# Consultation on an effective insolvency framework within the EU

Fields marked with * are mandatory.

## Introduction

An appropriate insolvency framework is important for society at large and in particular for investors, creditors and debtors. It is an essential element of a good business environment and is therefore important for jobs and growth.

A good insolvency framework maximises the efficiency, predictability and effectiveness of insolvency proceedings. This makes it easier to trade, supports an effective credit system and ensures a favourable investment climate, in turn benefiting the wider economy.

Insolvency frameworks should provide a transparent, predictable and cost-effective set of rules that can be used to preserve and maximise the value of debtors' assets. The rules should make it possible, either to:

- save businesses (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 that company has not prospect of survival.

Efficient insolvency rules could also help increase the recovery rate of debts and avoid the build-up of non-performing loans in the financial system.

The Commission's Annual Growth Survey 2016 explicitly recognises the importance of *'well-functioning insolvency frameworks'*. These are *'crucial for investment decisions since they define rights of creditors and borrowers in the event of financial difficulties'*.

Conversely, inefficient and ineffective frameworks result in the discontinuation of viable businesses, lengthy procedures and a low rate of recovery. This often translates into significant problems for the Member States concerned and for the wider European economy. These problems may take the following forms:

- Unnecessary liquidation of viable businesses, resulting in a loss of productive capacity;
- *De facto* or *de jure* disqualification of failed entrepreneurs or the exclusion from economic life of indebted members of the public;
- Barriers to corporate lending and investment, including cross-border investment. Uncertainty or difficulties over realising value from distressed debt may be particularly pronounced in the case of cross-border lending and investments. This may increase the cost at which investors and creditors are willing to invest in or lend to cross-border borrowers.
- Difficulties for creditors in recovering value from distressed debt. This may contribute to persistently high levels of non-performing loans, which weigh on bank balance sheets and may constrain bank lending.

In the public consultation on a Capital Markets Union, insolvency laws were singled out as one of the key barriers preventing the integration of capital markets in the EU. Consultation respondents broadly agreed that both the inefficiency and divergence of insolvency laws make it harder for investors to assess credit risk, particularly in cross-border investments. 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 [1].

**Focus on restructuring and a second chance:**

A clear and effective approach to debt restructuring can benefit both the borrowing and lending sides of the market. Businesses that are in temporary distress should be able to restructure and be saved if their business is viable. Member States' legal frameworks have a crucial role in creating the conditions for successful restructuring, whether within or outside formal insolvency proceedings.

To encourage entrepreneurial activity, entrepreneurs and managers of companies should not be stigmatised when honest business endeavours fail. Individuals should not be deterred from entrepreneurial activity or denied the opportunity for a 'second chance'. Similarly, managers of companies may benefit from clear rules on their disqualification over insolvency-related misconduct.

For consumers (i.e. individuals with debts of a non-professional nature), a possible second chance might give them the incentive to start consuming again and take up gainful employment without the stigma of insolvency burdening them for years on end.

This means that for individual debtors, whether entrepreneurs or consumers, the rules on how to discharge the remaining debt following bankruptcy are important. Any rules providing for debt discharge need to be carefully designed to prevent abuse and incentivise careful management of business debt from the outset.

As a result, in the Capital Markets Union Action Plan, the Commission announced its intention to propose a legislative initiative on business insolvency, including early restructuring and second chance. The legislative initiative seeks to address the most important barriers to the free flow of capital, building on national sets of rules that work well.

The Commission Communication '*Upgrading the Single Market: more opportunities for people and business*' states that the effects of a potential bankruptcy deter individuals from entrepreneurial activity. The prospect of a fresh start for bankrupt entrepreneurs encourages would-be entrepreneurs to start and scale-up new business activities. This creates a more beneficial environment for innovation.

**Helping creditors (banks) to recover value in the event of insolvency**

The Five Presidents' Report on '*Completing Europe's Economic and Monetary Union*' identified insolvency laws as a key component of Financial Union. An effective insolvency framework should also contribute to the efficient management of defaulting loans and reduce the accumulation of non-performing loans on banks' balance sheets.

This position on insolvency reform was set out in the Commission Communication '*Towards the Completion of the Banking Union*' of 24 November 2015. Efficient insolvency frameworks would increase recovery rates and improve pricing of non-performing loans in the interest of developing a secondary market. Such loans would not then remain on banks' balance sheets for protracted periods of time, debts could be at least partially recovered and debtors could have a fresh start.

The Commission has examined national insolvency regimes as part of the European Semester, the EU's economic governance framework. Lengthy, inefficient and costly insolvency proceedings in some Member States were found to be a contributing factor to insufficient post-crisis debt deleveraging in the private sector and exacerbating debt overhang.

**Objectives of this consultation**

This consultation asks about the key insolvency barriers. It focuses in particular on gathering views on:

- the efficient organisation of debt restructuring procedures;
- the rationale and the process for debt discharge for entrepreneurs (and its possible extension to consumers).

Beyond these two policy areas, the consultation also invites views on selected aspects of efficient and effective insolvency frameworks which may have particular importance for the Internal Market or the integration of capital markets. Such frameworks should help to maximise the value received by creditors, shareholders and other stakeholders.

The responses will be used to identify which aspects should form part of a legislative initiative [2] and other possible complementary action in this field. The responses will be taken into account alongside the results of an external economic study carried out on behalf of the Commission as well as other evidence and analysis. The results of the consultation are without prejudice to any potential future Commission proposal.

This consultation is run via the 'EU-Survey' online tool, which makes it easier to collect answers from the widest possible range of respondents. In addition to choosing from the pre-defined answers, respondents are encouraged to explain their views or add additional information or explanations in the free text boxes provided. Respondents can add additional information at the end of the consultation and/or can do so by clicking on the 'other' options and the boxes that follow. Alternatively, separate contributions can be sent to the dedicated mailbox.

[1] An Inception Impact Assessment which contains a detailed description of the problems found in this area, as well as the policy objectives and options for action is available on http://ec.europa.eu/smart-regulation/roadmaps/docs/2016_just_025_insolvency_en.pdf.
[2] The Commission Work Programme for 2016 announced a legislative initiative framing a new approach to business failure and insolvency.

## I. Information about you

This consultation is addressed to the broadest public possible, as it is important to get views and input from all interested parties and stakeholders.

***1. Please indicate your role for the purpose of this consultation**

- ○ Private individual
- ○ Self-employed person
- ○ Company
- ● Bank, credit institution, investment fund, financial institution
- ○ Judge
- ○ Insolvency practitioner
- ○ Other legal practitioner
- ○ Business adviser or business support organisation
- ○ Public authority
- ○ Academic
- ○ Think tank
- ○ Other

**Name of your organisation** (if applicable)

Association for financial markets in Europe (AFME)

**2. Is your organisation included in the Transparency Register?**

*(If your organisation is not registered, you can register here. You do not have to be registered to reply to this consultation.)*

- ● Yes
- ○ No

**If you are registered, please indicate your register ID Number:**

***3. Have you had practical experience with insolvency proceedings?**

- ○ Yes
- ● No

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**4. Please indicate the country where you are located:**

- ○ Austria
- ○ Belgium
- ○ Bulgaria
- ○ Cyprus
- ○ Czech Republic
- ○ Germany
- ○ Denmark
- ○ Estonia
- ○ Greece
- ○ Spain
- ○ Finland
- ○ France
- ○ Hungary
- ○ Croatia
- ○ Ireland
- ○ Italy
- ○ Lithuania
- ○ Luxembourg
- ○ Latvia
- ○ Malta
- ○ Netherlands
- ○ Poland
- ○ Portugal
- ○ Romania
- ○ Sweden
- ○ Slovenia
- ○ Slovak Republic
- ◉ United Kingdom
- ○ Non-EU country

**5. Please provide your contact information:**

*

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***6. Please indicate your preference over the publication of your response on the Commission's website:**

- ○ Under the name given: I consent to publication of all information in my contribution and I declare that none of it is subject to copyright restrictions that prevent publication.
- ◉ Anonymously: I consent to the publication of all information in my contribution, except my name/the name of my organisation and I declare that none of it is under copyright restrictions that prevent publication.
- ○ Please keep my contribution confidential (it will not be published, but will be used internally within the Commission)

*Please note that regardless of the option chosen, your contribution may be subject to a request for access to documents under Regulation 1049/2001 on public access to European Parliament, Council and Commission documents. In this case, the request will be assessed against the conditions set out in the Regulation and in accordance with applicable data protection rules.*

## II. Questions

In general, an insolvency framework should ensure that viable businesses can be restructured and continue operating, while non-viable ones can be quickly liquidated. Over indebted individuals should also have access to insolvency proceedings and discharge provisions subject to certain conditions. Member States have in place different systems, some of which comply at least partially with these requirements and some of which do not. These differences may have an impact on the functioning of the internal market.

## 1. Scope

**1.1. Which measures should be taken to achieve an appropriate insolvency framework within the EU?** (choose all that apply)

- [x] a) Preventive measures to enable the restructuring of viable businesses
- [x] b) Measures to increase the recovery rates of debts in insolvency
- [ ] c) Measures to ensure the discharge of debts for entrepreneurs (individuals)
- [ ] d) Measures to ensure the discharge of debts for consumers
- [x] e) Measures governing employees' rights in insolvency
- [x] f) Measures ensuring the enforcement of debts
- [ ] g) Other measures
- [ ] h) No opinion

**Please explain**

We believe that the proposals set out in the Commission Recommendation of 12.3.2014 provide a very helpful basis for future insolvency reform at both national and European level. While a new EU legislative initiative is in preparation and then under discussion with the co-legislators, we would encourage the Commission to continue to promote domestic insolvency reform within the EU Member States based on the principles of the 2014 Recommendation. This would culminate in a 'twin-track' approach to reform, with a consistent direction at EU and national level.

As stated in the Commission Recommendation of 12.3.2014 on a new approach to business failure and insolvency (the "EC Recommendations") and in subsequesnt pronouncements and publications, it is very important that viable business are given a chance to reorganise or restructure rather than being forced into liquidation which would, by definition, improve creditor recovery rates. The measures should not just be preventative, however, and the EC should ensure that all measures enacted, both preventative and those that are used post insolvency petition, are designed to ensure that a viable company is given a chance to continue as a going concern.

Creditors must be certain that in the case of a debtor insolvency they will be given an opportunity to maximise recovery of their claims, or at least a high percentage of them, in a reasonable period of time. Without such certainty investors may be deterred from investing in certain Member States. We would encourage the European Commission, and member States, to publish the statistics for each country showing the length of time required to complete insolvency proceedings, as well as creditor recovery rates, thus providing investors with the necessary information to access the predictability of such proceedings and recovery rates.

As a practical matter, the length and complexity of insolvency proceedings, particularly in cross-border contexts, has the potential to tie up capital, delay the delivery of assets to the appropriate parties and perhaps discourage investment in certain jurisdictions. While, in many cases, complex issues of law must be considered, sometimes in multiple jurisdictions, we believe that it is important that any legislative proposals or recommendations be designed to reduce the length and complexity of insolvency proceedings across Europe.

