Harmonising certain aspects of insolvency law


This briefing provides an initial analysis of the strengths and weaknesses of the European Commission’s impact assessment (IA) accompanying the above-mentioned proposal, submitted on 7 December 2022 and referred to the European Parliament’s Committee on Legal Affairs (JURI).

EU legislation in the area of insolvency has existed for more than 20 years, the initial intention having been to ensure smooth coordination and cooperation between the EU Member States on cross-border insolvency cases. Over time, the lack of harmonised insolvency regimes has been identified by capital market participants as one of the key obstacles to the freedom of movement of capital and to enhanced integration of the capital markets in the EU. The European Parliament has explicitly addressed insolvency rules in the context of the creation of capital markets union (CMU). During its previous legislature, the Parliament adopted a resolution on 9 July 2015 on ‘Building a capital markets union’, in which it noted the Commission's suggestion to address cross-border insolvency to the extent necessary for achieving a well-functioning CMU. The European Insolvency Regulation (EIR) of 2015 introduced uniform rules on international jurisdiction and applicable law for cross-border insolvency cases, i.e. the Member State in which the insolvency proceedings are to be conducted and the applicable law. Another step forward in the same direction was the 2019 Directive on Restructuring and Insolvency (DRI), which sought to bring about targeted harmonisation in the specific areas of pre-insolvency measures and debt-discharge procedures (post-insolvency). Similarly, in its resolution of 8 October 2020 on further development of the CMU, the Parliament highlighted the importance of increasing legal certainty for cross-border investments by making national insolvency proceedings more efficient and effective.

The present initiative was announced in the Commission’s CMU action plan of September 2020. The aim is to harmonise certain (non-financial) corporate insolvency rules across the EU – substantive rules on insolvency proceedings not yet regulated at EU level – making them more efficient, helping to promote cross-border investment and making the outcomes of insolvency proceedings more predictable. The proposal is included in the Commission’s 2022 work programme and in the working document accompanying the joint declaration on EU legislative priorities for 2023 and 2024.

Problem definition

The IA identifies two main problems, namely that:

- costly and lengthy (national and cross-border) insolvency proceedings lead to low recovery values;
- low predictability of insolvency proceedings lead to high information and learning costs and constitute barriers to cross-border investments.
The IA substantiates its findings with references to several sources, including external studies and reports, and the results of the Commission’s consultations with stakeholders. A problem tree illustrates the drivers behind the problems and the consequences deriving from them (IA, p. 34).

The IA defines the **problem drivers** as inadequately designed (or missing) features and large cross-border divergences (the IA provides detailed information about the differences in the main features of the Member States’ insolvency systems). More specifically, these divergences are as regards:

- asset recovery proceedings (components of insolvency regimes that help recover as much capital as possible from the insolvent company);
- the governance of insolvency proceedings (the absence of lighter procedures for small and medium-sized enterprises (SMEs) contributes to the workload of courts and insolvency practitioners);
- the procedures for distribution of recovered values.

In addition to the main problem drivers, the IA describes ‘out-of-scope’ drivers: the quality and capacity of judicial systems and the qualifications and incentives of insolvency practitioners (IPs). However, it makes clear that the initiative would not impact on these two areas, because significant political support for major reforms of the judicial systems in the Member States is lacking and the DRI is already expected to lead to some convergence towards greater efficiency in the court structures and the framework for IPs (IA, pp. 32–33). The IA comprehensively describes the views of stakeholders about the problem drivers and gives examples of diverging stakeholder’s views in a transparent way. For instance, views differ on how big an obstacle the different drivers are to the single market (IA, p. 31).

The IA examines the nature and scale of the problem, as well as who it would affect and how (IA, Annex 3). It however describes the expected evolution of the problem without EU action in fairly general terms, only saying that the absence of converging national insolvency regimes would limit cross-border investment and business relationships to levels below their potential (EU action would remain restricted to provisions in the DRI). The consequences (e.g. those relating to potential negative impacts on the single market for capital) could have been discussed in more detail.

