/ Grimaldi consortium, 24 August 2016.

Entrepreneur – An individual, with unlimited liability, carrying out a trade, profession, craft or business as a natural person.

Equity holder – Same as shareholder, see below **Shareholder**.

GDP – Gross domestic product

Going concern value – The value of the debtor's business if it is kept alive rather than liquidated.

Haircut – A reduction of the rights of creditors in restructuring or insolvency.

Insolvency – The state of being unable to pay the money owed, by a person or company, on time. There are two forms: cash-flow insolvency and balance-sheet insolvency. Cash-flow insolvency is when a person or company has enough assets to pay what is owed, but does not have the appropriate form of payment (liquidity shortcoming). Balance-sheet insolvency is when a person or company does not have enough assets to pay all of their debts.

Insolvency administrator – An individual who acts in a bankruptcy to liquidate assets and distribute proceeds of sale to creditors.

Insolvency practitioner – A person specialised in representing creditors and to administer or liquidate the assets of which the debtor has been divested or to supervise the administration of the debtor's affairs.

Insolvency proceedings – Means collective insolvency proceedings which entail the partial or total divestment of a debtor and the appointment of a liquidator or an administrator normally applicable to institutions under national law and either specific to those institutions or generally applicable to any natural or legal person.³⁹⁴

- **Formal insolvency proceedings** – They are those provided by national laws.
- **Informal insolvency proceedings** – When creditors negotiate informally with a debtor to achieve a restructuring by consensus. Creditors with sufficiently similar interests and incentives (such as banks) may also develop their own restructuring processes, for use where a debtor with exposure to multiple creditors of that class becomes distressed.³⁹⁵

Liquidation – A process where the assets of an insolvent company are sold and after the paying of expenses the balance to paid out to creditors according to the provisions of the appropriate statute or other legal provision.

³⁹⁴ Article 2 (1) (4) DIRECTIVE 2014/59/EU OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council.

³⁹⁵ (J. Armour and S. Deakin (2001), "Norms in private insolvency: The 'London Approach' to the resolution of financial distress", *Journal of Corporate Law Studies*, pp. 21-51).

Liquidation value – A value received by creditors under a restructuring plan which corresponds to what they would receive in a liquidation of the business.

Mediator – A person who assists the debtor and creditors in negotiations on a restructuring plan.

Moratorium – See **Stay**.

New finance – Finance that is provided to a person or company in financial distress or even when insolvent.

NINA (person) – No income, no asset person. It refers to persons, most unemployed, which do not have any revenues and property.

Non-performing loan – It is a loan that is in default or close to being in default, generally after being in default for at least 90 days.

Non-related party (transaction) – A person or a company that is not connected to the insolvent, usually through association or other economic interest.

Over-indebtedness – A situation where a company or a person's assets do not cover their liabilities.

Personal insolvency – Insolvency of a consumer or entrepreneur.

Pre-pack – An agreement for the sale of all or part of the debtor's business or assets which is entered into before the commencement of formal insolvency proceedings.

Restructuring – Changing the composition, conditions, or structure of assets and liabilities of debtors, or a combination of those elements, with the objective of enabling the continuation, in whole or in part, of the debtors' activity.

Restructuring plan – A plan aimed at restructuring of a business usually containing a description of the following elements: identification of the creditors who would be affected by the plan; the effects of the proposed restructuring on individual debts or categories of debts; the position taken by affected creditors on the restructuring plan; where applicable, the conditions for new financing; and the potential of the plan to prevent the insolvency of the debtor and ensure the viability of the business.

Ranking of claims – The order of priority established by the national legislation for the repayment of creditors in the insolvency proceedings.

Recovery rate – A function of the outcome, time and cost of insolvency proceedings in respect of a particular kind of local company.

Second chance – The opportunity to start again in terms of Entrepreneurial activity.

Secured creditor – A person having a security interest that is the right over property to ensure the payment of money or the performance of some other obligation.

Self-employed – Self-employed persons are defined as persons who are the sole owners, or joint owners, of the unincorporated enterprises in which they work, excluding those unincorporated enterprises that are classified as quasi-corporations. Self-employed persons are classified here if they are not also in a paid employment which constitutes their principal activity: in that latter case they are classified under employees.³⁹⁶

Shareholder – An owner of a company.

SME – Small and medium enterprise – The category of micro, small and medium-sized enterprises (SMEs) is made up of enterprises which employ fewer than 250 persons and which have an annual turnover not exceeding EUR 50 million, and/or an annual balance sheet total not exceeding EUR 43 million. A small enterprise is defined as an enterprise which employs fewer than 50 persons and whose annual turnover and/or annual balance sheet total does not exceed EUR 10 million. A microenterprise is defined as an enterprise which employs fewer than 10 persons and whose annual turnover and/or annual balance sheet total does not exceed EUR 2 million.

Stay (moratorium) on enforcement actions – A legal bar on creditors commencing or continuing legal action to recover debt.

Super-priority (for new financing) or also absolute priority rule – This is a principle requiring that creditors and other claimants against the debtor's estate should be paid in the same order under a restructuring plan as they would be paid in a liquidation of the debtor's business.

Supervisor – A person who oversees the activities of the debtor and takes the necessary measures to safeguard the legitimate interests of creditors and other interested parties.

Work-out (plan) – Same as Restructuring plan.

396 Eurostat's Concepts and Definitions Database, <http://ec.europa.eu/eurostat/documents/3859598/5826305/CA-15-96-001-EN.pdf/aec2852-bed2-46d2-9534-5859d3c911d5>.