As a specific measure to reduce the length of insolvency proceedings, we advocate to introduce, in case of a bankruptcy, a maximum period of 180 days for drafting a liquidation plan. The plan should include requirements for periodic reporting by the insolvency practitioner on their progress with respect to liquidating the assets of the relevant company(s). The 180 day period should not be seen as a deadline for actually liquidating the assets as this might have an impact on the ability of creditors to realise the highest value from the assets by forcing the insolvency practitioner to quickly sell assets on unfavourable terms.

Overall, any Eu insolvency framework should emphasise the importance of:

(1) generally respecting the creditor hierarchy
(2) pari passu distributions - i.e., ensuring that similarly situated claimants share equally in what is properly available to any of them and
(3) limiting the extent to which property available to satisfy the valid claims of a creditor can be appropriated without permission or sanction of a court (i.e., no creditor is left worse off).

**1.2. To what extent do the existing differences between the laws of the Member States in the areas mentioned below affect the functioning of the Internal Market?**

*(For example, differences affect the Internal Market when creditors or investors and debtors are located in different Member States and this has an impact on the recovery of debts, the legal certainty of transactions, the quantification of risks etc.)*

| | To a large extent | To a considerable extent | To some extent | Not at all | No opinion |
|---|---|---|---|---|---|
| a) Preventive measures to enable the restructuring of viable businesses | ◉ | ○ | ○ | ○ | ○ |
| b) Measures to increase the recovery rates of debts in insolvency | ○ | ◉ | ○ | ○ | ○ |
| c) Measures aimed to ensure the discharge of debts for entrepreneurs (individuals) | ○ | ○ | ○ | ○ | ◉ |
| d) Measures to ensure the discharge of debts for consumers | ○ | ○ | ○ | ○ | ◉ |
| e) Measures governing employees' rights in insolvency | ○ | ○ | ◉ | ○ | ○ |
| f) Measures ensuring the enforcement of debts | ○ | ◉ | ○ | ○ | ○ |
| g) Other measures | ○ | ◉ | ○ | ○ | ○ |

**Please explain**

All of the factors mentioned above have some effect. For instance, being subject to 28 different insolvency regimes has a great effect on cross-border transactions, as this increases uncertainty with respect to the treatment of assets and the effectiveness of credit support in these jurisdictions in the event of an insolvency.

Uncertainty is further increased by the use of shifts in a company's centre of main interest ("COMI") and other forum shopping techniques. This also affects recovery rates, which can have a negative impact on the willingness of investors to invest in certain jurisdictions. Other factors include valuation procedures, availability of debtor-in-possession financing, appropriate use of cramdown procedures, creditor rights and legal and administrative insolvency frameworks.

**1.3. To what extent do the measures mentioned below have an impact on the creation and operations of newly established companies?**

| | To a large extent | To a considerable extent | To some extent | Not at all | No opinion |
|---|---|---|---|---|---|
| a) Preventive measures to enable the restructuring of viable businesses | ○ | ○ | ● | ○ | ○ |
| b) Measures to increase the recovery rates of debts in insolvency | ○ | ● | ○ | ○ | ○ |
| c) Measures to ensure the discharge of debts for entrepreneurs (individuals) | ○ | ○ | ○ | ○ | ● |
| d) Measures governing employees' rights in insolvency | ○ | ○ | ● | ○ | ○ |
| e) Measures ensuring the enforcement of debts | ○ | ● | ○ | ○ | ○ |
| f) Other measures | ○ | ● | ○ | ○ | ○ |

**Please explain**

To the extent that an honest and diligent entrepreneur believes that he or she will be given a chance to recover if, as happens with many new businesses, the business becomes distressed , or is affected by an economic downturn, that entrepreneur might be more willing invest the time and money needed to start the business. In addition, investors might be more willing to invest in a business if it is more likely that the business will be given a reasonable opportunity to reorganise or restructure if it gets into trouble. Such chances will also likely increase recovery rates for investors, thereby freeing up more capital to be placed into the market.

## 2. Saving viable businesses in difficulty

In general, an insolvency framework should ensure that viable businesses can be restructured and continue operating. However, the conditions under which a company is deemed viable and should be restructured or liquidated differ from Member State to Member State. In this consultation, the term 'restructuring' covers both restructuring as an existing company and the sale of a company as a going concern to another company. There is also a difference between the viability of a legal entity and that of a business contained within it or even spread across several legal entities.

The rules regulating restructuring procedures (including the contents of the restructuring plan and related procedural issues) have a crucial role in creating the conditions for successful restructuring, whether within or outside insolvency proceedings. There are major differences across Member States in the rules on the procedure for adopting a restructuring plan, including required majorities for its adoption and the rights of dissenting creditors.

Laws of Member States also differ on the standards applied by the courts when asking for a stay of individual enforcement actions (i.e. a suspension of the right to enforce a claim by a creditor against a debtor, also known as a 'moratorium') to be granted, when approving the plan and the possibility to challenge such approval. Moreover, under certain national insolvency frameworks, courts may have wide discretionary powers over the approval of the plan and possible changes to it, while under other laws these powers are rather more limited.

Rigid and impracticable rules may hinder the chances of adopting a restructuring plan. Restructuring viable businesses avoids unnecessary liquidation and thus helps safeguard the debtor's assets as a going concern, maximising value for owners and shareholders as well as for creditors. An efficient business restructuring procedure may also give equity investors a chance to recover the value of their investment. At the same time, restructuring procedures must be safeguarded against misuse and depletion of the assets in the process.

There are also significant differences between the criteria for opening insolvency proceedings. In certain Member States, insolvency proceedings may be opened only for debtors that are already affected by financial difficulties or are already considered insolvent. In others, proceedings can be opened for solvent debtors that anticipate facing insolvency in the imminent future. Such proceedings do not have the character of informal pre-insolvency proceedings. Further differences may also be found in insolvency tests (liquidity test, balance sheet test, over-indebtedness test) and in the obligation for a debtor to file for the opening of insolvency proceedings when insolvency occurs.

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.

## GENERAL QUESTIONS

**2.1. To what extent do existing differences between the laws of the Member States in the areas mentioned below affect the functioning of the Internal Market?**

*(For example, differences affect the Internal Market when creditors or investors and debtors are located in different Member States and this has an impact on the recovery of debts, the legal certainty of transactions, the quantification of risks etc.)*

| | To a large extent | To a considerable extent | To some extent | Not at all | No opinion |
|---|---|---|---|---|---|
| a) Measures to give access to a toolkit enabling fast restructuring | ○ | ○ | ● | ○ | ○ |
| b) Measures to ensure the assessment of a debtor's viability | ○ | ● | ○ | ○ | ○ |
| c) Measures to provide minimum standards in relation to the definition of insolvency | ○ | ● | ○ | ○ | ○ |
| d) Measures to lay down the duties of directors in companies in financial distress | ○ | ● | ○ | ○ | ○ |
| e) Measures to protect new financing given to companies that are being restructured | ● | ○ | ○ | ○ | ○ |
| f) Measures to clarify the position of shareholders of companies in insolvency or close to insolvency | ○ | ○ | ● | ○ | ○ |
| g) Measures to promote assistance to financially distressed debtors | ○ | ○ | ● | ○ | ○ |
| h) Other measures | ● | ○ | ○ | ○ | ○ |

**Please specify which other measures in national laws affect the functioning of the Internal Market.**

We interpret "measures to ensure the assessment of a debtor's viability" to mean valuation procedures, and we believe that these are very important in an insolvency context. Valuation affects which creditors would be considered to have a continuing economic interest int he business, can influence the decision of investors to provide financing, and can ultimately have an impact on whether a company is liquidated or permitted to have a second chance. In Europe, it is much more likely that a company in trouble will end up in liquidation than is the case in the US, for instance. This is at least partly because many European jurisdictions favour a liquidation valuation where a distressed company is valued according to the price that would be realised if all of its assets were sold. A better alternative would be to value a viable distressed company according to its value as a going concern, or as a company that is possibly worth more than the value of its assets.

We also think that it is important that Europe have a framework to protect new financing that is provided to a viable company in distress. New financing is a key restructuring tool which allows companies to receive additional financing to meet their funding requirements whilst a restructuring plan is devised and executed . creditors who decide to inject liquidity in a distressed company should be given a sufficient degree of certainty and predictability on the recovery of their investment. Otherwise, potentially interested investors could be discouraged and companies in desperate need of working capital might be left without the possibility of financing their day-to-day operations, tot he detriment of the real economy.

Therefore, any new financing should have adequate and relevant protection (including from undue court challenges or modification in the event of bankruptcy) in order to encourage investors to provide new financing to companies in distress..

**2.2. What impact do the different types of measures mentioned below have on saving viable businesses?**

| | Very strong impact | Considerable impact | Little impact | No impact at all | No opinion |
|---|---|---|---|---|---|
| a) Measures to give access to a toolkit enabling fast restructuring | ◉ | ○ | ○ | ○ | ○ |
| b) Measures to ensure the assessment of the viability of a debtor | ○ | ◉ | ○ | ○ | ○ |
| c) Measures to provide minimum standards in relation to the definition of insolvency | ○ | ○ | ○ | ○ | ◉ |
| d) Measures to lay down the duties of directors in companies in financial distress | ○ | ○ | ○ | ○ | ◉ |
| e) Measures to protect new financing given to companies that are being restructured | ○ | ○ | ○ | ○ | ○ |
| f) Measures to clarify the position of shareholders of companies in insolvency or close to insolvency | ○ | ○ | ◉ | ○ | ○ |
| g) Measures to promote assistance to financially distressed debtors | ○ | ◉ | ○ | ○ | ○ |
| h) Other measures | ○ | ◉ | ○ | ○ | ○ |

**Please specify which other measures have an impact on saving viable businesses.**

Please see our explanation in relation to part 2.1. In addition to the factors mentioned in our response to question 2.1, we would add consistent and effective creditor stay provisions and appropriate use of judicially approved cramdown procedures.

With respect to directors' duties considerations, under existing local laws, there are significant differences between the duties imposed on directors when a company enters financial difficulties throughout the EU. For example directors of German companies are under a duty to commence insolvency proceedings without undue delay, and in any event within 21 days of their actual knowledge of the company's insolvency (unless certain exceptions apply). In contrast under English law the wrongful trading test is far more flexible and directors are required to assess whether there is a reasonable prospect of avoiding an insolvent liquidation / administration. The differences in directors duties within the EU can lead to perverse outcomes, particularly where group companies incorporated in different Member States have common directors, since a director may feel compelled to commence insolvency proceedings in relation to one group company due to local law requirements but not be under a duty to take equivalent steps in relation to a second group company due to different local law requirements. In the worst case, such inconsistencies can precipitate unnecessary group-wide insolvencies where the premature insolvency of one subsidiary can cause cross-defaults and/or funding losses leading to the insolvency of the entire group.