### Subsidiarity / proportionality

The legal basis of the proposal is Article 114 TFEU. According to the IA, this choice is justified the by the fact that the proposal addresses problems in the functioning of the single market for capital and the completion of the CMU. These problems are caused by disincentives for cross-border investment resulting from differences among and inefficiencies of the Member States’ national insolvency laws. Annex 5 (IA pp. 156–229) provides detailed information about these differences. The IA includes a section on **subsidiarity** (IA, pp. 35–36), where it describes the legal basis and explains the need for and added value of EU action. The IA highlights that ‘Member States’ different starting points, legal traditions and policy preferences imply that reforms at national level in this area are unlikely to lead to converging insolvency systems in the EU, and that Member States would ‘tailor them to their domestic preferences rather than aiming to make them more similar to those in other Member States’ (IA, p. 35). Concerning EU added value, the IA explains that targeted measures at EU level could ensure a level playing field and avoid distortions of cross-border investment decisions due to existing differences in the national insolvency laws. The IA’s approach to selecting the preferred option by comparing the policy options against **proportionality**, as required by the Better Regulation Guidelines (BRGs), does not appear to be particularly exhaustive and could have been explained in more detail. According to the IA, the options would be entirely proportionate for reaching the objectives of the initiative (IA, p. 36). The deadline for the **subsidiarity check** by national parliaments was 20 March 2023. No reasoned opinions were submitted by that date.

### Objectives of the initiative

The **general objectives** of the initiative are:
Harmonising certain aspects of insolvency law

- to allocate capital in the economy more efficiently, which requires more efficient (non-financial) national corporate insolvency regimes capable of generating a higher recovery value of liquidated companies in a shorter time and at lower costs;
- to ensure the free movement of capital in the single market, by fostering investors’ trust and increasing cross-border investment, creating a level playing field with regard to insolvency rules for all economic operators in the EU, regardless of their location.

According to the IA, the two general objectives reinforce each other in the sense that more efficient national insolvency regimes would be beneficial for cross-border investment, and an alignment of targeted aspects of the Member States’ insolvency rules would positively affect cross-border investment decisions.

The specific objectives of the initiative are:

- **SO1**: the development of more efficient and similar rules in the Member States for better value recovery, notably in the areas of transaction avoidance, asset tracing, directors’ duties and pre-pack procedures;
- **SO2**: the development of more similar rules in the Member States for more efficient insolvency proceedings, in particular with respect to micro- and small enterprises (MSEs) procedures, insolvency triggers and insolvency rule transparency, to support a timelier conclusion of insolvency proceedings for (non-bank) companies;
- **SO3**: the development of more similar rules for efficient and fair distribution of recovered values in the Member States, notably in the area of creditor committees and the ranking of claims, to reduce legal uncertainty and information costs related to insolvency proceedings for cross-border creditors.

The objectives correspond to the problems and the problem drivers identified in the IA. With regard to the S.M.A.R.T. criteria (specific, measurable, achievable, relevant and time-bound), the specific objectives appear to be specific, achievable and relevant, but not time-bound. That said, an evaluation of the initiative is planned five years after its implementation. The IA does not present operational objectives, defined in terms of the deliverables of specific policy actions after identifying and selecting the preferred option, as recommended in the BRGs (see Better Regulation Toolbox, **Tool #15**). However, the IA includes potential indicators relating to the achievement of the specific objectives (see Section on ‘Monitoring and evaluation’ below).

**Range of options considered**

The IA identifies only two policy options in addition to the baseline scenario (no further EU action).

Under the baseline scenario, the IA considers that the identified problems would persist. According to the IA, after the transposition of the DRI and ongoing CMU measures in other areas, it is expected to be unlikely that Member States would further enhance the convergence between substantive elements of their national insolvency rules without further EU action.