ANNEX 6

MS	Restructuring possibilities	Early warning tools	Length of insolvency proceedings	Restructuring procedure scored	Conditions for initiating the procedure	Debtor in possession	Possibility of stay	Length of stay	Cram-down involving all classes of creditors	New financing support measures	Court involvement	Discharge periods
	0 - no possibility of restructuring, 1-late possibility inside insolvency procedures, 2-somewhat earlier possibility, when firm is only in imminent insolvency; 3-early possibility, when debtor is in financial difficulties	0-no tools; 1-1 or 2 tools; 2-3 or 4 tools; 3-5 tools or more	0-more than 2 years; 1-between 1.5 and 2 years; 2-between 1 and 1.5 years; 3-under 1 year	Where more than one restructuring procedures exists in the Member States, the information in this table relates to that procedure which yielded higher scores on most of the dimensions analysed.	0-debtor must be insolvent; 1- insolvency certificate or other expert evidence; or the procedure must be launched with a big majority of creditors agreeing (60% in IT); 2-insolvency must be imminent, but no expert evidence required; 3-debtor must be in financial difficulties; 4-no test required	0-debtor may be divested of the day-to-day operation of business and an insolvency practitioner appointed by court; 1-an insolvency practitioner is appointed by the court, but he does not take over the administration of business, or the court itself supervises the procedure; 2- an insolvency practitioner can be appointed outside court (e.g. elected by the committee of creditors); 3-no obligation to appoint an insolvency practitioner	0-no possibility of stay; 1-stay is general and automatic; 2- stay is general but on request; 3- stay is targeted and on request	0-no possibility of stay; 1-possibility of stay for longer than 4 months or for an indefinite period; 2- possibility of stay for less than 2 months; 3- possibility of stay between 2 and 4 months	0-no possibility of cram-down or no possibility of affecting the rights of creditors; 1- possibility of cram-down , but certain creditors excluded(tax authorities, employees, secured creditors, commercial creditors); 2- possibility of cram-down involving all types of creditors and all creditors, whether affected or not; 3-possibility of cram-down involving all types of creditors and possibility to involve only those who would be affected by the plan	0-new finance not allowed; 1-new finance not forbidden, but on the risk of debtor; 2-new finance can have super-priority; 3-new finance is exempted from avoidance actions	0-full court involvement, from launch of the procedure to end, including appointing an insolvency practitioner and voting by creditors in court; 1-court involvement from launch, but negotiations and voting out-side court; 2-limited court involvement, only for appointing the insolvency practitioner or the confirmation of plan;	0-no discharge; 1- indefinite discharge period, discretion for the judge or discharge period of more than 3 years; 2- discharge period of 3 years but conditional on certain factors, eg payment of a percentage of debt; 3-discharge period of 3 years or less with no repayment threshold
AT	2	0	2		1	1	0	0	0	3	2	2
BE	3	2	3	Formal reorganisation	3	3	1	1	2	1	0	1
BG	0	2	0		0	0	0	0	0	0	0	0
CY	3	1	2	Examinership	3	0	2	1	2	1	1	2
CZ	1	1	0		0	3	2	3	0	2	0	1
DK	1	2	3		0	1	1	1	3	2	0	1
EE	3	2	0		3	1	1	1	1	1	1	1
FI	2	3	3		2	1	2	1	3	2	0	2
FR	2	3	1	Procédure de sauvegarde	3	2	1	1	2	2	1	2
DE	2	3	2	Protective shield procedure	1	1	1	3	2	2	1	2
EL	3	2	0	Rehabilitation procedure	3	3	2	1	2	3	1	3
HU	1	1	1	Bankruptcy procedure	0	2	2	3	1	0	0	1
IE	2	1	3	Examinership procedure	1	2	1	3	2	1	0	1
IT	3	1	1	Accordo di ristrutturazione dei debiti	1	3	2	3	1	3	2	1
LV	3	2	2	Restructuring proceedings (in-court)	3	1	1	1	1	2	1	1
LT	1	2	0	Interim measure during insolvency	2	1	1	1	0	2	1	2
LU	2	2	1	Concordat preventif de faillite	3	1	1	1	1	2	1	1
MT	2	0	0	Company recovery procedure	2	0	1	1	2	1	1	1
NL	2	3	2	Surseance van betaling	2	0	1	1	1	1	0	3
PL	2	2	0	Arrangement proceedings	2	1	1	3	1	1	1	1
PT	3	3	1	SIREVE	1	3	1	3	1	3	2	1
RO	3	1	0	Preventive scheme of composition	3	1	2	1	2	1	1	1

SK	1	1	0		0	1	1	1	2	0	1	2
SI	3	1	3	Compulsory settlement procedure	3	3	2	1	1	3	1	2
ES	2	2	2	Cram-down procedure	2	3	1	2	1	3	2	1
SE	3	2	1		3	1	1	3	1	2	1	3
UK	3	3	3	Company Voluntary Arrangement	4	1	2	3	1	1	2	3
HR	1	0	0		1	1	1	3	1	1	1	1
Source	INSOL Study	Business Dynamics study	The EU Justice Scoreboard 2016		INSOL Study	INSOL Study	INSOL Study	INSOL Study	INSOL Study	INSOL Study	INSOL Study	Business Dynamics Study+Review of 2014 Recommendation
Comments			The longer the insolvency proceedings, the less incentive to try early restructuring.		The earlier the possibility of restructuring the higher the success rate. For PT, a score of 1 is given because the IAPMEI needs to approve the plan.	There is an expectation that the higher the control the debtor keeps on his assets and his affairs, the higher the incentives for him to attempt early restructuring. Losing control over the business may create a barrier to engaging in a process of restructuring.	Where certain creditors are excluded (eg secured creditors - SE, PL, or dissenting creditors - PT) from the stay, a score of 1 is given (eg SE, PL). Stay must be a tool to support negotiations, it must be effective as against dissenting creditors, not just those who agree to negotiate (as is the case in PT SIREVE)	Where there is no set duration for the stay but there is a maximum duration for the entire procedure, and the stay is granted from the beginning of the procedure until the end, the duration of the stay will be given by the maximum duration of the procedure (eg PT). Where there is a set duration for the stay, but the period can be extended by application to a court up to a certain maximum, the initial period of stay shall be taken into account. In such cases, it can assume that the length of the stay is a measure of the complexity of the case, and not of unjustified delays.	In a situation where a quorum representing a majority of the value of debts of creditors (eg PT has a 50% quorum, EL has 60% plus 40% of secured creditors) will fall in category 1. This is because the procedure would not permit the debtor to select only those creditors whose rights would be affected by the restructuring plan, but a fixed number irrespective of whether their rights would be affected or not. Furthermore, this solution makes it possible that the debtor does not involve creditors which rights would be in fact affected by the restructuring plan. All creditors except unsecured creditors are excluded from the cram-down possibility in SE, SI. ES: no principal haircut is a disincentive.	Protection of new finance is an important ingredient for the successful implementation of restructuring plans. Protection against avoidance actions is key to providers of new financing. A super-priority rule is also helpful; however, since it may change the order of priority of pre-existing creditors, it may also have the adverse effect of discouraging creditors from supporting the restructuring plan.	Situations where confirmation of a plan is necessary only if a cram-down is sought by the debtor are scored with 2 (eg PT).	Discharge periods for cases where the debtor keeps his residential home should not be taken into account

ANNEX 7 - WHO IS AFFECTED BY THE INITIATIVE AND HOW

PRACTICAL IMPLICATIONS OF THE INITIATIVE FOR BUSINESSES

The initiative ensures that businesses in financial distress will have access in all Member States to a preventive restructuring mechanism which provides for the same efficiency elements irrespectively of the place of its application. It will ensure in the future that viable businesses survive and restructure also in cases in which today they would be driven to liquidation.

The initiative will assist companies in recognizing at an early stage cases of financial distress which need to be addressed by the preventive restructuring framework, by putting in place early warning alert mechanisms. This will enable that directors of companies take early actions and will further contribute to the survival of viable businesses. The initiative gives room for manoeuvre for the Member States in determining that in which way they want to incentivise businesses for early action. In this context they may also introduce certain accounting or reporting duties for the companies.

The initiative will help distinguishing quickly viable and not viable businesses, by short stay period and involvement of the courts in drafting restructuring plan. Viable businesses will be given a possibility to run business as usual during this short stay. Non-viable business will be able to liquidate assets quickly, without substantial losses.