In addition, directors are often confused as to what they can or should do during the "zone of insolvency". Enumerating their rights, duties and responsibilities int his context would have a significant effect on how (and how timely) the difficulties or crises faced are addressed.

**SPECIFIC QUESTIONS**

**2.3. If creditors are situated in a different Member State(s) than their debtors, what impact does this have on the restructuring of the business of debtors as opposed to a purely national situation?**

- (●) a) Very significant impact
- ( ) b) Significant impact
- ( ) c) Little impact
- ( ) d) No impact at all
- ( ) e) No opinion

**Please explain your choice, including which aspects are particularly affected.**

If creditors are situated in different member states than their debtors they must, in the first instance, engage local legal and other advisors to guide them through the relevant legal, regulatory and other frameworks and to understand the implications of the differences between the various insolvency regimes. This situation is amplified when the creditor has received liens or other security interests over the debtor's assets or guarantees or other credit support from entities outside the creditors' jurisdiction (which would each presumably be governed by the laws of the jurisdiction in which the relevant asset or guarantor is located), causing increased uncertainty,

While assessment of these matters should be made prior to the lender providing financing, navigating the various laws, practices, and peculiarities in practice is sometimes different from a pre-lending analysis. The varied and complicated nature of any legal or other advice received could amplify any qualifications or lack of complete certainty about outcomes of legal or regulatory proceedings. In addition, the need for reform in European insolvency has led to more than twelve European jurisdictions instituting new and different insolvency legislation in the past few years, while COMI shifts and other forum shopping mechanisms can also cause a difference between expectations an actual events.

Minimum insolvency standards across Europe would lessen the need for continuous reforms and dis-incentivize companies from engaging in COMI shifts.

**2.4. When should debtors have access to a framework of restructuring measures enabling them to restructure their business/liabilities?**

- ○ a) Only once the debtor is already insolvent
- ○ b) Before the debtor is insolvent, but where there is a likelihood of imminent insolvency (for example because the debtor has lost a major client)
- ○ c) At any time
- ● d) At another moment in time
- ○ e) No opinion

**Please explain**

Debtors should have access to restructuring at an early stage , when the first signs of significant financial difficulties become "visible". In order to be efficient, restructuring proceedings need to be triggered as soon as possible, without any delays. Directors should not, however, be forced to prematurely seek access to insolvency or restructuring frameworks.

Moreover, EU jurisdictions should ensure that creditors are entitled to directly propose a restructuring plan for distressed companies. For example, creditors that represent a high percentage of debt should be allowed to submit a restructuring plan including - among other things - the possibility of converting all or part of non-performing debt into ordinary shares, provided that certain conditions are met (e.g., equal value to the credit, approval of a large majority of affected creditors). This credit-oriented approach would help companies in financial distress to foster business continuity and help to prevent bankruptcy.

**2.4.1. Should such restructuring measures always require, at some stage, the opening of some sort of a formal procedure in which a court (or other competent authority or body) is involved?**

- ○ a) Yes, as of the beginning of the negotiations on a restructuring plan
- ○ b) Yes, from the moment it becomes necessary to stay enforcement actions (moratorium) or obtain confirmation for the restructuring plan
- ○ c) No, the involvement of a court should not be an absolute requirement
- ◉ d) Other options
- ○ e) No opinion

**Please explain**

It is important that debtors have access both to preventative (i.e., pre-insolvency) measures, as well as post-petition measures, that are designed to give that business, if viable, an opportunity to restructure or reorganise itself and continue as a going concern. This would benefit employees, creditors, and the economy as a whole.

Creditors and debtors should be given an opportunity to agree a restructuring plan without court supervision.

However, once it becomes clear that stay of enforcement actions will be imposed, or a cramdown of minority creditors will be enforced, or that protected new financing will be necessary for the company to continue as a going concern, it is important that courts become involved to make sure that these and other procedures
are necessary and fair for all of the stakeholders involved

**2.4.2. Should such restructuring procedures always require publicity (e.g. through an Insolvency Register)?**

- ○ a) Yes, as of the beginning of the negotiations on a restructuring plan
- ○ b) Yes, from the moment it becomes necessary to stay enforcement actions (moratorium) or obtain confirmation for the restructuring plan
- ○ c) No, publicity should not be an absolute requirement
- ◉ d) Other options
- ○ e) No opinion

**Please explain**

Publicity should not be an absolute requirement. Because of the stigma attached to restructuring negotiations and other actions, and the potential impact on the company's ongoing business (i.e. supplier and customer perceptions), the parties involved should be given an opportunity to agree a plan before it becomes public knowledge.

**2.5. Restructuring measures in which the courts are involved to a lesser degree (e.g. only for the confirmation of a restructuring plan) or not at all (e.g. an out-of-court process) should be available to:** (choose all that apply)

- ☑ a) Microenterprises (up to 10 employees)
- ☑ b) Small and medium-sized enterprises, excluding microenterprises
- ☑ c) Large enterprises
- ☑ d) Other
- ☐ e) No opinion

**Please explain**

As stated above, in the first instance creditors and debtors should be afforded an opportunity to agree a
restructuring or reorganisation plan without court involvement. Court intervention in this context should be limited to a supervisory role, including checking key milestones of the restructuring proceedings and making sure that the process was fairly and appropriately agreed by the parties. This would help to avoid unfair, burdensome and unduly time-consuming processes.

**2.6. Who should do the assessment of whether a debtor is viable and fit for restructuring?**

- ○ a) The courts or external experts appointed by the courts
- ○ b) The debtor or external experts chosen by the debtor
- ○ c) The creditors or external experts chosen by the creditors
- ◉ d) Other persons or bodies than those listed in points a), b) or c)
- ○ e) No one
- ○ f) No opinion

**Please specify who**

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If the creditors and the debtors agree that the company is viable and fit for
restructuring, they should be permitted to agree a plan for such
restructuring.  However, if the parties cannot agree, then any such decision
should be made by a court or an external expert appointed by the court.
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**2.7. Is there a need for a common definition of insolvency at EU level?**

- ◉ a) Yes
- ○ b) No
- ○ c) Other
- ○ d) No opinion

**2.7.1. What should be included in such a definition (insolvency test)?**

- ○ a) Inability to pay debtsas soon as they fall due (illiquidity/cash flow test)
- ○ b) Value of a company's assets compared with its liabilities, including prospective and contingent liabilities (balance sheet test)
- ○ c) The combination of an illiquidity and a balance sheet test
- ◉ d) Other
- ○ e) No opinion

**Please specify**

```
While a combination of an illiquidity and a balance sheet test could be
workable, any definition should be flexible enough that it can, if necessary,
be tailored to a specific situation, company or industry.
```

**2.8. Should debtors in the context of restructuring measures be able to keep control over the day-to-day operations of their business (so-called 'debtor-in-possession arrangements')?**

- ○ a) Yes, without any supervision or control
- ● b) Yes, but subject to supervision from a suitably qualified mediator/ supervisor/ court
- ○ c) Yes, but subject to conditions other than supervision from a suitably qualified mediator/ supervisor/ court
- ○ d) No, debtors should not be able to keep control over the day-to-day operations at all
- ○ e) Other
- ○ f) No opinion

**Please explain**

If a viable company is to be given a chance to reorganise and continue as a going concern, it may be necessary that debtors (i.e., the management) is allowed to continue to run the business on a day-to-day basis in order to take advantage of their experience with and knowledge of the company (of course, in the absence of fraud or gross negligence or incompetence). However, this control should be subject to some form of oversight or supervision, either from creditors, an outside mediator/administrator or a court.

As to the role of mediators, we fully share the principle set out in the European Commission Recommendations 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. However, we would welcome the introduction of minimum standardized rules on the role of mediators, which should include among others: (i) professional qualification standards; and (ii) general principles covering their remuneration.

**2.9. When should debtors be able to ask for a stay of individual enforcement actions?**

- ○ a) Only in formal insolvency proceedings
- ● b) In formal insolvency proceedings and in preventive/pre-insolvency restructuring procedures
- ○ c) Other
- ○ d) No opinion

**Please explain**

```
If sanctioned by a court, debtors should be able to ask for stays of
individual enforcement actions.  Without
court approval, such stays should be allowed if agreed by both creditors and
debtors (and other relevant stakeholders).

The benefits of permitting a stay in order to allow the company breathing time
to agree and implement a viable restructuring plan should be balanced,
however, with the need to make sure that the stay is not so long or onerous
that it ties up funding or discourages investment.  In order to provide for a
fair balance between the rights of the debtor and those of creditors, stay
periods should not be granted for more than [2-3] months, with the possibility
of renewal (but only if the restructuring plan proves, or reasonably promises,
to be successful).   . Moreover, there should be a possibility of lifting the
stay if it becomes clear that it is not working or that agreement will not be
reached on the restructuring plan.
```

**2.9.1. For how long should the enforcement of actions of individual creditors be stayed once the restructuring attempts are ongoing?**

- ○ a) 2-3 months, without the possibility of renewal
- ○ b) 4-6 months, without the possibility of renewal
- ◉ c) 2-3 months, with the possibility of renewal in certain circumstances
- ○ d) 4-6 months, with the possibility of renewal in certain circumstances
- ○ e) Any time limit set by the court subject to the fulfilment of certain conditions
- ○ f) Other
- ○ g) No opinion

**Please explain**

```
The appropriate length of any stay of enforcement will depend on the
particular situation,

The length of a stay procedure must balance the interests of debtors and
secured creditors. It must be long enough to allow for sufficient time to
secure the business, but not so long as to erode confidence in asset-based
lending. Therefore, stay proceedings should not be so long or onerous that
they trap financing or unduly prevent or discourage creditors from providing
necessary financing to the market. A stay provision that is too long or
onerous may, in certain circumstances, actually erode value.
```

**2.9.2. Should an individual creditor be allowed to ask the court to lift the stay granted to the debtor?**

- ○ a) Yes, in all cases
- ◉ b) Yes, subject to certain conditions
- ○ c) No
- ○ d) Other
- ○ e) No opinion

**Please explain**

Creditors should be permitted to petition a court to lift a stay of enforcement action in prescribed circumstances. Any legislative initiative should enumerate the circumstances under which a creditor is allowed to bring such a petition.

**2.10. Should a restructuring plan adopted by the majority of creditors be binding on all creditors provided that it is confirmed by a court?**

- ○ a) Yes, including on secured creditors
- ○ b) Yes, but secured creditors should be exempted
- ○ c) No
- ◉ d) Other
- ○ e) No opinion

**Please explain**

The possibility  of a "cramdown" on minority dissenting creditors is very important so that creditors with no remaining economic interest in a distressed company are not able to veto any plan approved by the other parties, and cannot therefore make it more likely that a viable company will end up in liquidation rather than given a second chance. Any such cramdown should be sanctioned or approved by a court to make sure that it is necessary and reasonable under the particular circumstances.