Table 1 below provides an overview of the options. The two proposed options are cumulative – it is questionable whether they qualify as alternative options under the BRGs. This range of options is very limited, some policy measures do not have alternatives at all. The IA provides information about the discarded options, for instance, the option to propose non-legislative measures and/or to address the problems through a Recommendation. According to the IA, the majority of stakeholders responding to the open public consultation held by the Commission were in favour of introducing legislation, either alone or in combination with a Recommendation. Harmonising the full domain of ranking of claims was discarded upfront, being ‘potentially problematic from a subsidiarity perspective and politically non-feasible’ (IA, p. 46). The measures that were retained are linked to the specific objectives and the problem drivers. Overall, the IA describes the options sufficiently and in a balanced manner. For both options, the IA describes a series of policy measures to be taken, and groups these according to which of the three specific objectives they seek to achieve.
### Table 1 – Overview of policy options

<table>
<thead>
<tr>
<th>SO1</th>
<th><strong>Transaction avoidance</strong></th>
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<tr>
<td></td>
<td><strong>Measures that target value recovery</strong></td>
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<tr>
<td>Option 1</td>
<td>Introduce minimum harmonisation of specific rules, such as those relating to: the scope of the legal acts concerned, avoidance grounds, the definition of related parties, the period before insolvency under scrutiny and the legal consequences of avoidance.</td>
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<tr>
<td>Option 2</td>
<td>As in Option 1.</td>
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<tr>
<td></td>
<td><strong>Asset tracing and recovery</strong></td>
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<tr>
<td>Option 1</td>
<td>Strengthen asset traceability by ensuring improved access for insolvency practitioners (IPs) to asset registers, especially in a cross-border setting, by building on already existing EU-wide interconnected registries.</td>
</tr>
<tr>
<td>Option 2</td>
<td>Enhance the ability of IPs to seize assets in other Member States; improve their access to asset registers and their direct powers to seize or recover assets from abroad.</td>
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<tr>
<td></td>
<td><strong>Director's duties and liability</strong></td>
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<tr>
<td>Option 1</td>
<td>Oblige directors to file for insolvency within a pre-defined time limit of 3 months. Directors who fail to comply with this obligation would be held liable.</td>
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<tr>
<td>Option 2</td>
<td>Shift of the fiduciary duties for directors of the company in the vicinity of insolvency to be owed to the creditors of the debtor.</td>
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<td></td>
<td><strong>'Going concern' sales in insolvency</strong></td>
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<tr>
<td>Option 1</td>
<td>Introduce minimum harmonised standards for a pre-pack liquidation regime. These include harmonising the rules on: 1) conducting negotiations on the sale of the business before insolvency filing; and 2) realising the value of the insolvency estate right or shortly after the official opening of the proceedings.</td>
</tr>
<tr>
<td>Option 2</td>
<td>As in Option 1.</td>
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<tr>
<th>SO2</th>
<th><strong>Measures that improve procedural efficiency</strong></th>
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<td><strong>Insolvency trigger</strong></td>
<td>Require Member States to further enhance the transparency of the main elements of their insolvency rules (on the public e-Justice portal website), including through the provision of targeted information about insolvency triggers.</td>
</tr>
<tr>
<td>Option 2</td>
<td>Accomplish a targeted harmonisation of a common liquidity criterion for the latest possible triggering of the insolvency procedure (harmonised liquidity test).</td>
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<tr>
<td><strong>Specific treatment of micro- and small enterprises</strong></td>
<td>Introduce a special harmonised liquidation procedure for MSEs at EU level as a way to reduce the formalities and costs associated with the liquidation process. The liquidation process should also apply in asset-less scenarios. Introduce debt discharge for entrepreneurs.</td>
</tr>
<tr>
<td>Option 2</td>
<td>As in Option 1.</td>
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<th>SO3</th>
<th><strong>Measures that govern the distribution of recovered values</strong></th>
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<tbody>
<tr>
<td><strong>Ranking of claims</strong></td>
<td>Oblige the Member States to enhance transparency (public e-Justice portal website) on creditor ranking.</td>
</tr>
<tr>
<td>Option 2</td>
<td>Harmonise the treatment of public claims.</td>
</tr>
</tbody>
</table>
Assessment of impacts

The IA describes the key benefits and costs of the options, exploring how each performs in achieving the initiative's objectives as regards the relevant stakeholder groups (creditors, cross-border creditors/investors, insolvent company and directors (going concern), SMEs, employees, insolvency practitioners, the public sector). The assessment of impacts of the options in the IA is mainly a qualitative exercise, supported by a quantitative element in the form of a cost-benefit analysis.