Beyond that, the Initiative does not impose regulatory obligations for businesses relating, for example, to information, reporting, organisational or administrative requirements, and thus, does not create additional costs related thereto.

Another practical implication, especially for SMEs, will be the availability of model restructuring plans adapted to the respective insolvency laws of the Member States, which facilitate actual access to restructuring for this type of businesses, by decreasing the costs of the process. Short discharge periods will enable defaulting entrepreneurs to take second chance opportunity without the burden of loss of reputation.

The harmonisation of restructuring frameworks of Member States according to common minimum principles will facilitate the restructuring of cross-border groups of companies with group members in several Member States. In too complex enterprise group structures this is currently practically not possible or very difficult due to the differences in restructuring rules of affected Member States.

PRACTICAL IMPLICATIONS OF THE INITIATIVE FOR CONSUMERS

In Member States which decide to extend the principles of the initiative on second chance to consumers (to individual debtors not exercising independent business or professional activity) it is to be expected that consumers will gain on shorter discharge periods where now those discharge periods are substantially longer than 3 years. After having adjusted to the new situation created by the discharge conditions of the initiative, they will be able to come back to normal professional and personal life, to ordinary consumption and care for their health and education of the children. They will be no more a burden for social assistance. Also, hard

experience of insolvency reduces the repetition of subjective factors triggering personal over-indebtedness ("learn from default").³⁹⁷

Some of them may start their own businesses. When their financial standing will stabilise, they will be able to return as customers of financial products, as loans, saving products, private pensions.

PRACTICAL IMPLICATIONS OF THE INITIATIVE FOR FINANCIAL INSTITUTIONS

Financial institutions interested in cross-border investment banking will gain on the greater alignment of national restructuring regimes as this reduces costs both in the level of ex-ante risk assessment and by a better recovery rate of the invested resources in case of failure. Recovery rate will be more predictable and recovery itself will be faster. As more borrowers will be saved from liquidation and able to return to normal activity; creditors may expect to recover higher proportion of debts and, moreover, to continue lending to them.

Financial institutions as secured creditors of businesses in financial difficulties will have to adapt their lending practices in legal systems, where secured claims are not affected by a moratorium in preventive restructuring procedures, or where such claims may not be crammed down by majority decisions relating to restructuring plans. However, the initiative foresees specific safeguards to mitigate potential negative impacts in this respect (see in detail in Chapter 7 of the Report).

Higher convergence of discharge regimes for debtors will have a positive impact on financial institutions as creditors, by enabling them to better foresee the prospects of repayment of debts by companies and individuals.

Financial institutions in general will gain from the positive impact of the initiative on the reduction in the share of non-performing loans.

PRACTICAL IMPLICATIONS OF THE INITIATIVE FOR EMPLOYEES

Since early restructuring saves companies rather than drive them into liquidation, it is expected that jobs will be saved rather than lost. It was hard to measure the exact impact on jobs, though. Promulgating second chance for entrepreneurs will also affect employment positively: "restarters" could create up to 3 million new jobs³⁹⁸.

On the other hand, the initiative will not impact on the protection of employees, including their rights to information and consultation, as guaranteed by EU law. This is clearly spelled out in the proposal. Furthermore, it contains a flexibility to ensure that employees as a class can be adequately protected. For example, courts can exempt an entire class of creditors from the stay of enforcement if such a class will be unfairly prejudiced by the stay. Furthermore, salaries will need to be paid during the stay period. Salaries will also be protected under the

³⁹⁷ From the Commission 2014 Study on household over-indebtedness it appears that principal cases of over-indebtedness are external to the people (loss of income, disease, family problems). Nevertheless, other causes were also identified as important, which were "subjective" such as lack of money-management skills, or incapacity to deal with financial products. Study on over-indebtedness of European households, http://ec.europa.eu/consumers/financial_services/reference_studies_documents/docs/part_1_synthesis_of_findings_en.pdf, p. 157, 162.

³⁹⁸ Annual Report on European SMEs 2015/2016, SMEs as the engine of growth in 2016, SME Performance Review 2015/2016, March 2016, prepared for Directorate-General for Internal Market, Industry, Entrepreneurship and SMEs.

'safe harbour' provision of the initiative. Also, restructuring plans will not be confirmed by a court if they do not guarantee at least liquidation value to all creditors.

PRACTICAL IMPLICATIONS OF THE INITIATIVE FOR INSOLVENCY PRACTITIONERS

Although insolvency practitioners³⁹⁹ do not constitute a separate and independent regulated profession in the majority of the Member States, they are, nevertheless, subject to codes of professional ethics and disciplines as members of other professional groups (lawyers, accountants) and in this context their activity is usually appropriately supervised also in these States⁴⁰⁰. In addition, in most of the Member State specific qualification requirements are in place for being licensed or authorised as an insolvency practitioner.⁴⁰¹ From this outset, the implementation of the standards of the initiative with regard to professional conduct and qualification does not imply significant changes to them, except that in some Member State, where it is not yet the case, additional obligation to participate in professional training courses may be imposed on them, the costs of which they will need to bear, most probably.

Certain adaptation is to be required with regard to professional activity in Member States where the selection of insolvency practitioners to concrete cases currently does not take into account the requirements set in the initiative. Similarly, a slight shift may be expected in terms of the allocation of fees to insolvency practitioners in concrete cases in the Member States⁴⁰², where regulation of remuneration currently does not follow all the principles set by the initiative (see e.g. rules do not take into account the timely resolution of cases).

PRACTICAL IMPLICATIONS OF THE INITIATIVE FOR PUBLIC ADMINISTRATIONS

Except for the obligation to transpose the Directive into national law and enforce it, there are no specific practical implications for public administrations and courts.

In terms of the early alert mechanism, costs will be generated in public administration if a Member State decides that it will establish and operate a State funded system providing free or low cost advice to businesses. Nevertheless, Member States have large discretion defining the modalities of the mechanism, and the Directive does not impose any solution which would charge the budget of the State.

Most of the Member States already apply the specialisation of judges or concentrate jurisdiction in insolvency proceedings to specialized sections of the courts or to specialized courts. Those few who do not follow currently this model (e.g. Estonia, or Germany in lower courts) need to comply with the requirement of the Directive. This obligation, however, will not generate new costs, except in some cases funding for additional training for the judges might be required, if the Member State concerned decides to facilitate specialization by this way. It must be stressed in this context, that specialization in the field of insolvency can usually be obtained by long-standing practical experience and not necessarily by vocational trainings. Exchange of best practices between the judiciaries of the Member States will be

³⁹⁹ The initiative uses the concept of „practitioners in the field of restructuring, insolvency and second chance”, which is a broader concept as the one of „insolvency practitioner” in the Regulation (EU) 2015/848 on insolvency proceedings, as it includes also mediators or other professionals providing service in this regard. In this Annex we address the profession in the narrower sense of the Regulation.

