BRIEFING

EU Legislation in Progress

European Parliament

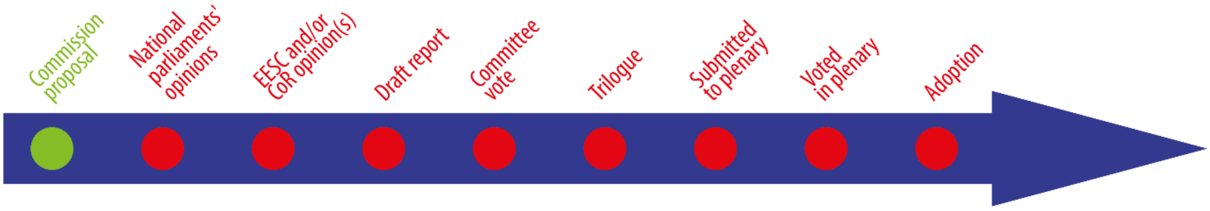
Harmonising certain aspects of insolvency law in the EU

OVERVIEW

On 7 December 2022, the Commission tabled a proposal for a directive aimed at enhancing and harmonising insolvency law in the EU. The proposal seeks to make it easier to recover assets from the liquidated insolvency estate; render insolvency proceedings more efficient; and ensure a predictable and fair distribution of recovered value among creditors. The directive would complement two recently adopted pieces of legislation, namely, the directive on pre-insolvency proceedings and debt discharge following insolvency proceedings, and the regulation on the determination of jurisdiction and applicable law for cross-border insolvency.

In the European Parliament, the referral was announced in plenary on 26 January 2023, and the file was assigned to the Committee on Legal Affairs (JURI). Parliament has expressed concern at the lack of harmonisation of insolvency law across the EU on several occasions in the framework of previous legislative procedures.

Proposal for a Directive of the European Parliament and the Council harmonising certain aspects of insolvency law		
Committee responsible:	Committee on Legal Affairs (JURI)	COM(2022) 702 7.12.2022
Rapporteur:	Pascal Arimont (EPP, Belgium)	2022/0408(COD)
Shadow rapporteurs:	René Repasi (S&D, Germany) Yana Toom (Renew, Estonia) Marie Toussaint (Greens/EFA, France) Angel Dzhambazki (ECR, Bulgaria) Emmanuel Maurel (The Left, France)	Ordinary legislative procedure (COD) (Parliament and Council on equal footing – formerly 'co-decision')
Next steps expected:	Awaiting committee decision	



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Introduction

On 7 December 2022, the European Commission tabled a proposal for a directive harmonising certain aspects of insolvency law. The initiative is part of the Commission's priority objective of strengthening capital markets union (**CMU**). In particular, it relates to action 11 of the 2020 CMU action plan: 'Making the outcome of cross-border investment more predictable as regards insolvency proceedings'. It furthermore reaffirms the opinion expressed in the 2015 Five Presidents' Report, that a true capital markets union requires addressing the most 'important bottlenecks' preventing the integration of capital markets in areas such as insolvency law, company law, property rights and the legal enforceability of cross-border claims. The proposal aims for 'minimum harmonisation in targeted areas of core non-bank insolvency proceedings', by addressing the discrepancies among the EU countries' domestic non-financial corporation insolvency laws. The Commission cites the efficiency of insolvency laws as a 'key criterion' for cross-border investors.

The proposed directive lays down common rules for all aspects related to insolvency proceedings, including the annulment of transactions entered into by the debtor prior to the opening of insolvency proceeding (avoidance actions); the tracing of assets belonging to the insolvency estate; the duty of directors to submit a request for the opening of insolvency proceedings; simplified winding-up proceedings for microenterprises; and creditors' committees. It also provides that Member States should draw up an information factsheet on their domestic laws on insolvency proceedings. The directive does not apply to proceedings related to financial institutions, including insurance and re-insurance companies, credit institutions, investment firms or collective investment undertakings, central counterparties, and other financial institutions.

The proposal is based on Article 114 of the Treaty on the Functioning of the European Union (**TFEU**), which grants the European Union (EU) the competence to lay down appropriate provisions for the approximation of Member States' laws, with a view to the establishment and functioning of the internal market (Article 26, TFEU).

Back in 2014, the Commission published a recommendation for a new approach to the handling of business failure and insolvency,[1] where it presented the main aspects of a common legal framework for national insolvency rules.

Existing situation

As EU legislation does not cover insolvency[2] law, it is up to the Member States to develop it as part of their national body of law. The proposal partly complements but also differs from two recently adopted pieces of legislation – Directive 2019/1023 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt; and Regulation 2015/848 on insolvency proceedings.