**2.10.1. Should a '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), be possible?**

- ○ a) Yes, in all cases
- ◉ b) Yes, but subject to certain conditions
- ○ c) No
- ○ d) Other
- ○ e) No opinion

**Please specify**

```
A cross-class cramdown should be possible if sufficient percentage of
creditors that still have an economic
interest in the enterprise  agree (with reference to ranking of claims). Any
such cramdown should, however,
should be sanctioned by a court to ensure that it is fair to all parties and
is necessary for the distressed company to continue as a going concern.
```

**2.11. Should financing necessary for the implementation of a restructuring plan/ensuring current operations be protected if the restructuring subsequently fails and insolvency proceedings are opened?**

- ○ a) Yes, always
- ○ b) Yes, but only if agreed in the restructuring plan and confirmed by the court
- ○ c) No, never
- ◉ d) Other
- ○ e) No opinion

**Please specify**

New financing is a key restructuring tool which allows companies to receive additional financing to meet their funding requirements whilst a restructuring plan is devised and executed . Creditors who decide to inject liquidity in a distressed company should be given a sufficient degree of certainty and predictability on the recovery of their investment. Otherwise, potentially interested investors could be discouraged and companies in desperate need of working capital might be left without the possibility of financing their day-to-day operations, to the detriment of the real economy.

Any new financing should have adequate and relevant protection both pre- and post-petition (including from undue court challenges or modification in the event of bankruptcy) in order to encourage investors to provide new financing to companies in distress. Otherwise potential creditors will be dis-incentivised to provide new financing to a company in distress. Such financing, and any protections afforded to such financing should, however, be agreed in the restructuring plan and confirmed by a court to ensure that it is necessary for the company to continue as a going concern and that it is fair to the existing creditors.

**2.12. Should directors of companies be incentivised to take appropriate preventive measures if companies are in distress but not yet insolvent, for example by being able to avoid related liability?**

- ◉ a) Yes
- ○ b) No
- ○ c) Other
- ○ d) No opinion

**Please explain**

```
There is still a fair amount of stigma attached to a director of a company
that enters insolvency proceedings.
For this reason, it sometimes happens that Directors wait too long to seek
assistance or to take other unfortunate actions in fear of being held
responsible for the company's troubles, even if such troubles
 are not necessarily due to the directors' actions or inaction.

Therefore, it would be helpful for any legislative initiative to include
incentives for directors to take necessary action at the appropriate time and
to be as forthcoming as possible without fear of civil or criminal liability
(of course, in the absence of fraud, gross negligence or other malfeasance).

Specific measures could be considered (e.e., a committee of independent
directors or independent advisers) when management coincides with
shareholders, as is often the case with privately held companies.
```

**2.13. Should Member States be encouraged to take specific action to help debtors in financial distress, such as setting up special funds or insurance systems covering the provision of cheap and accessible restructuring advice, possibly subject to certain conditions?**

- ○ a) Yes, for all debtors
- ○ b) Yes, but only for SMEs
- ◉ c) Yes, but only for SMEs and individuals
- ○ d) Yes, but only for individuals
- ○ e) No
- ○ f) Other actions
- ○ g) No opinion

## 3. Second chance

The Competitiveness Council in May 2011[3] invited Member States to promote a second chance for entrepreneurs by limiting, where possible, the discharge period and enabling debt settlement for honest entrepreneurs once they are insolvent. An 'honest' failure is a case in which the business failure occurred through no obvious intentional fault of its owner or director, i.e. it was honest and above-board. This would be contrary to cases in which the bankruptcy was fraudulent, for example where the debtor transferred its assets outside the jurisdiction, made an advance payment to a single creditor, accumulated excessive private expenses, etc.

An important element to support an effective second chance regime is the 'time to discharge'. This is the time from when an entrepreneur enters into insolvency proceedings to when he/she can effectively restart an entrepreneurial activity. Currently, the discharge time varies significantly from country to country. In some countries, honest entrepreneurs in bankruptcy are automatically granted a discharge immediately once liquidation of the assets is finished. In others, bankrupted entrepreneurs have to apply for a discharge, while in some countries they cannot obtain discharge at all.

Furthermore, the procedures to release consumers from a 'debt trap' vary significantly between Member States. In some countries, there is no bankruptcy or debt settlement procedure for consumers. In others, a general insolvency regime with some changes applies to consumers.

[3] Council of the European Union, Competitiveness (Internal Market, Industry, Research and Space), Brussels, 30 and 31 May 2011. Press release available at: https://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/intm/122359.pdf.

**3.1. Should honest debtors (entrepreneurs and consumers) who are over-indebted be offered the chance to restructuring their debt?**

- ○ a) Yes, entrepreneurs (individuals) as well as consumers
- ○ b) Only entrepreneurs (individuals) for debts related to their professional activity
- ○ c) Only consumers
- ○ d) Neither entrepreneurs (individuals) nor consumers
- ○ e) Other options
- ◉ f) No opinion

**3.2. Should over-indebted individuals have access to free or low cost debt advice?**

- ○ a) Yes, entrepreneurs (individuals) and consumers, possibly subject to certain conditions
- ○ b) Only entrepreneurs (individuals) for debts related to their professional activity, possibly subject to certain conditions
- ○ c) Only consumers, possibly subject to certain conditions
- ○ d) Neither entrepreneurs (individuals) nor consumers
- ○ e) Other options
- ◉ f) No opinion

**3.3. Should a full discharge of debts, possibly subject to certain conditions, be offered to all over-indebted individuals provided they are 'honest' debtors?**

- ○ a) Yes, to entrepreneurs (individuals) and consumers
- ○ b) Only to entrepreneurs (individuals) for debts related to their professional activity
- ○ c) Only to consumers
- ○ d) Neither to entrepreneurs (individuals) nor to consumers
- ○ e) Other options
- ◉ f) No opinion

**3.4. If it is decided that the discharge of debts should be offered to all individuals, whether entrepreneurs or consumers, should the conditions for the discharge be the same?**

- ○ a) Yes
- ○ b) No, the conditions applicable to entrepreneurs should be stricter than those applicable to consumers
- ○ c) No, the conditions applicable to consumers should be stricter than those applicable to entrepreneurs
- ○ d) Other options
- ◉ e) No opinion

## 4. Increasing the efficiency and effectiveness of the recovery of debts

The efficient and effective recovery of debts depends on many factors. The recovery rates of debts may depend on:

- the effectiveness of insolvency proceedings;
- their length;
- the specialisation of the people dealing with them;
- the qualification of the directors of distressed companies.

The recovery rate of debts also has an impact on high levels of non-performing loans in the EU.

The laws of Member States differ significantly on the priority of claims in insolvency. This has an impact on how insolvency proceedings are run and how debts are recovered. Laws 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.

Also, the laws of Member States have different rules on insolvency practitioners themselves, namely the qualifications and eligibility for their appointment and also their licensing, regulation, supervision, professional ethics and conduct. The questions related to insolvency practitioners concern any mediators or supervisors engaged in the insolvency process. Moreover, in most Member States, insolvency proceedings are administered by a judicial authority, often 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.

There is currently no rule at EU level which ensures that directors who have been disqualified in one Member State, e.g. because of fraudulent behaviour, are prevented from setting up a new company or from being appointed as director of a company in another Member State. This means that disqualified directors can easily move from one Member State to another and manage companies in the EU even if they were not allowed to, at least for a certain period of time, in the Member State that disqualified them. The European Commission supports cross-country access to information about whether directors have been disqualified. The Commission will establish a decentralised system to interconnect insolvency registers. Under this system, Member States are invited, in accordance with Article 24(3) of Regulation (EU) 848/2015, to include in their national insolvency registers documents or additional information such as insolvency-related disqualifications of directors.

**GENERAL QUESTIONS**

**4.1. To what extent do existing differences between the laws of the Member States in the areas mentioned below affect the functioning of the Internal Market?**

*(For example, differences affect the Internal Market when creditors or investors and debtors are located in different Member States and this has an impact on the recovery of debts, the legal certainty of transactions, the quantification of risks etc.)*

| | To a large extent | To a considerable extent | To some extent | Not at all | No opinion |
|---|---|---|---|---|---|
| a) Minimum standards on the ranking of claims in formal insolvency proceedings | | X | | | |
| b) Minimum standards on avoidance actions | | X | | | |
| c) Minimum standards applicable to insolvency practitioners/mediators/supervisors | | X | | | |
| d) Measures providing for a specialisation of courts or judges | | X | | | |
| e) Measures to shorten the length of insolvency proceedings | | X | | | |
| f) Measures to prevent disqualified directors from starting new companies in another Member State | | | X | | |
| g) Other measures | X | | | | |

**Please explain**

In a cross border context, differences in laws relating to ranking of claims increase uncertainty and can make an insolvency proceeding unnecessarily complicated and time consuming as a creditor's rights, responsibilities and appropriate actions will differ based on the ranking of its investment. This may also lead to inconsistent and confusing results.

Avoidance actions, legal/administrative practitioners and frameworks, and length and efficiency of insolvency proceedings are all important in making sure that investors can recover their investments in an effective and timely manner and that capital is quickly and appropriating freed up to be invested in the markets and economies of Europe.

As a practical matter, the length and complexity of insolvency proceedings, particularly in cross-border contexts, has the potential to tie up capital, delay the delivery of assets to the appropriate parties and perhaps discourage investment in certain jurisdictions. While, in many cases, complex issues of law must be considered, sometimes in multiple jurisdictions, we believe that it is important that any legislative proposals or recommendations be designed to reduce the length and complexity of insolvency proceedings across Europe.

As a specific measure to reduce the length of insolvency proceedings, we advocate to introduce, in case of a bankruptcy, a maximum period of 180 days for drafting a liquidation plan. The plan should include requirements for periodic reporting by the insolvency practitioner on their progress with respect to liquidating the assets of the relevant company(s). The 180 day period should not be seen as a deadline for actually liquidating the assets as this might have an impact on the ability of creditors to realise the highest value from the assets by forcing the insolvency practitioner to quickly sell assets on unfavourable terms.

Overall, any Eu insolvency framework should emphasise the importance of:

(1) generally respecting the creditor hierarchy
(2) pari passu distributions - i.e., ensuring that similarly situated claimants share equally in what is properly available to any of them and
(3) limiting the extent to which property available to satisfy the valid claims of a creditor can be appropriated without permission or sanction of a court (i.e., no creditor is left worse off).

**4.2. Which measures would contribute to increasing the recovery rates of debts?** (choose all that apply)

- ☑ a) Minimum standards on the ranking of claims in formal insolvency proceedings
- ☑ b) Minimum standards on avoidance actions
- ☑ c) Minimum standards applicable to insolvency practitioners/mediators/supervisors
- ☑ d) Measures providing for a specialisation of courts or judges
- ☑ e) Measures to shorten the length of insolvency proceedings
- ☐ f) Measures to prevent disqualified directors from starting new companies in another Member State
- ☑ g) Other measures
- ☐ h) No opinion

**Please explain**

World Bank data has, not surprisingly, found that recovery rates are highest where there are strong
procedures for, and opportunities to, restructure or reorganise a company (rather than liquidation). We agree with the Commission's March 2014 Insolvency recommendations, which cited the following factors as important in increasing recovery rates:

a) permitting the debtor to retain control of the business and to request a temporary stay of individual enforcement actions;

b) the possibility of an approved restructuring plan "cramming down" dissenting or apathetic creditors if
confirmed by the court; and

c) various protections for lenders willing to provide new financing to assist in the implementation of a
restructuring plan.