When comparing the policy options, the IA considers their effectiveness, efficiency and coherence, in line with the BRGs; it does not however address proportionality in much detail (see Section on ‘Subsidiarity / proportionality’ above). To facilitate the comparison of options and to illustrate the rationale behind the selection of the preferred option, the IA presents the two options in a summary table showing how the options score under the above-mentioned comparison criteria (IA, p. 68).

When assessing **effectiveness** and **efficiency**, Option 2 would yield higher benefits regarding the objectives to i) preserve the best possible value of assets that are due for liquidation; and ii) reduce legal uncertainty and information and learning costs related to insolvency processes. However, some measures envisaged in Option 2 would lead to conflicts with other areas of national law (potential inconsistencies with property law, company law and labour law). Option 1 would deliver comparable benefits but in a more cost-effective manner and would limit itself to measures that are **coherent** with the broader legal frameworks of the Member States.

On the basis of its analysis and comparison of the options, the IA concludes that **Option 1 is the preferred option**. When assessing **social** and **environmental impacts** (not quantified), the IA explains that the preferred option is not expected to have direct impacts on employees or the environment. The IA mentions potential positive indirect effects, for instance, the option offers stronger opportunities to preserve employment for ‘going concern’ parts of the business, and fosters the transition to a more sustainable economy. This could be achieved by reducing the share of companies that have low productivity yet manage to survive (‘zombie companies’) in the economy through the reallocation of capital and labour towards companies with a higher rate of innovation and productivity.

In the **economic assessment**, the IA estimates that with the measures envisaged under the preferred option, direct and indirect **benefits** are expected to exceed €10 billion annually. These benefits would result, for instance, from the reduction of costs to the national judicial systems and the higher recovery value (€4.9 billion, of which €1.9 billion from simplification of insolvency proceedings). It would also simplify the insolvency procedure for MSEs, promote creditors’ coordination, lower debt funding costs (€1.6 billion), increase productivity growth (€7.2 billion) and lower information and learning costs for cross-border investment.

The IA expects the total **costs** to be limited and to largely accrue to Member States. For instance, these costs would include direct administrative costs for drawing up factsheets on the key aspects of the insolvency frameworks, as well as costs to cover the potential increase in insolvency proceedings for MSEs (€0.9-2 billion). Some indirect costs are also expected for companies due to a higher liability of directors (higher wage demands and/or more difficult recruitment of company directors).

The IA points out that the preferred option would have a neutral impact on **fundamental rights**, while the impacts on the **UN Sustainable Development Goals (SDGs)** relate to ‘Decent work and economic growth’ (SDG No 8), ‘Industry, innovation, and infrastructure’ (SDG No 9) and ‘Peace,
justice and strong institutions’ (SDG No 16). The IA also describes the expected progress towards the goals (IA, p. 98). The IA expects slightly positive impacts on digitalisation (higher process automation in the simplified insolvency procedure for MSEs and broader use of the e-Justice portal). Creditors from third countries are also expected to benefit from the measures of the preferred option as intra-EU creditors would do.

**SMEs / Competitiveness**

The IA recognises that the initiative is relevant for SMEs, stating that the predominant part of insolvency cases concern SMEs. For SMEs, the costs of insolvency proceedings can be so high, that little or nothing is left for allocating to creditors after these costs have been paid. Oftentimes insolvency proceedings against SMEs are not even opened because of their inability to cover the costs. **The IA envisages a simplified insolvency procedure for insolvent microenterprises and small enterprises (MSEs) as regards winding-up proceedings.** This move would render proceedings less costly and guarantee an orderly liquidation (see Section on 'Coherence between the Commission’s legislative proposal and IA' below). The IA states that an SME test has been carried out (see Better Regulation Toolbox, Tool #23) and reports on its results in Annex 7 (IA, pp. 235-236).

In the description of the SME test, the IA points out that efforts have been made to consult SMEs through the consultation activities and external supporting study, but that ‘specific outreach to SMEs was not done as this was considered too time-consuming in the light of very little, if any, negative impacts expected and positive impacts materialising for resource-strained SMEs that are in the process of business exit, which would likely not have capacity to interact with the Commission services’ (IA, p. 235). However, only one business association that represents SME interests participated in the public consultation. The IA states that ‘since the proposal for an MSE regime was developed at a rather late stage, it did not feature in the public consultation’ (IA, p. 235).