Directive 2019/1023 on preventive restructuring frameworks

Directive 2019/1023 addresses two aspects of the bankruptcy code: the 'pre-insolvency procedure' and the debt discharge following the closure of insolvency proceedings.[3] It provides the tools for restructuring the debts 'before insolvency' but does not provide a framework for the liquidation of assets of insolvent debtors. It rather aims to help companies in distress avoid insolvency by giving them access to preventive schemes that allow them to restructure their debts and possibly return to viable business. The directive does not address insolvency proceedings as such; instead, it provides a legal framework for the 'discharge' of debts as the outcome of insolvency proceedings. The legal basis for Directive 2019/1023 is Article 114 TFEU on the approximation of laws.[4]

Regulation 2015/848 on insolvency proceedings

Regulation 2015/848 determines the territorial jurisdiction of insolvency proceedings and the law applicable to cases of cross-border insolvency. It does not touch upon the 'content of insolvency law'. Instead, it seeks to enhance both cross-border information sharing and the application of insolvency proceedings and decisions. The regulation introduces uniform rules on international jurisdiction (that is, the EU Member State that should open insolvency proceedings) and on the applicable law for cases of cross-border insolvency. In parallel, it introduces uniform rules ensuring that the judgments made by the courts having jurisdiction in such cases are recognised, and if needed, enforced across all Member States. It has no impact on the content of national insolvency law. It determines the applicable law but does not prescribe any features or minimum standards for that law. Therefore, it does not address the discrepancies among the Member States' insolvency laws (and the resulting problems and costs). The legal basis of the regulation is Article 81 TFEU on judicial cooperation.

Parliament's starting position

In its resolution of 8 October 2020 on Further development of the Capital Markets Union (CMU): improving access to capital market finance, in particular by SMEs, and further enabling retail investor participation, Parliament highlights the 'importance of increasing legal certainty for cross-border investments by making national insolvency proceedings more efficient and effective' (clause 24). It furthermore asks the Commission to make a 'stronger commitment to achieving real progress on issues such as … insolvency laws, which still represent major obstacles to the true integration of EU capital markets' (clause 1).

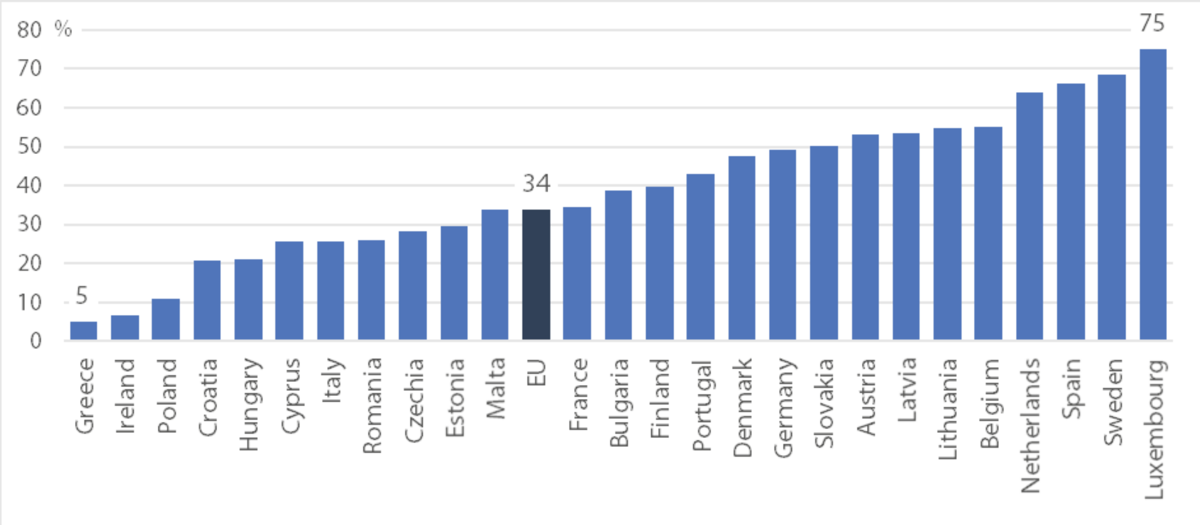
In the previous legislature, in the context of the discussion on the proposal for a directive on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures and amending Directive 2012/30/EU, Parliament sought greater harmonisation of insolvency laws among the Member States. The report of 2 July 2018 by the Committee on Legal Affairs (JURI) included amendments calling for 'a higher degree of harmonisation in the field of restructuring, insolvency and second chance is … indispensable for a well-functioning single market in general and for a working Capital Markets Union in particular' (amendment 6).