**SPECIFIC QUESTIONS**

**4.3. Which claims should have priority in insolvency proceedings (i.e. be satisfied first from the proceeds of the insolvent estate)?** (choose all that apply)

- ☐ a) Secured creditors should be satisfied in principle before all other creditors
- ☑ b) Secured creditors should be satisfied before unsecured creditors but not before privileged creditors such as employees and/or tax and social security authorities
- ☐ c) Tort claims should have a higher priority than other unsecured claims
- ☐ d) Other ranking of priorities
- ☐ e) No opinion

**Please explain**

```
It would be difficult, from both a cultural and political viewpoint, to
institute an insolvency  framework where trade and financial creditors are
paid prior to tax, social security or employee-related entities or groups.
However, secured creditors should be able to rely on the priority afforded
them as creditors with security
over the debtor's assets. Therefore, these creditors should retain priority
over unsecured creditors or equity holders, for instance.
```

**4.4. What minimum standards should be harmonised for 'avoidance actions'?** (choose all that apply)

- [x] a) Rules on the types of transactions which could be avoided
- [x] b) Rules on 'suspect periods' (periods of time before insolvency when a transaction is presumed to be detrimental to creditors)
- [x] c) Other rules
- [ ] d) No opinion

**Please explain**

```
It should be very clear in any  legislative initiative on insolvency which
types of transactions could be avoided,
as well as rules on suspect periods, and any assumptions that will be used in
determining whether an action should be avoided (and also all actions, if any,
that will be presumed to be acceptable and
therefore not necessarily avoided).

It may be advisable to provide a list of "safe harbour" transactions that
would be presumed to have been made in good faith and therefore not subject to
avoidance actions.
```

**4.5. In what areas would minimum standards for insolvency practitioners help to increase the efficiency and effectiveness of insolvency proceedings?** (choose all that apply)

- [x] a) Licensing and registration requirements
- [x] b) Personal liability
- [ ] c) Subscribing to a professional liability insurance scheme
- [x] d) Qualifications and training
- [x] e) Code of ethics
- [x] f) Other
- [ ] g) No standards should be harmonised
- [ ] h) No opinion

**Please specify**

It is important that judicial and administrative insolvency practitioners are experienced and competent to deal with the myriad of practical, legal, regulatory and mediatory aspects of an insolvency proceeding, particularly with respect to the increasing number of sophisticated and complicated cross-border transactions and investments.

Taking into consideration that insolvency practitioners may influence in a considerable way the outcome of insolvency proceedings, we would welcome the introduction of minimum standardized rules on the role of mediators, which should include among others: (i) licensing and professional qualification standards; (ii) general principles covering their remuneration, (iii) prerequisite levels of experience and (iv) a code of ethics (which could include provisions regarding mutual recognition and cooperation with proceedings held in, and appropriate decisions made by, other European jurisdictions).

As to professional qualification standards:

Members States should ensure that insolvency practitioners are selected among people who have strong and relevant professional qualifications (i.e.: academics with expertise in law and economics; experts enrolled in the professional registers in the countries where they pursue their activities and with an adequate level of relevant experience; retired bankruptcy judges; and professionals in possession of a significant and proven expertise in the field of insolvency). Furthermore the selection procedure should guarantee that nominees are chosen by both representatives of the credit institutions and the borrowers.

As to remuneration principles:

In some European jurisdictions insolvency practitioners (such as mediators) are remunerated based on a percentage fee based on the recovered assets. This may cause a potential conflict of interest since mediators might be tempted to act in their own interest, rather than on behalf of the involved parties. The EU Directive should foresee a different remuneration system to avoid such possible conflicts of interest. This might include a requirement for a Creditor Committee to oversee the fees of the insolvency practitioners.

Licensing and registration requirements will help to keep track of which practitioners are working on, or have worked on, particular insolvencies, while qualifications and training will help to ensure that proceedings are conducted in a competent, professional and efficient manner, and a code of ethics will help to ensure that these parties are acting in the best interests of all parties involved.

**4.6. Which additional minimum standards, if any, should be imposed on insolvency practitioners specifically dealing with cross-border cases?** (choose all that apply)

- ☑ a) Relevant foreign language knowledge
- ☑ b) Sufficient human and financial resources in the insolvency practitioner's office
- ☑ c) Pre-defined period of experience
- ☐ d) Others
- ☐ e) No additional standards are needed compared with those relevant for domestic insolvency cases
- ☐ f) No opinion

**4.7. What are the causes for the excessive length of insolvency proceedings?** (choose all that apply)

- ☑ a) Judicial activities concerning the supervision or administration of insolvency proceedings
- ☑ b) Delays in the liquidation of the debtor's assets
- ☑ c) 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)
- ☑ d) A lack of promptness in exercising creditors' rights
- ☐ e) 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.
- ☐ f) Other
- ☐ g) No opinion

**Please explain**

All of the factors referred to above contribute to the excessive length of insolvency proceedings but an overarching problem remains the complexity and time commitment necessary to organise and conduct an insolvency proceeding when multiple jurisdictions or applicable laws are involved. This is increasingly the case with cross border transactions and the number and sophistication of such transactions will likely increase in the future.

In many such cases, there are various entities, security interests and credit support attached to a single transaction, and these parties and interests are often scattered across various European jurisdictions. In this case reference to separate and disparate insolvency regimes makes it extremely difficult to quickly and efficiency determine liquidate assets, determine and exercise creditor rights and generally obtain final decisions concerning the rights and duties of the debtor. The implementation of appropriate minimum insolvency standards across Europe would go a long way in alleviating some of these difficulties.

In addition, creditors in many Members States struggle with lengthy foreclosure proceedings, which make credit recovery difficult to predict and quite uncertain. In order to counterbalance such problems, it might be advisable to: (i) allow creditors to immediately enforce that part of the credit that has not been challenged by the debtor and (ii) provide for a fixed time-limit for the corresponding foreclosure to be completed.

Moreover, in order to accelerate the insolvency proceedings, hearings and creditor meetings could be organized without requiring their physical presence, leveraging on new / digital technology.

**4.8. Would a target maximum duration of insolvency proceedings — either at first instance or including appeals — be appropriate?**

- ○ a) Yes
- ○ b) Yes, but only for SMEs
- ○ c) No
- ● d) Other possibilities
- ○ e) No opinion

**Please explain**

```
The question above presupposes that all insolvency proceedings will be court
driven. As some processes can be creditor driven, it is important that any
consideration of maximum duration for insolvency proceedings does not result
in limiting or restricting the rights of creditors.

In any case, a targeted maximum duration for insolvency proceedings, or the
liquidation of assets, would be difficult to enforce in practice, particularly
in large cross-border proceedings.  It is also difficult to envision what
would happen once any maximum time limit had been reached.

Emphasis should be placed on the principle of timely proceedings rather than
hard limits that may impact creditor recoveries.
```

**4.9. What incentives could be put in place to reduce the length of insolvency proceedings?** (pleas e explain)

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The following factors might help in reducing the length of insolvency
proceedings:

a) Cramdown of minority creditors (where appropriate and approved by a court),


b) specialisation/increased expertise of insolvency practitioners,
administrators and legal personnel, and

c) for the reasons stated in our previous responses. general implementation of
appropriate minimum insolvency standards and procedures across Europe.

d) provisions for a specific streamlined process in insolvency cases where
there are no assets to liquidate.
```

**4.10. When disqualification orders for directors are issued in one Member State (i.e. the 'home State'), they should:**

- [x] a) be made available for information purposes via the interconnected insolvency registers so that other Member States are informed
- [ ] b) automatically prevent disqualified directors from managing companies in other Member States
- [x] c) not automatically prevent disqualified directors from managing companies in other Member States, but make them subject to intermediary steps (e.g. a court order)
- [ ] d) Other options
- [ ] e) No opinion

**Please explain**