Regarding the preferred option, the IA expects positive impacts on SMEs, such as an improvement of the business environment; a quicker realisation of a ‘second chance’ for entrepreneurs (to be discharged from the debts of the previous undertaking and start a new business); and an orderly winding down of ‘asset-less’ MSEs through the ‘simplified procedure’. According to the IA, as the preferred option does not impose obligations on or compliance costs for SMEs, there is no need to design mitigating measures for SMEs. Overall, it appears that the SME test was not conducted to the full extent, because SMEs were not specifically consulted.

Regarding **competitiveness**, the IA expects the preferred option to ‘indirectly improve the competitiveness of the EU business sector through better prospects to wind up zombie companies’ (IA, p. 70). The reallocation of capital and labour to more productive means and the greater predictability of the outcome of insolvency procedures would benefit the economy as a whole and make companies more competitive through better access to finance.

**Simplification and other regulatory implications**

In light of the new ‘one-in, one-out’ approach, the IA identifies no cost impacts on businesses and EU citizens (IA, Annex 3). The IA explains the complementarity of the proposal with other existing EU legislation, in particular with the Directive on Restructuring and Insolvency (DRI), the Regulation on Insolvency Proceedings (EIR) and the Environmental Liability Directive (ELD).

**Monitoring and evaluation**

The IA briefly explains how the impacts of the policy initiative will be monitored and evaluated. In relation to the specific objectives, the IA explains that key indicators, such as recovery rates, time of recovery and costs of insolvency proceedings, would be used to measure the impacts of the initiative. Contrary to the BRGs, the IA does not present any operational objectives. It mentions some data sources (e.g. new data on the length of procedures following the adoption of an implementing act under the DRI; statistical data produced by Eurostat, the European Central Bank, the European Banking Authority, the Joint Research Centre and national players) that would be monitored for the evaluation of the initiative, to be carried out five years after its implementation.
Stakeholder consultation

In accordance with the BRGs, the IA describes the stakeholder consultations in a separate annex (IA, Annex 2) and provides a list of the stakeholder groups consulted (IA, p. 84). The consultation on the inception impact assessment received 26 responses between 11 November and 9 December 2020. The Commission launched an open public consultation (OPC) from 18 December 2020 to 16 April 2021 (with 129 responses), meeting the BRG’s 12-week requirement. The IA presents a breakdown of outcomes by stakeholder groups (civil society, companies and business organisations, business associations, EU citizens, public authorities, academic/research institutions). Other consultation activities include a stakeholder workshop on 8 March 2022 with selected stakeholders having a particular interest in insolvency proceedings (representatives of the financial, business/trade sector, employees, practitioners working in insolvency proceedings, representatives of employees and consumers, academia and think tanks); a workshop on 22 March 2022 with experts of the Member States; and nine meetings (between April 2021 and January 2022) of the Commission’s Group of experts on restructuring and insolvency law.

The IA describes the stakeholder groups’ views on the problems and their drivers, the objectives and the policy options in a comprehensive manner. It notes that different stakeholder groups responded differently to the policy measures associated with the two options. In particular, the IA takes into account the expected impacts of the options on the stakeholder groups identified as being most affected, namely businesses (notably insolvent businesses and creditors) and Member States. The summary of the stakeholder consultations is clear and detailed. Overall, stakeholder views are reflected consistently throughout the IA and appear to have been taken broadly into account.