⁴⁰⁰ AT, BE, CY, CZ, DK, FI, DE, EL, HU, IE, IT, LU, MT, NL, ES, SE See Table 2.1. in the Study on a new approach to business failure and insolvency, University of Leeds, January 2016, pp. 82-93.

⁴⁰¹ BG, BE, CY, CZ, DE, EE, EL, ES, FR, HU, IE, LV, LT, MT, NL, PL, PT, RO, SK, SI, SE. Idem pp. 82-93.

⁴⁰² e.g. AT, BE, DE, HU. Idem pp. 82-93.

done in the context of the European Judicial Network, at no extra cost for public administrations.

Cost of reporting obligations: many Member States already have statistical data, and only need to make it available to the Commission once a year. For the rest of the Member States, the costs of gathering such data are not expected to be significant. Nevertheless, in the long term specialised judges, court sections and courts would contribute to cost savings due to efficiency gains.

ANNEX 8

EVALUATION OF THE IMPLEMENTATION OF THE COMMISSION RECOMMENDATION

of 12.3.2014

ON A NEW APPROACH TO BUSINESS FAILURE AND INSOLVENCY

2015-2016 Review exercise

The Member States were invited to implement the principles set out in Commission Recommendation of 12 March 2014 on a new approach to business failure and insolvency⁴⁰³ by 14 March 2015 and to communicate to the Commission, on a yearly basis, data concerning the insolvency procedures.

In 2015, the Commission services sent a questionnaire on the review of the Recommendation to the Member States to enquire about its implementation. 24 Member States have sent their contributions to the Commission explaining how they have implemented the Recommendation⁴⁰⁴. No reaction was received from four Member States⁴⁰⁵.

In the 2016 review, the Commission, by a new questionnaire sent to the Member States, seeks to collect data which has become available in the meantime and was not communicated already in 2015 as well as to receive information on further national reforms in the areas covered by the Recommendation. 19⁴⁰⁶ Member States have sent their contributions, while 9⁴⁰⁷ Member States have not replied to the Questionnaire.

Part 1

The first part provides information on the reform processes in the Member States undertaken since the adoption of the Recommendation according to the data received in 2015 and 2016. In addition, it includes a detailed and comparative analysis of the implementation of the main principles of the Recommendation by the Member States.

1. Reform processes in the Member States undertaken since the adoption of the Recommendation

1.1 2015 Review exercise

⁴⁰³ COM (2014) 1500 final.

⁴⁰⁴ Austria, Belgium, Bulgaria, Croatia, Czech Republic, Estonia, Finland, France, Germany, Greece, Hungary, Italy, Latvia, Lithuania, Luxembourg, The Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden and the UK.

⁴⁰⁵ Cyprus, Denmark, Ireland and Malta.

⁴⁰⁶ Belgium, Croatia, Czech Republic, Cyprus, Denmark, France, Greece, Ireland, Italy, Lithuania, Luxembourg, the Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain and the UK.

⁴⁰⁷ Austria, Bulgaria, Estonia, Finland, Germany, Hungary, Latvia, Malta and Sweden.

According to the responses received in 2015, a few Member States have undertaken reforms which, in some cases, resulted in legislation implementing the Commission's Recommendation (legislation was passed in SI introducing a preventive restructuring procedure, ES, HU and RO have improved their personal insolvency regime, HR in both personal and corporate restructuring regimes, now PL is also due to pass legislation soon in the area of corporate restructuring). Such legislation in most cases implements only partially the Commission Recommendation: for example, SI has implemented a preventive restructuring procedure which is limited to debtors which are medium and large companies, but excludes from its scope small enterprises, and to financial creditors only; ES has implemented a personal insolvency procedure, but did not follow the Commission's recommendation on limiting the discharge period for honest debtors to three years, instead limiting it to five years.

In NL a reform process which aims at improving the existing preventive restructuring procedures which does not seem to function properly is still on-going, in LT improvements to the personal insolvency laws are being discussed, while in others Member States consideration is still being given to whether any specific action is necessary following the adoption of the Commission Recommendation (for example in Sweden a special committee was appointed to look at the need to adapt national legislation in the light of the Recommendation and the results are expected in October 2016; in the UK a public consultation has recently been carried out).

1.2 2016 Review exercise

According to the responses received in 2016, a few Member States have undertaken reforms in the meantime, implementing some of the principles of the Recommendation; others have introduced amendments in the previous legislation; while in others, legislative proposals are still pending.

More specifically, in 2015, there was a new package of insolvency laws approved in CY: the reform entailed the introduction of *examinership*, a simple majority in value for a “cram-down” of liabilities in the course of a voluntary business arrangement, personal repayment plans and debt relief after 3 years under certain conditions. In PO, a new restructuring law entered into force in 2016 introducing new types of restructuring proceedings and the implementation of pre-packaged restructuring plans. In HR, an insolvency act entered into force in 2015 introducing pre-bankruptcy proceedings in case of insolvency and in 2016, a system of consumer bankruptcy proceedings was developed.

In EL, in 2015, the restructuring processes were amended: the likelihood of insolvency was introduced as a criterion for filing early, an automatic stay is available under certain circumstances, the profession of insolvency administrator was initiated and a discharge period of maximum 3 years was agreed for entrepreneurs. In SI, in 2016, an amending act on insolvency proceedings entered into force, providing for simplified compulsory (restructuring) proceedings for micro-enterprises and introducing a discharge period of maximum 2 years but not less than 6 months accompanied by additional safeguards against abuses.

In NL, in 2015, a legislative proposal introducing a procedure to prevent unnecessary losses caused by bankruptcy and facilitate second chance for business has been submitted to the Parliament, while a second proposal introducing new legislation on compulsory composition for restructuring of debts outside of bankruptcy is being prepared. In LU, a legislative

proposal aiming at modernizing bankruptcy law and preventing bankruptcies through various reorganization measures for business in difficulty is still pending and in PT, there is an internal on-going discussion on the subject of preventive procedures and restructuring.

2. Implementation of the principles of the Recommendation by the Member States

Two years after the adoption of the Commission Recommendation, on the basis of the responses of the Member States, the main elements of the Recommendation are implemented in different ways in the Member States.

2.1. Preventive restructuring procedures

Enterprises do not have the same opportunities to deal with their financial difficulties everywhere in the Union. In some Member States businesses in financial difficulties have more opportunities than in others of restructuring their debts by having access to efficient, fast and low cost procedures. In several Member States, flexibility is also built into the legal framework, in that debtors can choose between several such procedures according to their needs (such as the need to restructure only certain of their debts, e.g. financial debts; or the need to obtain a stay), or can combine several such procedures as negotiations on a restructuring plan evolve (for example where a stay becomes necessary only at a later stage).

Several conditions may contribute to the efficiency of restructuring procedures, but six in particular seem to stand out. The Recommendation has focused on these six conditions which, in order to increase the efficiency of restructuring procedures, should be met cumulatively.

a) The possibility to file early with the objective of avoiding insolvency

The later a business initiates restructuring proceedings, the higher the costs of restructuring and the lower the management powers and success rate. Debtors in financial difficulties should have the possibility to restructure their debts before they are insolvent, when the risk of insolvency is however apparent for example because the debtor is unlikely to be able to repay his debts as they fall due in the foreseeable future.