```
Information about disqualified directors should be shared with all member
states, but this should not automatically disqualify such parties from
managing businesses in all instances.  While some disqualification actions or
behaviours may be so egregious as to merit disqualification across all
European jurisdictions, in some cases, the rules for disqualification under
local law should be considered. Any such person should, however, be subject to
court approval or some other formal process before being allowed to manage a
company in any European jurisdiction.
```

**4.11. Directors disqualified in one Member State (home State) should be prevented from managing companies in other Member States (host States):** (choose all that apply)

- [ ] a) Always
- [x] b) Only for the duration applicable to equivalent disqualification orders in the host State
- [ ] c) Only in the same or similar sector of activity
- [ ] d) Never
- [ ] e) Other options
- [ ] f) No opinion

**4.12. Which measures would contribute to reducing the problem of non-performing loans?** (choos e all that apply)

- [x] a) Measures to improve the effectiveness of insolvency proceedings
- [x] b) Measures enabling the rescue of viable businesses
- [x] c) Measures to provide user-friendly information about national insolvency frameworks
- [ ] d) Measures to ensure a discharge of debts of entrepreneurs (individuals)
- [ ] e) Measures to ensure a discharge of debts of consumers
- [x] f) Other measures related to insolvency
- [ ] g) Measures unrelated to insolvency (e.g. enforcement of contracts)
- [x] h) No opinion

**Please explain**

The NPL issue is particularly pressing. Based on a standard definition, the ECB's 2014 comprehensive assessment identified €879 billion in non-performing exposures in the banking system. In its most recent economic assessment on the Euro area, the IMF found that "high NPLs are hindering lending and the recovery" and highlighted pan-European insolvency reform as a priority in order to reduce the large stock of NPLs. The IMF finds that "NPL disposal can free up large volumes of regulatory capital and generate significant capacity for new lending", calculating that freeing-up capital disposed for NPL could unlock new lending of between €167-€522 billion, provided there is corresponding demand for new loans.

There is evidence that sound insolvency regimes contribute to accelerating the speed of adjustment of NPLs. Countries with stronger insolvency regimes are able to adjust more rapidly their NPL ratios than countries with weaker regimes. The rationale of this finding is that stronger insolvency frameworks facilitate the restructuring and continuation of debtor's operations and therefore smooth the progress towards a rapid positive change in unsustainable debt levels. This result is supported by IMF analysis which found that countries with stronger insolvency regimes deleveraged more rapidly in the post crisis period.

Therefore it is clear that strengthening Europe's insolvency framework by implementing minimum insolvency standards designed to strengthen insolvency regimes across Europe will have a positive contrition to reducing the problem of non-performing loans.

In addition to this general point, it might also be helpful for any legislative initiative to take steps to strengthen enforcement frameworks in Europe when appropriate, and taking into account all of the relevant factors and the overall objective of giving a viable company an opportunity to restructure or reorganise and continue as a going concern. In doing this, it would be worth to leverage on the best practices set by jurisdictions where these enforcement frameworks have already been implemented and proven effective in making it easier and faster for creditors to recover their debts. This is particularly the case of the UK where - at the occurrence of certain conditions agreed upon by the debtor and creditor - secured creditors may obtain to retain property of the underlying secured asset.

Moreover, in the context of ordinary enforcement procedures, we would suggest to allow the direct/automatic enforcement of the claims or part of the claims that have not been objected by the debtor, without any court intervention.

## 5. Additional comments

**Are there any additional comments you wish to make on the subject covered by this consultation?**

We believe that the proposals set out in the Commission Recommendation of 12.3.2014 provide a very helpful basis for future insolvency reform at both national and European level. While a new EU legislative initiative is in preparation and then under discussion with the co-legislators, we would encourage the Commission to continue to promote domestic insolvency reform within the EU Member States based on the principles of the 2014 Recommendation. This would culminate in a 'twin-track' approach to reform, with a consistent direction at EU and national level.

In addition, please see the following attachments to our consultation response:

Appendix 1 - a short document setting out the features that we believe should be included in any legislative initiative containing minimum insolvency standards to be applied across Europe; and

Appendix 2 - a short document setting out our views on the practical and economic benefits of European insolvency reform.

**You can also send a separate written contribution by uploading your document here:**

**213ed5ef-5deb-4623-912a-fe069077afe7/EC_Insolvency_consultation_-_APPENDIX_2.docx**
**6f146d71-9bc7-4942-885a-1755aed873fd/Insolvency_consultation_paper_-_APPENDIX_1__final_.docx**

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Finance for Europe

THE INVESTMENT ASSOCIATION

# APPENDIX 1

## MATTERS FOR CONSIDERATION AND INCLUSION IN ANY LEGISLATIVE INITIATIVE RELATING TO MINIMUM INSOLVENCY STANDARDS ACROSS EUROPE

**Introduction**

The Association for Financial Markets in Europe ("**AFME**") represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. The Investment Association ("**IA**") represents the institutional investors that provide funding to the businesses that are critical to a prosperous European economy. We are both keen to ensure that any European insolvency framework brings about a greater convergence of insolvency and restructuring practices and proceedings that would facilitate and encourage cross border investment and greater legal certainty for investors and other market participants, as well as encourage the timely restructuring of viable companies in distress. It is important that such a framework addresses the most important substantive and procedural barriers to the free flow of capital and, to the extent possible, builds upon national regimes that work well in this area.

As an initial matter, we point out that our response is focused on corporate insolvency only and uses the term "creditor" to refer to both banks and institutional investors as providers of debt financing to companies. In this context, we set out below the items that we believe should be included in any legislative proposal related to minimum insolvency standards across Europe.

We believe that major differences between national insolvency frameworks in Europe have a range of negative effects on the economy and financial markets, including:

- discouraging cross-border investment (particularly with respect to multinational companies or those with complicated financing structures), thereby reducing the efficiency of EU capital markets in general;
- discouraging the timely restructuring of viable companies in financial difficulties, often resulting in a distressed company entering liquidation rather than restructuring as a going concern;
- increasing uncertainty amongst issuers, investors and other stakeholders with respect to creditor recovery rates;
- putting SMEs at a competitive disadvantage, as they generally do not possess the financial resources required to take advantage of more efficient restructuring procedures available in other member states; and
- making it harder to address high levels of non-performing loans (NPLs), which absorb bank capital, reduce the efficiency of capital allocation, and represent a challenge to banking system stability.

Because of the divergence in European national insolvency rules and practices, creditors, administrators and other stakeholders involved in an insolvency proceeding can expect to receive different rights, obligations, protections and outcomes depending on the European jurisdiction in which the proceeding is conducted. These differences lead to uncertainty and inefficiency, and can, on a cumulative basis, have a negative effect on European capital markets.

**Recommendations for inclusion in legislative insolvency initiative**

With the above matters in mind, we consider the following elements as the most important to enhance the efficiency of European insolvency practices, notably by enhancing the possibilities for restructuring, and also as the mot important items to be included in any legislative proposal related to minimum insolvency standards across Europe:

**Stay**

By preventing precipitate action by creditors, a stay procedure is critical to the successful rescue or orderly workout of a failing business. Most EU member states have some form of stay but arguably the precise forms in certain jurisdictions do not go far enough. Because of the divergence in European national insolvency rules and practices, creditors, administrators and other stakeholders involved in an insolvency proceeding can expect to receive different rights, obligations, protections and outcomes depending on the European jurisdiction in which the proceeding is conducted. These differences lead to uncertainty and inefficiency, and can, on a cumulative basis, have a negative effect on European capital markets.

Stay provisions need to strike a balance between preventing precipitate action by creditors and offering certainty and predictability around the contractual provisions linking debtors and creditors. Inadequate or overly restrictive stay provisions are likely to reduce the chances for a successful turnaround and damage the overall value of the business. 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. Alternatively, upon a default, an ineffective stay might not prevent creditors from instituting proceedings to seize secured assets or taking other actions that would hinder a successful restructuring.

The length of a stay procedure must balance the interests of debtors and secured creditors. It must be long enough to allow for sufficient time to secure the business, but not so long as to erode confidence in asset-based lending. Therefore, stay proceedings should not be so long or onerous that they trap financing or unduly prevent or discourage creditors from providing necessary financing to the market. A stay provision that is too long or onerous may, in certain circumstances, actually erode value. For example, a stay period should be granted for no more than is reasonable under the circumstances. This period should be permitted to be renewed, but only upon evidence of reasonable progress in negotiation of the restructuring plan, as stated in the EC 2014 Recommendations. On the other hand, in extraordinary circumstances there should be a possibility of lifting the stay period.

**Valuation**

A reliable valuation is a critical aspect of insolvency proceedings, and progress should be made toward a consistent framework should be created for fast judicial resolution of valuation disputes.

Valuation is necessary in order to:

1. establish whether a distressed company is technically insolvent or able to continue to trade;
2. determine which stakeholders retain an economic interest in the business;
3. inform any restructuring plan, whether creditor- or debtor-led; and
4. assign new interests to stakeholders as appropriate, including rights to any future value in the restructured company.

In a restructuring context, the two main valuation methodologies used to assess a company's value are "going concern" valuations and liquidation (or "gone concern") valuations. A going concern valuation assesses the value of a company as an operating business and therefore ascribes value both to the company's assets and its future earning power and prospects.

In contrast, a gone concern valuation is concerned only with determining the value of a company's individual assets sold on a piecemeal basis out of an insolvency process, and therefore, tends to be lower than a going concern valuation. Thus, a universally applied going concern valuation approach is likely to save more viable businesses than a liquidation valuation approach.

Unlike the United States, Europe does not yet have a consistent methodology for valuing companies in a restructuring process. Each member state has its own rules governing the technical basis for insolvency, which leads to inconsistent outcomes, particularly for a cross-border group of companies. There is also currently no consistent method or platform for resolving shareholders' disputes as to the basis of valuation, short of a company entering formal insolvency proceedings.

A more harmonised approach to valuation would provide creditors with greater certainty and predictability regarding their rights when a company faces financial difficulties, enabling commercial parties transacting across EU borders to more accurately evaluate downside risks. A desirable minimal requirement, which has already been implemented in some European jurisdictions, would be a "Best interests test" to establish whether creditors are at least as well off under the proposed restructuring plan as they would be under a liquidation scenario.

In addition, while in certain European countries there are proceedings outside of formal insolvency which use their own valuation methods, a more consistent framework could be created across Europe to resolve valuation disputes quickly outside formal insolvency proceedings. This would enable practice and precedent to develop in restructuring valuations, providing stakeholders relative certainty of outcome, whilst avoiding the value loss associated with formal insolvency proceedings.