Supporting data and analytical methods used

The IA describes the supporting data and analytical methods in a separate annex (IA, Annex 4 and pp. 79-80). With regard to supporting data, the IA lists the external supporting study6 (referenced in the IA but not published by the time of writing) and available sources such as literature, publicly available reports and studies; stakeholder consultations; and targeted online surveys and interviews with stakeholders. The IA explains the limitations and uncertainties in the analysis, one example being the limited information on the actual costs of insolvency proceedings. The IA does not quantify the expected benefits from the introduction of a dedicated simplified winding-up procedure for MSEs or from improved coordination among cross-border creditors. Indirect benefits, for instance the reallocation of capital, can only be quantified with the help of assumptions. The same goes for the estimation of indirect costs from an expected increase of insolvency proceedings. The assumptions are explained in Annex 4 of the IA. Several estimates are based on a combination of financial and macroeconomic data and survey data from the external supporting study.7

Follow-up to the opinion of the Commission Regulatory Scrutiny Board

The Commission’s Regulatory Scrutiny Board (RSB) gave a negative opinion on a draft IA report on 24 June 2022. It noted significant shortcomings, for instance: insufficient evidence on how current insolvency proceedings negatively affect cross-border investment; insufficient analysis of how divergent the situation in Member States is; insufficient explanation of how this initiative links to the DRI and the EIR; insufficient assessment of the impact on the capacity of Member States’ judicial systems to handle the expected increase in the volume of cases involving SMEs and how this may affect the expected benefits; an insufficiently balanced assessment of the options considered and of why the IA is geared towards the preferred option; missing robust assessment methodology and clear underlying assumptions; missing SME test. The IA explains how the RSB’s comments have been addressed (IA, pp. 77-79). Following the submission of a revised version, the RSB issued a positive opinion on 10 October 2022. It appears that the RSB’s recommendations for improvements – including a more detailed analysis of the Member States’ courts’ capacity and a clearer description of data collection for future monitoring and evaluation – were taken into account in the revised version of the IA.
Coherence between the Commission’s legislative proposal and IA

The proposal appears to follow the preferred policy option of the IA. While the IA clearly states that a simplified liquidation procedure is envisaged for MSEs, Article 1 of the proposal lays down rules on simplified winding-up proceedings only for microenterprises. However, Recital 35 of the proposal states that although the provisions on simplified winding-up proceedings apply only to microenterprises, it should be possible for Member States to extend their application also to SMEs.

The initiative aims to harmonise certain substantive rules on insolvency proceedings across the EU. The IA examines the nature and scale of the problems and who they affect. It establishes a clear intervention logic, from the problems and their drivers to the initiative’s objectives and options. The IA identifies only two options, which are cumulative. It is questionable whether such options qualify as alternative options, as required in the BRGs. This range of options is very limited, and some policy measures do not have alternatives. The assessment of the economic, social and environmental impacts is mostly qualitative, but the IA also presents quantified estimates. Limitations and uncertainties in the analysis are described in a transparent manner. The IA gives an exhaustive account of the stakeholder groups’ views on the problems, their drivers, the objectives and the options. The IA would have benefited from a more comprehensive analysis of the impacts on SMEs. It is in fact questionable whether the SME test has been fully performed, as it would appear from the IA that a dedicated consultation of SMEs was not conducted.

ENDNOTES

1 See e.g. World Bank Doing Business report (2020), European Banking Authority benchmark study, European Central Bank report (2018), International Monetary Fund Staff Discussion Note (2019).
2 The sale of the business is agreed before the insolvency starts.
3 In the Charter of Fundamental Rights of the EU, this concerns in particular Article 17 (right to property), Article 16 (freedom to conduct a business), Article 15 (freedom to choose an occupation and right to engage in work), Article 47(2) (right to a fair trial), Article 27 (workers’ right to information and consultation within the undertaking), Article 8 (protection of personal data) and Article 7 (respect for private and family life).
4 The proposal defines microenterprises in accordance with the Annex to Commission Recommendation 2003/361/EC, as an enterprise that employs fewer than 10 persons and whose annual turnover and/or annual balance sheet total do not exceed €2 million (Recommendation 2003/361/EC, Annex, Article 2(3)).
5 Winding-up is ‘the process of closing a business that is not successful and has debts that it cannot manage’.
6 Deloitte/Grimaldi (2022), Study to support the preparation of an impact assessment on a potential EU initiative increasing convergence of national insolvency laws.
7 Survey with 120 insolvency experts from 24 EU Member States about their assessment of the impact of harmonisation of targeted areas in insolvency rules on the determinants of the recovery rate (e.g. time of recovery, judicial costs).