Member States' procedures fall in several categories. In BG, HU, SK, DK and HR debtors do not have access to any type of structured procedure to restructure their debts with their creditors before they are actually insolvent or are already late with re-payments. AT, DE, IT and PT offer debtors the possibility to restructure before they are insolvent, but under very strict access conditions (e.g. an expert certificate must be filed or proof of a high majority of creditors already supporting the plan is required). Finally, BE, CZ, EE, FI, FR, EL, ES, LV, LT, LU, NL, PL, RO, SE, CY, IE and UK offer the debtor in financial difficulties the possibility to restructure at an early stage when there is a likelihood of insolvency in the future, without strict conditions being attached.

b) The position of the debtor

In order to encourage debtors to address their financial difficulties at an early stage, they should be left in principle in control of the day-to-day operation of their business. This would also ensure that the least disruption to the activity of the enterprise. Where necessary, a mediator or a supervisor should be appointed by the court. Debtors should be left in principle in control of the day-to-day operation of their business.

In FR, CY and NL the debtor may lose certain powers of control over the business during preventive restructuring procedures. In AT, CZ, EE, FI, DE, LV, LT, LU, PL, RO, SK, SI, SE, UK, IE and HR the debtor is left in possession, but an insolvency practitioner or administrator is also appointed (AT, DE, EE, FI, FR, DK) or the court itself supervises the debtor (BE). Finally, in EL, IT, PT and ES there is no obligation for a court to appoint insolvency practitioner or such a practitioner can be appointed out-of-court, while in FI an insolvency practitioner is not required in a simplified restructuring procedure.

c) The possibility of a stay on individual enforcement actions

During negotiations on a restructuring plan, the debtor should be able to apply to a court for suspension of individual enforcement actions which could otherwise jeopardise the success of the restructuring process. The stay could be requested against any type of creditor, but at the same time safeguards should be put in place in order to ensure that it is used strictly for the purposes of facilitating negotiations on a restructuring plan. The first such safeguard is the duration of the stay, which should be calibrated to the complexity of the case and not exceed four months; only in more complex cases should the court be able to prolong the initial duration of the stay upon proof of progress in the negotiations. The second safeguard is the possibility to have the stay lifted when it is clear that it is no longer needed to attain the objective of the procedure.

In AT there is no possibility to obtain a stay of individual enforcement actions in such preventive restructuring procedures. In many Member States the stay period is limited in time and can be extended in more complex cases or upon evidence of progress in negotiations (CZ, FR, IT, LV, LT, NL, PT, SE, SI, CY, IE and UK), while in some it cannot be extended (DE, ES, EL, PL). Where there are several procedures in place, the length of the stay usually varies from one procedure to another. In BE, EE, FI, LU, RO and DK, the stay is for an indefinite period, until the restructuring plan is adopted or rejected. In BE, DE, EL, SE, CY, IE the stay may be lifted by the court before the expiry of the stay period if the objectives of the stay can no longer be achieved or there is evidence of abuse. Most often the stay also means that insolvency procedures cannot be open against the debtor. In some Member States some actions cannot be stayed (e.g. in BE, DK and SE in respect of specific secured transactions; in EE in respect of employment claims).

d) Adoption of the restructuring plans by creditors

The Recommendation provides for the adoption of restructuring plans by creditors representing the majority stipulated under national law. It also requests that creditors should vote in classes constituted according to their interests, but that as a minimum secured and unsecured creditors should be treated in different classes for the purposes of adopting restructuring plans. Furthermore, the majority should be weighted depending not merely on the number of creditors, but on the amount of their claims. For the success of restructuring plans, it is necessary to involve those creditors likely to be affected by the plan. While formal voting is not absolutely necessary, when it is foreseen in national law, creditors should whenever possible be allowed to vote by distance means of communication. This will increase creditor participation by lowering their ancillary costs.

In AT and LT there is no possibility of binding dissenting creditors by majority voting. In CZ, EE, EL, ES, HR, IT, LV, LU, NL, PL, PT, SI and the UK binding dissenting creditors is in principle possible, but certain categories of creditors are exempted (e.g. public creditors, employees, secured creditors, commercial creditors). In DK, creditors are not treated in separate classes for the purposes of voting on a restructuring plan and the restructuring plan is

adopted if not opposed by a majority of creditors, while in CY there is a simple majority in value for a “cram-down” of liabilities in the course of a voluntary business arrangement. BE, DE and RO offer the possibility of binding dissenting creditors, but they require that all creditors are involved, even those whose rights are not affected. Finally, FI, FR and SI give the possibility that only certain categories of creditors which are affected by the plan are involved (e.g. financial creditors).

e) The protection for new finance granted in restructuring procedures

Encouraging new financing is necessary to ensure the success of a restructuring plan. As a minimum, the most effective means of protecting new financing which was agreed on in the context of a restructuring plan are first to exempt it from avoidance actions and second to exempt providers of such new financing from civil and criminal liability, where it exists. Furthermore, no protection should be granted where fraud was established.

In most MS new finance during restructuring proceedings is allowed (albeit debt-equity swaps are permitted to a lesser extent), however in EE, HR, LT, LU, , DK and SE it does not seem to be protected in subsequent insolvency proceedings in any special way. In AT, EL, ES, FR, IT, NL, PT, SI and the UK new finance is protected from avoidance actions while in BE, CZ, FI, FR, IT, DE, EL, LV SI, SK, PL, RO and the UK it receives super-priority or a special status in subsequent insolvency proceedings.

f) The involvement of courts when third party rights could be affected

The Recommendation encourages certain limits to the extent of court involvement. Certain steps in a restructuring process require court involvement. This is the case where the rights of dissenting creditors are affected, either at the stage of imposing or subsequently lifting a stay of individual enforcement actions, or at the stage of validating a restructuring plan which affects such creditors or which provides for new financing directly or indirectly affecting the rights of certain creditors. However, most other steps in the restructuring process do not need to take place in court. For example, when formal voting is required in national laws this could take place out-of-court.

In BE, FI, DK and NL early restructuring procedures require full court involvement, from starting negotiations, and including the appointment of an insolvency practitioner and voting on a plan. In CZ, EE, FR, DE, LV, LT, LU, PL, RO, SE, SI, CY, IE and the UK, while a court must be involved early at the beginning of the process, negotiations between debtor and creditors and voting take place outside court. Finally, in AT, EL, IT, PT and ES the court is involved only to approve a stay or to confirm a restructuring plan.

2.2. Second chance provisions

a) Discharge of debt to allow second chance for entrepreneurs

The Commission Recommendation urges Member States to provide for a reasonable discharge period of maximum three years from the opening of liquidation of assets proceedings or, in cases where a repayment plan has been approved, from the moment the plan is put into application. The provision also contains exemptions which are aimed either at discouraging dishonest entrepreneurs from thinking they can benefit from a quick discharge, or to safeguard the livelihood of the debtor, for example.