Furthermore, such an assessment should be made by external experts/auditors, with adequate professional expertise and experience, chosen by the creditor or if there is court involvement, by the court].

**Cramdown**

Creditors or shareholders with (on a proper valuation basis) no economic interest in the enterprise, should not be in a position where their "veto" could force the commencement of formal insolvency proceedings or delay otherwise viable restructurings. There should be a possibility, under appropriate circumstances, for decisions made by creditors with a continuing economic interest in the enterprise to bind creditors that no longer have an economic interest (otherwise referred to as a "cramdown" of such "out-of-the-money" creditors).

Having established a valuation for the enterprise to be restructured, it may become evident that some lower ranking stakeholders (e.g. shareholders and subordinated creditors) would likely receive little or no return on their credit or investment under the insolvency proposal and therefore no longer have an economic interest in the enterprise. Traditionally, however, the agreement of these "out-of-the-money" junior creditors and/or shareholders would nevertheless be required for an out-of-court restructuring. More recently, parties have realised that making a restructuring dependent upon the consent of stakeholders with no remaining economic interest in an enterprise is not conducive to an efficient restructuring.

Ad hoc approaches to cramdown create uncertainty concerning stakeholders' rights and, ultimately, make restructurings outside of formal insolvency proceedings more difficult. The issue will become increasingly important as more complex capital structures predominate. Practice currently varies across Europe. With respect to cramdown procedures, English courts apply a "fairness test" prior to sanctioning an English scheme of arrangement. This contrasts with Spain where creditors suffering a "disproportionate sacrifice"[1] may only challenge a scheme after it has been sanctioned by the court.

To create a robust and readily available cramdown regime that effectively binds out-of-the-money stakeholders, minority dissidents and apathetic creditors, there should be more consistency and an improvement in minimum requirements and protections for those affected stakeholders dissidents to ensure that this tool is being used fairly. In particular, creditors or shareholders who no longer have an economic interest in the enterprise as determined by a universally approved valuation methodology should not be in a position where their "veto" forces formal insolvency proceedings or delays otherwise viable restructurings.

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[1] This term is not defined under Spanish law and nor has any guidance been developed by Spanish courts

**Role of creditors**

Member states should allow creditors or third parties to play a more influential role, even in formal insolvency proceedings, including permitting creditors to propose insolvency plans, and providing creditors with all relevant information about the affected enterprise and any proposed plans or proceedings, as early in the process as possible. The participation of creditors or third parties could yield new solutions or additional funding, thereby making it easier to distinguish between viable "supported" companies from those which creditors are unwilling to support and which should be subject to liquidation procedures. For example, creditors that represent a significant share of debt (20-30%) should be allowed to submit a restructuring plan including – amongst other proposals – the possibility of converting all or part of non-performing debt into ordinary shares, provided that certain conditions are met (e.g. equal value of the credit, approval of creditors with a strong majority e.g. 60%). This credit-oriented approach would help companies in financial distress to foster business continuity and prevent bankruptcy.

Where a debtor is not obliged to put a creditor's restructuring proposal to a vote, creditors are effectively forced either to approve the debtor's plan or push the company into liquidation. However, in recent years there has been much greater receptiveness across Europe to lender-led restructuring proposals. A number of jurisdictions now grant creditors the right to propose their own restructuring plan (or a counter-proposal to a debtor's plan), most notably in France and Spain.

In court-supervised pre-insolvency proceedings, creditors – and potentially, other interested third parties such as shareholders – should be granted the right to submit a restructuring plan to a debtor, which should be put to creditor vote. This would allow credit-bids and, more generally, create an incentive for the debtor to 'stay honest' and present more achievable restructuring proposals.

In addition, creditors should be given greater disclosure of relevant information on the affected enterprise as early in the process as possible, as well as information relating to non-creditor sponsored restructuring proposals.

**Financing**

Steps should also be taken to address the issue of ongoing funding for distressed companies (debtor-in-possession, or "DIP" financing), in order to ensure that a greater proportion of economically viable companies can be turned around, thereby limiting destruction of value in a restructuring.
In the absence of DIP financing arrangements, under which a company under court-supervised protection can receive additional financing after it has entered into insolvency or similar proceedings, a distressed company has to rely on existing creditors to meet its interim funding requirements whilst a restructuring plan is devised. Whether and how this is achieved depends on the support of existing lenders and the nature of existing credit facilities. The process can be complex where a large number of financial institutions (with differing investment and exit strategies) are involved and in complicated cross-border proceedings where the rights and obligations of creditors, directors and other stakeholders differ, often leading to conflicting objectives and considerations.

For court-supervised restructurings within Europe, there should be automatic priority status for new financing and no regulatory restrictions on the provision of interim financing to debtors. In particular, the market should be open to alternative sources of finance, such as hedge funds, and any usury thresholds should be removed. Such reforms would greatly increase the potential sources of financing, improving the chances for businesses to restructure successfully and also promoting the development of a European DIP financing market. Court supervision should ensure that the terms of the interim financing (including any priority status) are warranted by the actual needs of the business and in the context of the specific restructuring, and should also help to ensure that existing creditors are not unduly prejudiced by the terms of any DIP financing.

DIP financing providers should also be protected by some form of immunity against criminal liability, as supported by the Commission Recommendation of March 2014, and/or public guarantees (provided State aid rules are complied with). Moreover, a super senior ranking within the hierarchy of creditors should be introduced in order to encourage lending by creditors willing to provide new (risky) financing to distressed companies. Member States should ensure that this super-senior status is not challenged or modified by the courts in the event that the company subsequently files for bankruptcy. Creditors who decide to inject liquidity in a distressed company should have some degree of certainty and predictability on the recovery of their claims. Therefore, the super-senior ranking should not be subject to any ex post revision. Otherwise, potentially interested investors maybe discouraged from investing and companies in desperate need of working capital may be left without the possibility to finance their day to day operations, to the detriment of the real economy.

A convergence to best practices could be achieved through a harmonised approach under which minimum standards are issued for each of the elements referred to above, and are then applied to national insolvency regimes across Europe. In this respect, similarly situated stakeholders involved in insolvency proceedings should be able to expect reasonably similar rights, obligations, protections and outcomes across all EU jurisdictions. Otherwise, as is currently the case, we will continue to see an aggregation of negative country specific effects resulting from specific reforms in different jurisdictions.

There are important practical and political judgments to be made on the priorities and phasing of further insolvency reform in the EU. AFME advocates pursuing a fairly narrow and focused EU legislative initiative to embed the key minimum standards of an effective insolvency law into national systems. Alongside, we advocate the development of recommendations and the sharing of best practice (both at EU and OECD level) on a range of wider issues. The table below summarises our proposals for new EU legislation and a related Commission Recommendation.

**Early stage and timely Restructuring**

Timely access to restructuring procedures can help to avoid liquidation of otherwise viable companies, preserve existing productive capacity and enhance creditors' prospects for value recovery in the long term. We agree with the Recommendations that, in order to be effective, restructuring procedures should be initiated at an early stage, i.e. when there is a likelihood that serious financial difficulties are imminent or likely.

In this context, adequate "alert mechanisms" should be put in place to make it compulsory for directors or others with oversight functions to monitor the financial situation of a company and raise creditors' awareness at an early stage regarding any sign of financial weakness which ha a reasonable chance to turn into serious financial distress. This could be done either through "alert mechanisms" managed by internal oversight functions (i.e. audit or compliance) or directly by individual directors where internal oversight functions do not exist (such as in the case of small companies). However, in our view, the alert mechanism procedure could in fact be more effectively managed by national Revenue agencies/Tax authorities. Practical experience shows that Revenue Agencies are among the first creditors whose claims are not satisfied when companies start facing financial difficulties. In fact, in many cases companies in financial difficulties first fall behind in payments to suppliers, then fail to meet their value-added tax (VAT) payment deadlines with Tax Agencies (this means in all likelihood that they are already in an advanced phase of crisis). Banks are generally amongst the last creditors to become aware of a crisis. Revenue Agencies are therefore in a privileged position to detect whether a company is experiencing financing difficulties and are best placed to adequately manage an "alert mechanism".

In addition, Member States should always ensure that restructuring proceedings are initiated only when there is a clear restructuring plan. Currently, many jurisdictions still allow debtors to open restructuring proceedings, although there is not a pre-defined restructuring project. However, such practices are often used as stalling or blocking tactics.

**Additional considerations**

In addition to the matters discussed above, the following items should be considered as part of any European insolvency reform, either as part of a legislative proposal or as part of any new recommendations on insolvency practices and procedures:

**Non performing loans**

The IMF recently found that *"high NPLs are hindering lending and the recovery. By weakening bank profitability and tying up capital, NPLs constrain banks' ability to lend and limit the effectiveness of monetary policy."* The IMF has identified improving Europe's insolvency framework as a priority in order to reduce Europe's large stock of NPLs. Based on a standard definition, the ECB's 2014 comprehensive assessment identified a total of €879 billion in non-performing exposures in the banking system. A recent EBA study has identified that in most Member States the highest share of NPLs is in the SME lending book. The EU weighted average for SME loans was 18.5 % in June 2015. The EBA explains that high NPL ratios for SMEs are caused by *"the relatively lower resilience of SMEs to adverse economic conditions compared to other corporates... and by legal and other difficulties surrounding the disposal/write-off of SMEs' NPLs."* In addition, a recent study European Commission study found evidence of the contribution of sound insolvency regimes (among other factors such as GDP growth and debt ratios) in accelerating the speed of adjustment of NPLs.

Countries with stronger insolvency regimes were able to adjust more rapidly their NPL ratios than countries with weaker regimes. The rationale of this finding is that stronger insolvency frameworks facilitate the restructuring and continuation of debtor's operations and therefore smooth the progress towards a rapid change of unsustainable debt levels. This result is supported by similar analysis by the IMF, which finds that countries with stronger insolvency regimes deleveraged more rapidly in the post crisis period.

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." The IMF finds that "NPL disposal can free up large volumes of regulatory capital and generate significant capacity for new lending", calculating that freeing-up capital disposed for NPL could unlock new lending of between €167–€522 billion, provided there is corresponding demand for new loans.

**The judicial system**

It is important that there is an adequate judicial and professional framework in place to successfully administer any European insolvency reform. For example, there should be consistency among the courts in the application of insolvency laws, rules and regulations. In some jurisdictions the outcome of an insolvency proceeding may be completely different depending on the judicial region in the applicable country in which the case is heard, or depending on which judge presides over the case. The adoption of minimum insolvency standards across Europe would help to reduce any negative effects of judicial inconsistencies in the interpretation or application of insolvency laws.

It is also important that judicial, administrative and regulatory officials charged with interpreting and administering insolvency rules and regulations are sufficiently knowledgeable about, and experienced in, matters relating to insolvency to be able to apply such rules and regulations in a consistent and reasoned manner. It would be helpful if the Commission were to encourage the development of a network of dedicated, knowledgeable and independent court and administrative officials across the EU to interpret and administer its insolvency rules and regulations in a balanced and consistent manner.

**Professional and administrative standards**

The administrative and professional personnel involved in insolvency proceedings should also be considered, especially for large cross-border insolvencies. This is not a regulated profession and standards vary across Europe, particularly outside of the larger cities. At a minimum, these parties should have experience and a high level of knowledge regarding accounting, legal and business practices, financial markets and related issues, and general insolvency structures and practices, as well as the specific considerations that enter into cross-border insolvencies or insolvencies involved sophisticated or unusual deal structures. In the U.S., for example, there are courts, and therefore judges, in each federal judicial district which only hear bankruptcy cases, as well as corresponding administrative personnel that exclusively administer and control bankruptcy estates under the direction of these courts. Accordingly, there has developed in the US an extremely experienced and knowledgeable network of judicial and administrative officials and practitioners, which provides a relatively high degree of certainty to issuers, creditors and other stakeholders with respect to the conduct and, to some extent, the outcome of an insolvency proceeding.

**Reporting and transparency**

The research that we have conducted for this report has made it clear that there is a dearth of information relating to certain aspects of insolvency proceedings and their effect on European capital markets (and the European economy). More and better data on insolvency proceedings and procedures would be useful in assessing the utility of the legal and practical aspects of insolvency frameworks discussed in this report, and would also be helpful in analyzing their effects on companies that have been successfully reorganized.

Reporting by national insolvency agencies is generally patchy across Europe, with reporting typically limited to a small number of cases and outcomes (possibly with some sectoral classification). Key data points which are not yet typically reported publicly by insolvency agencies include performance metrics such asthe speed of procedures; outcomes achieved; and the percentage of asset value recovered or preserved in bankruptcy. Such data points would help to inform policymakers regarding the need for additional reforms, or changes to existing proposals or reforms. If we are to improve the understanding of insolvency frameworks and their effects on the European economy it is essential that more data is made available to both policymakers and the market generally.

**Capital Markets Union**

We not that the benefits of reforms to insolvency and bankruptcy regulations need to be considered in the context of the EU's agenda for capital markets union ("CMU"). The Commission intends that progress towards CMU will broaden financing channels across the EU, notably by increasing the scope for non-bank financing, and deepen the markets for financial services. CMU is also expected to enhance growth and financial stability, in a context in which cross-border investment and cross-border supply chains are an important aspect of commercial practices and a driver of economic value.

One of the necessary conditions for achieving these objectives is addressing the problem of divergent insolvency regulation. In its 2014 assessment of the costs of continued regulatory fragmentation, the Commission noted that the status quo in Europe typically entails: "high costs for cross-border creditors, incentives for forum-shopping, and obstacles to the re-organisation of cross-border groups of companies."

In its recent action plan on capital markets union, the Commission highlighted that adopting minimum standards across Europe for insolvency frameworks would help to alleviate these negative effects. In its action plan on capital markets union, the Commission stated its intention to propose a legislative initiative on business insolvency, including early restructuring and providing viable companies with a second chance, drawing on the experience of the EC Recommendation on insolvency reform issued in March 2014.

**Conclusion**

We cannot expect the disparities in national insolvency and restructuring laws to be resolved or determined by market forces. Stakeholders approach each restructuring with their own agenda and strategy, often looking for positions of control and influence to gain leverage, and are not always seeking common ground and consensus. In addition, policymakers in various local jurisdictions often cite political considerations, or historical and cultural practices, as serious impediments to insolvency reform and harmonisation. As a result, and as highlighted above, the absence of a consistent, predictable and well supervised European restructuring regime continues to create a considerable layer of uncertainty, increases costs and, to some extent, alters the economics of capital markets transactions. Fashioning ad hoc restructuring frameworks around national or market driven influences results in greater transaction risks and higher costs of capital.

Further harmonisation of minimum standards for European insolvency regimes would help to facilitate more predictable and orderly outcomes for corporate restructurings. Market participants are more likely to invest and are willing to pay a price premium when purchasing assets in countries with the most predictable restructuring outcomes. Divergent and inadequate insolvency regimes limit the potential of the private sector to attract investment, while developing sound minimum standards introduce a greater level of predictability to creditors and other stakeholders, boosting investment and enhancing the 'single market' benefits arising from a more integrated economic environment. Accordingly, we believe that certain key aspects highlighted above, when enacted properly and supported by the relevant jurisdiction's legal, judicial and regulatory frameworks, would greatly increase the effectiveness of European insolvency and restructuring laws and, where appropriate, would positively enhance a company's ability to effectively restructure and avoid formal insolvency.

A predictable, consistent and radically superior restructuring process is singularly lacking across Europe. There is no doubt that the targeted reforms to European insolvency laws described above would help to increase the efficiency of, and confidence in, European capital markets. While introducing such reforms will lead to improvements generally, they will have their greatest positive impact on European markets, and the economy, to the extent that they are introduced in each jurisdiction with as little variation as possible.

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# APPENDIX 2

## ECONOMIC CONSIDERATIONS RELATED TO THE BENEFITS OF EUROPEAN INSOLVENCY REFORMON

**The economic case for insolvency reform**

A body of research points to the positive effect of well-functioning insolvency regimes on financial markets and economic performance.

The benefits of adequate insolvency frameworks range from improving the size and deepness of capital markets; improving access to finance; enhancing entrepreneurship and company formation; and contributing to faster and more efficient deleveraging and adjustment of NPLs.

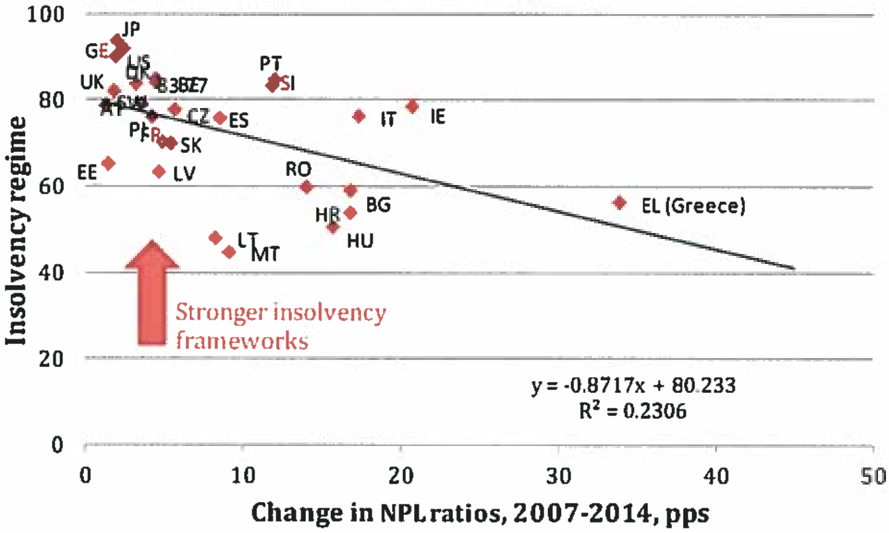
**Insolvency frameworks and NPLs**

Sound insolvency regimes provide the opportunity for viable companies in distress to restructure quickly, while inadequate costly frameworks could precipitate liquidation or make companies accumulate excessive levels of debt which could evolve into non-performing loans (NPLs).

This is particularly relevant in the current context of high non-performing loans in some European countries. The ECB's 2014 comprehensive assessment identified €879 billion in non-performing exposures in the European banking system, which absorb high levels of bank capital, reduce the efficiency of capital allocation, and represent a challenge to banking system stability.

The IMF (2015) found that countries with better insolvency frameworks deleveraged faster during the post-crisis period. Also, countries with sound insolvency frameworks were able to adjust their NPL ratios more rapidly than countries with weaker regimes (see graph below and also EC (2015)).

**Quality of insolvency regimes in 2015 (distance to frontier) and change in NPLs in Europe, Japan and the United States**




Source: World Bank and Doing Business 2015

**Access to finance, entrepreneurship and cross-border investment**

Inadequate insolvency regimes create uncertainty for creditors, generating greater difficulties for companies seeking to access credit. Davydenko and Franks (2008) find that unfriendly bankruptcy codes lead to higher collateral requirements. Also, a recent study by the ECB (2015) found that sound and efficient investor protection rules increase the likelihood of companies gaining access to credit.

Likewise, adequate insolvency regimes encourage entrepreneurship estimated as the likelihood of self-employment (EC, 2015) and rate of new firm entry (Leea et. al, 2011).

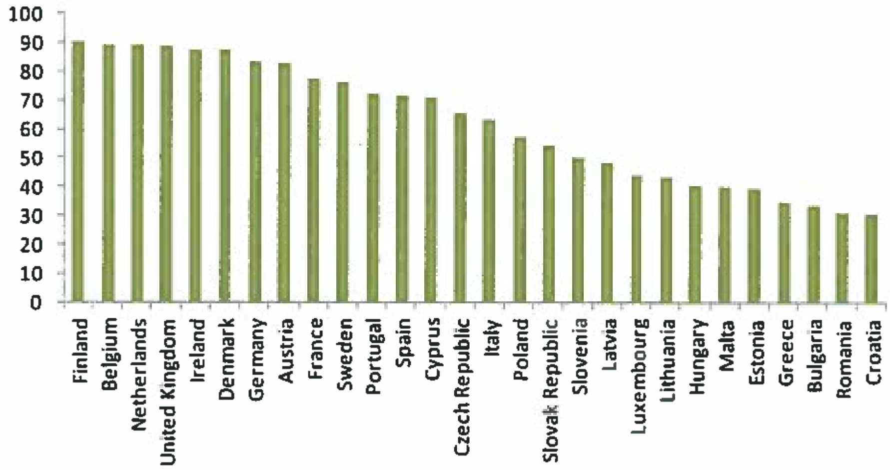
On the other hand, due to the existing divergence in national European insolvency regimes, creditors, administrators and stakeholders can expect to receive different rights, obligations, protections and outcomes depending on the European jurisdiction in which the insolvency proceeding is conducted. This creates uncertainty for cross-border investment, making it harder for investors to assess credit risk and reducing the benefits of PanEuropean economic integration.

**Sound insolvency frameworks reduce borrowing costs**

In principle, creditors should set higher risk premia for bonds issued by companies whose assets are located in unfriendly insolvency regimes (i.e., regimes with high restructuring costs and uncertain likelihood of recovering one's investment or loan should a company become insolvent).

Using a panel of corporate bonds issued by EU members states and two OECD countries, we modelled bond spreads (bond yields against risk-free rates) as a function of liquidity, time to maturity, credit ratings, market beta, institutional variables, and quality of insolvency regimes. We proxied quality of insolvency regimes as the annual recovery rate as reported by the World Bank[1].

**Recovery rate in Europe (%)**




Source: Doing Business (2015)

Our results indicate that improving the insolvency recovery rate by 10 percentage points (pp) reduces corporate bond spreads by 18 to 37 basis points (bps). That is, creditors are willing to reduce risk premia by between 18-37 bps if they expect to reduce their loss given default by 10 pp if a company declares insolvent.

In our results, we have also established an indirect impact via credit ratings as we found evidence that credit ratings agencies adjust individual bond ratings in light of a jurisdiction's recovery rating.

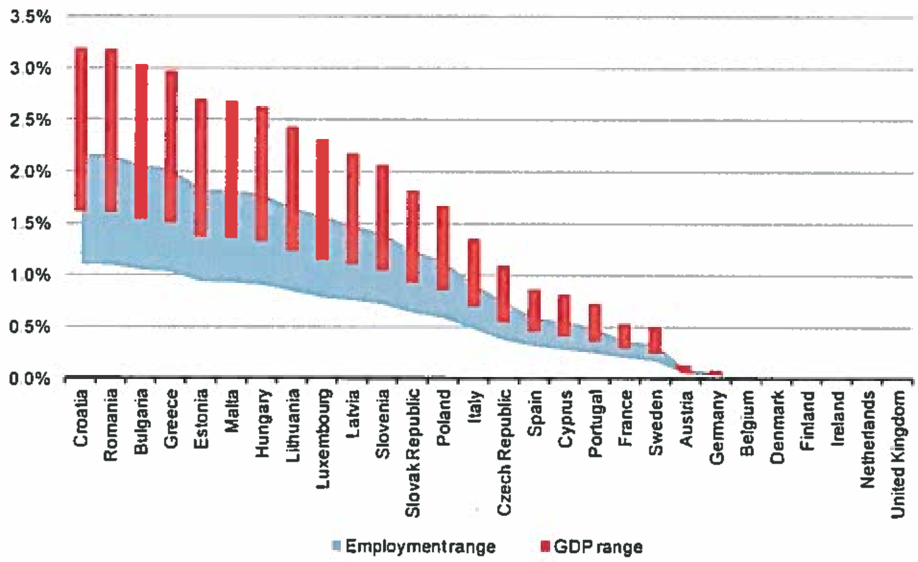
As a second step, we derived the impact of insolvency reform on macroeconomic performance based on existing evidence of the relationship between bond spreads, GDP and employment in Europe. Our estimations are based on the results of Bleaney et al (2013), who find that a percentage point reduction in bond spread is associated with a 1.57 percentage point increase in long-term GDP and a 1.06 percentage point increase in long-term employment

Applied across the EU, assuming that reform would improve recovery rates to the level of the top 6 EU economies (to 85% from the current weighted average of 77%) lower corporate bond spreads could add between 0.3% to 0.55% to EU GDP over the long-term and an employment increase of between 600,000 to 1.2 million.

The biggest gains in absolute terms accrue in large economies such as Italy and Spain. However, smaller Member States such as Bulgaria, Croatia and Greece stand to gain the most in relative terms, adding as much as 2% to long-term GDP if they can bring their recovery rates to 85%.

[1] Other metrics for insolvency frameworks were utilised for robustness checks

### Relative impact of reform by country: potential employment and GDP impact




Source: Frontier analysis of Datastream, World Bank, S&P and Moody's data

These results are first estimates of the benefits of sound insolvency regimes on borrowing costs. These are in addition to the wider economic benefits described earlier on NPLs adjustment, entrepreneurship, company restructuring, access to finance and economic integration.