In DE, IE, LV, FI, FR, NL, SK, UK, EL, CY and DK discharge periods are largely complying with the Recommendation, although in some cases there are strict conditions attached (e.g. in

DE the need for the repayment of 35% of debt, in HU 50%). Gaps still remain: there is no possibility of discharge in BG, in HR and LU there is no definite discharge period and the discharge is left to the discretion of the judge, while in PL, a full discharge can be obtained after a successful fulfilment of a 3-year repayment plan. Discharge periods are still too long in CZ, EE, ES, LT, PT, SI, SE (5 years), AT and BE (7 years).

2.3 Consumer insolvency

Although consumer insolvency is not covered by the scope of the Recommendation, some principles may also be relevant (e.g. debt discharge and second chance). Thus, the MS were invited to explore the possibility of applying these recommendations also to consumers.

In the majority of the MS, there is no distinction between consumers and other natural persons and there are not any special procedures or mechanisms for consumer insolvency, since the personal bankruptcy/insolvency proceedings are also available to them (LT, SI, AT, CZ, BE, IT, SK, IE, UK, DK, FI, DE, EE, LV, NL). However, special procedures for individuals not exercising professional activity can be found in FR, EL and PT⁴⁰⁸. In CY, there is a mediation procedure through the Financial Ombudsman. Only in BG, there are currently no procedures available for consumer insolvency and second chance. Recent important reforms can be found in LU and HR; in LU, a law on over indebtedness of private persons came into force on 1 February 2014 introducing a new personal recovery procedure in order to contain more safeguards and provide the debtor with a second chance. In HR, in 2016, consumer bankruptcy was introduced to the legal system, enabling also for extrajudicial settlement of obligations.

3. Initial impact of reforms implementing the Recommendation

As a general rule, it can be noticed in Member States with weak preventive restructuring frameworks the number of restructurings is low or very low.

As for the recent reforms, although it is still too early to make a comprehensive assessment of their impact, the initial results in the Member States are already visible. For example, in Member States which have introduced a preventive restructuring procedure for the first time, the number of restructurings has increased significantly while the amount of debt-overhang has decreased.

4. Conclusion resulting from the implementation of the Recommendation

In conclusion, it can be seen that among the Member States who replied, several Member States consider that they already largely comply with the Recommendation, and that a significant number of those which do not comply have not launched any reforms to date.

While it is clear that the Recommendation has provided useful focus for those Member States undertaking reforms in the area of insolvency, it has not succeeded in having the desired impact in facilitating the rescue of businesses in financial difficulty and in giving a second chance to entrepreneurs because of its only partial implementation in a significant number of Member States, including those having launched reforms. These differences in the implementation of the Commission Recommendation mean continuing legal uncertainty and

⁴⁰⁸ In PT, in 2013, important amendments were introduced to the legal framework applicable to retail banking markets, which widened the rights of bank customers and in particular of over indebted customers. Sole traders, craftsmen, professionals and consumers can benefit from such procedure.

additional costs for investors in assessing their risks and continuing barriers to the efficient restructuring of viable companies in the EU, including cross-border enterprise groups.

Part 2

This part contains specific data related to several elements of the Recommendation (number of preventive restructuring proceedings initiated per MS, size of the debtor involved, outcome of the proceedings and data on formal insolvency proceedings). The data received is not always comprehensive, thus only general conclusions can be drawn.

1. Data on the number of preventive restructuring proceedings initiated

Number of preventive restructuring proceedings initiated in 2015

MS	2015
France	4551 ⁴⁰⁹
Portugal	3121 ⁴¹⁰
Italy	3029
Croatia	1791
UK	1764 ⁴¹¹
The Netherlands	369 ⁴¹²
Denmark	102 ⁴¹³
Lithuania	50
Czech Republic	22 ⁴¹⁴
Slovenia	5
Cyprus	1 ⁴¹⁵

Detailed data on the number of preventive restructuring proceedings per year for six MS can be found in the following column chart.

Number of preventive restructuring proceedings initiated during 2013-2015

⁴⁰⁹ The data refer to *sauvegarde, mandat ad hoc* and *conciliation*.

⁴¹⁰ This number refers only to PER. With regard to SIREVE, from 2012 until the mid of 2015, 504 requests were submitted.

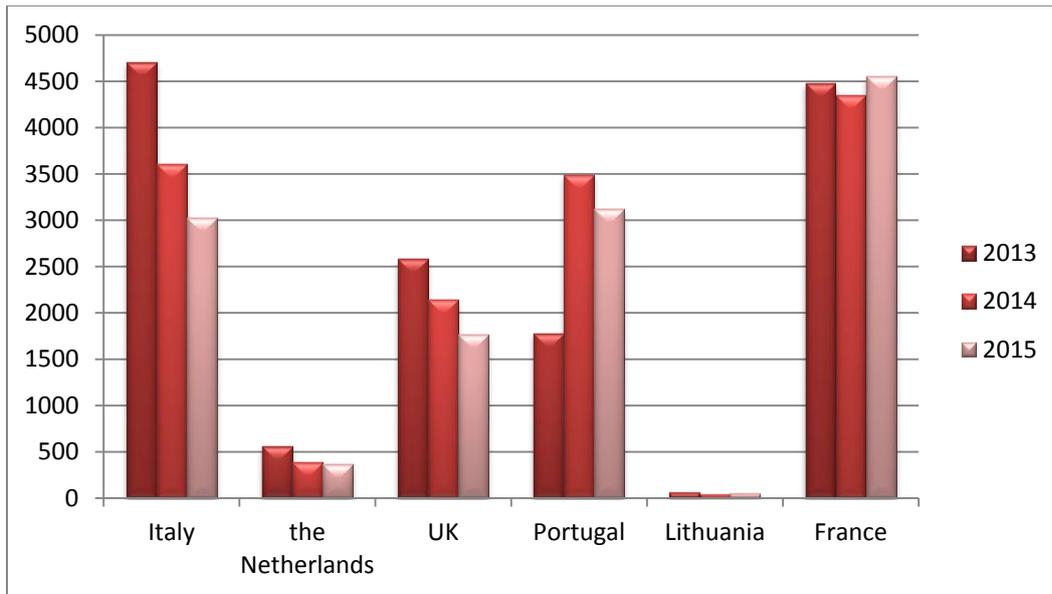
⁴¹¹ The data refer to the insolvency procedures used in restructuring (Administrations and CVAs). There is no information on Schemes of Arrangement as these are restructuring procedures available to all companies and not just those facing insolvency.

⁴¹² The data refer to the number of cases in which suspension of payment was granted. Under Dutch law, there are currently no other preventive restructuring proceedings.

⁴¹³ This number concerns finalised cases instituted in District Court and in Maritime and Commercial Court.

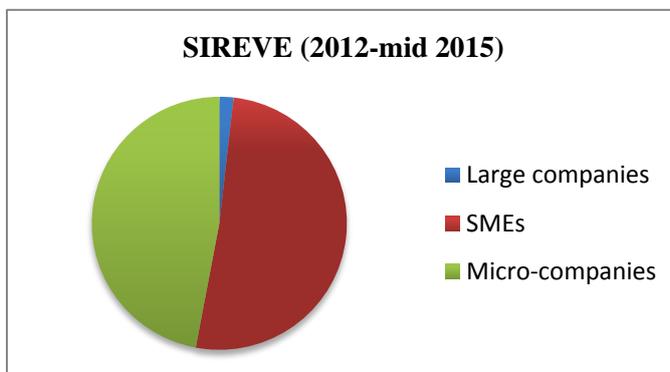
⁴¹⁴ The statistics do not distinguish between ordinary *roorganizace* (in the situation of insolvency) and preventive *reorganizace* (in the situation of a likelihood of insolvency).

⁴¹⁵ The number of preventive restructuring proceedings is 1 application for *Examinership*. Restructurings are also done through the Financial Ombudsman Procedure of Mediation and the Arrears Management Directive of the Central Bank, which include both personal and corporate entities.



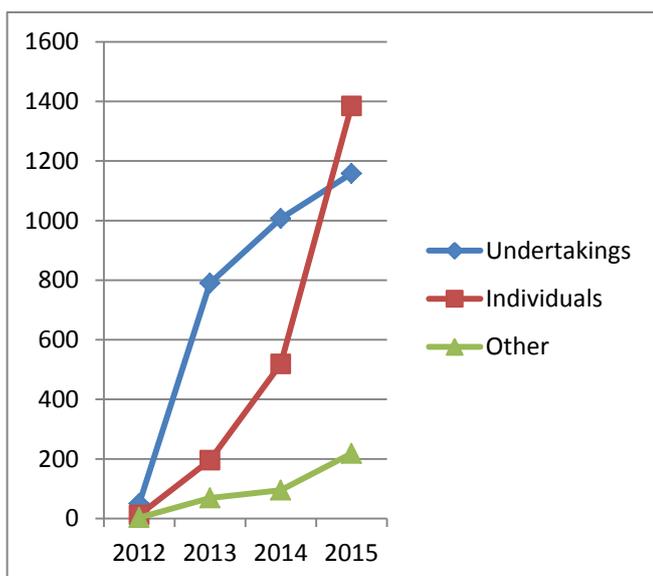
2. Data on the size of debtors involved

From the data we received, it is apparent that the vast majority of debtors that make use of restructuring proceedings are micro enterprisers and SMEs.



In **PT**, from 2012 until the mid of 2015, 237 micro companies, 258 SMEs and only 9 large companies submitted requests under the ‘SIREVE’ (Extrajudicial Business Recovery System).⁴¹⁶

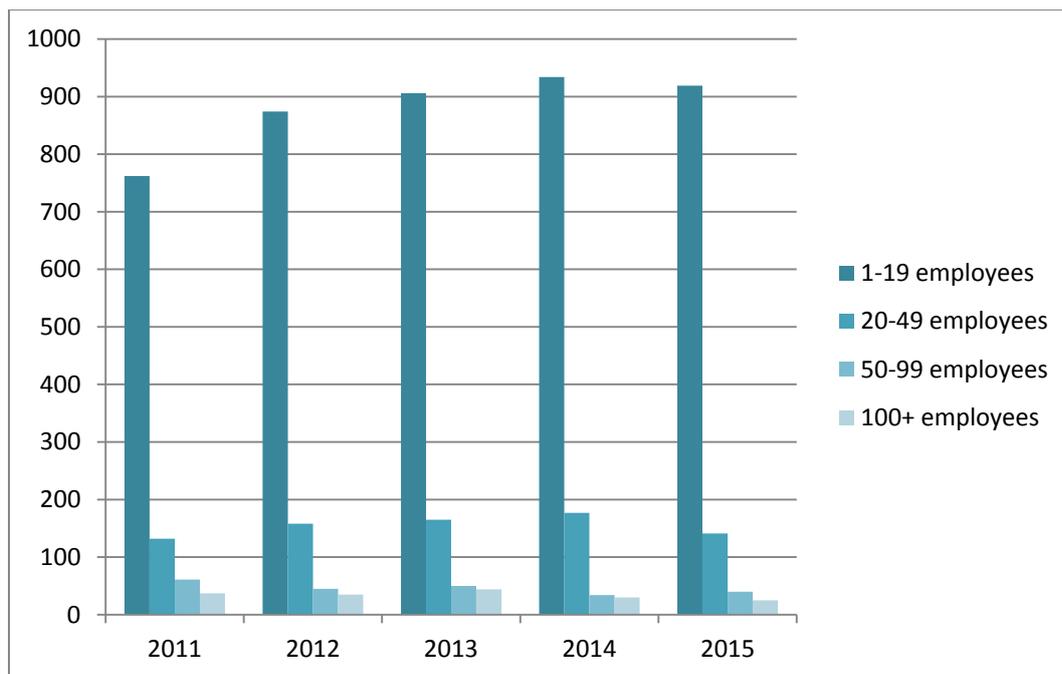
⁴¹⁶ For these purposes, micro companies are those with less than ten employees and an annual turnover or a total annual balance sheet of EUR 2 million; small and medium-sized enterprises are those with less than 250 employees and an annual turnover or total balance sheet under EUR 43 million and large companies are the remaining ones.



Regarding the PER, the Special Revitalisation Process, it is evident that in the course of 2012 until 2015, not only did the total number of debtors significantly increase, but also the number of individuals gradually augmented. Particularly, in 2015, 50% of debtors involved in PER were individuals, while 42% were undertakings. On the contrary, in 2012, only 18% of the debtors involved were individuals, while 77% were undertakings.

In **FR**, in 2015, the vast majority of enterprises involved in *sauvegarde* were enterprises with less than 100 employees (approximately 1.000 enterprises or 78% of the total number of debtors involved). More specifically, from a total of 1533⁴¹⁷ enterprises involved in these proceedings in 2015, approximately 733 (48%) were micro enterprises (less than 10 employees), while those that had more than 100 employees were only 25 (1.6%). The same patent was observed during the previous years.

⁴¹⁷ Approximately 400 companies are indicated as companies with 0 employees or with unknown number of employees.



In LT, in 2015, the average number of employees per debtor involved in restructuring proceedings was 23 employees with an average size of assets per debtor of 1.491.000 euros. At the same year, with regard to the composition with creditors in the course of bankruptcy procedure, the average number of employees per debtor involved is 1 employee and the average size of assets per debtor was 762.000 euros.

Restructuring proceedings

	2011	2012	2013	2014	2015
Average number of employees per debtor	17	32	45	22	23
Average size of assets per debtor	4.232.000	2.707.000	3.849.000	2.197.000	1.491.000

Composition with the creditors in the course of bankruptcy procedure

	2011	2012	2013	2014	2015
Average number of employees per debtor	14	8	4	4	1
Average size of assets per debtor	2.579.000	195.000	729.000	18.000	762.000

In 2014, in SE, there was an average of 22 employees per debtor involved in cases that were granted composition. In ES, both in 2014 and in 2015, approximately 65% of the debtors

involved in restructuring were microenterprises and SMEs, while only 12% were big enterprises.

In RO, data available only for restructuring inside formal insolvency procedures: of 768 successful restructurings completed during 2015 (but filed between 2011- 2015), 616 are small enterprises, 131 are medium enterprises and 16 are large enterprises.

3. Data on the outcome of the preventive proceedings

From the data received, the rate of successful restructuring varies across the EU.

On the one hand, in 2015, in DK, only 2 cases ended up with a successful reconstruction, while 78 preventive restructuring cases were initiated. LT also seems to have a rather low successful restructuring rate, since during the past 5 years, 12 cases were successfully finished out of 220 restructuring proceedings initiated. During the past 3 years in IT, around 15% of preventive restructuring cases are completed within the restructuring agreement, while 67% failed and 15% changed into insolvency proceedings.

On the other hand, in SE, during 2008-2012, 18% of all company reconstructions were successful. In PO, during 2010-2014, from a total of 127 preventive restructuring cases initiated, 27 were approved, amounting to approximately 20%. In EL, during 2011-2015, from a total of 291 applications for recovery, 66 were completed with ratification. In HR, during the last 5 years, approximately 28% of all preventive restructuring proceedings received a confirmation of a pre-bankruptcy settlement. Finally, in PT, in 43% of preventive restructuring cases, there was a confirmation of the plan and in SI, 6 out of 9 cases initiated in 2014 were successful.

It is not possible to determine from the data provided if debtors successfully undergoing a restructuring procedure lapse into financial difficulties shortly after.

4. Data on the length of proceedings

The average length of preventive restructuring proceedings varies across the MS. However, from the data received, apart from Lithuania, Czech Republic and Italy, where the average length for restructuring proceedings is more than one year, in the other countries restructuring proceedings last less than one year with an average duration between 5 and 8 months.

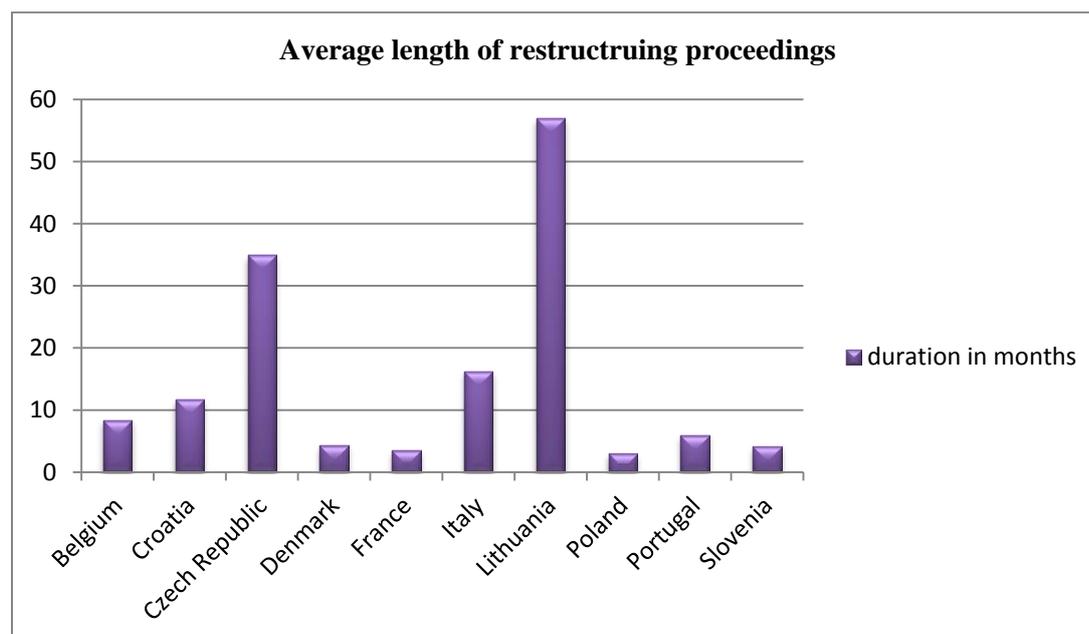
In detail, the countries can be divided in three categories according to the average length of the proceedings:

- Less than 5 months: France (21.2 days for *mandat ad hoc* and 2.2 months for *conciliation*), Denmark (4.3 months), Slovenia (4.23 months⁴¹⁸), Portugal (5 months for PER) and Poland (3 months).

⁴¹⁸ It is indicated that this number concerns preventive restructurings that are successfully concluded.

- 6-12 months: Portugal (7.1 months for SIREVE), France (7.8 months for *sauvegarde*), Belgium (8.38 months), Croatia (11.7 months).
- More than one year: Czech Republic (3 years), Lithuania (4.7 years for closed proceedings and 2.4 years for terminated proceedings⁴¹⁹), Italy (1.3 years⁴²⁰).

The average duration of preventive restructuring proceedings per country is depicted in the following column chart.



5. Data on the number of ordinary/formal insolvency proceedings and their outcome

In general, it can be noticed that in many countries, the number of formal insolvency and bankruptcy proceedings per year is higher than that of preventive restructuring. As for the rate of successful restructuring within the formal insolvency proceedings, it varies across the EU, but in most countries, the majority of cases in formal insolvency end up in liquidation. It can be argued that in comparison with the preventive measures, the formal insolvency proceedings have a lower rate of a possibility of a successful restructuring.

For example, in DK, the majority of cases initiated in formal insolvency proceedings end up in bankruptcy. During the past five years, the rate for successful restructuring in formal insolvency is 1.5-2%, while in 2015, 67% of formal insolvency cases ended up in bankruptcy. In the same year in Portugal, 17.235 insolvency cases were initiated (approximately 14.000 more than in preventive restructuring procedures) out of which 14.612 ended up with a declaration of bankruptcy and only 3 with confirmation of a restructuring measure. In HR,

⁴¹⁹ Restructuring proceedings are closed when the restructuring plan is successfully implemented.

⁴²⁰ According to the data received, the average length for insolvency proceedings (*procedura fallimentari*) in Italy in 2015 was 7.6 years.

during the last five years, there were more than 35.000 incoming cases (in comparison to almost 9.000 cases in preventive proceedings).⁴²¹ Finally, in CZ, every year, 20 cases in preventive restructuring proceedings are initiated, while 1000-15000 bankruptcy orders are issued.

In RO, in 2015 there were 768 confirmed judicial reorganisation procedures opened in the period 2011-2015, and 10,274 new applications for insolvency proceedings.

⁴²¹ The largest number of incoming cases (almost 20.000) was received in 2015 due to the new legislative insolvency framework.