Context

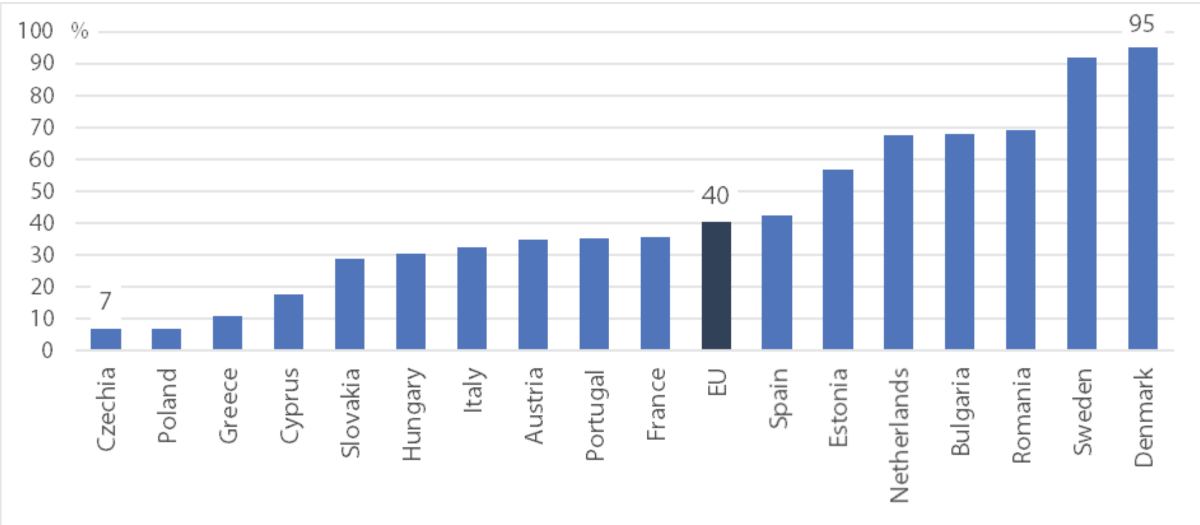
According to a European Banking Authority (**EBA**) study published in 2020, the recovery time during insolvency proceedings ranges from 0.6 to 7 years on average across Member States. The (simple) average recovery rate of corporate loans in the EU was 40 % of the amount outstanding at the time of the default, but it varied between 6.9 % (Poland) and 95.2 % (Denmark).[5] The average rate for small and medium-sized enterprises (**SMEs**) was 34 % as of 2018 (Figure 1).

Figure 1 – Average recovery rate for loans in insolvency proceedings, EU-27 (%), 2018

PANEL A: Small and medium-sized enterprises



PANEL B: Large firms



Data source: EBA Report on the benchmarking of national loan enforcement framework, 2020.

Preparation of the proposal

At the end of 2022, the European Commission published an impact assessment (IA) accompanying the proposal.[6] According to the IA, Member States' insolvency laws vary extensively, and such significant differences constitute a serious obstacle to the capital markets union. Collecting information about other Member States' insolvency laws is costly and has a negative impact on cross-border investment decisions. Furthermore, the impact assessment argues that national insolvency regimes continue to differ in terms of efficiency, notably regarding the time it takes to liquidate a company and the value that is recovered. Proceedings in some Member States are marked with much longer delays and have considerably lower recovery rates than those in the best-performing Member States.

Therefore, the IA argues that the new legislation should pursue two general objectives, namely enhancing the efficiency of the allocation of capital in the economy and levelling the playing field among corporations in the EU capital markets.

Furthermore, the IA mentions specific objectives linked to the three key dimensions of insolvency law, namely:

- **higher recovery values**, more particularly through the introduction of rules on avoidance actions and asset tracing;
- **higher efficiency of insolvency proceedings**, more particularly through the establishment of a special insolvency regime for micro- and small enterprises;
- **fair distribution of recovered value among creditors in the Member States**, more particularly through the introduction of rules on creditor committees and the ranking of claims.

Insolvency rules need to be consistent with the wider legal system in the Member States, covering areas such as company law, labour law and property law. The convergence of insolvency rules should not compromise either the consistency of national insolvency regimes with other parts of the national legal systems or the fair treatment of debtors, creditors and other stakeholders in companies undergoing insolvency procedures.

The IA considered two options: Option 1: targeted harmonisation; and Option 2: a comprehensive harmonisation.

The two options target the three key dimensions of insolvency law, namely the recovery of assets from the liquidated estate, the efficiency of procedures and the predictable and fair distribution of recovered value among creditors. Option 2 is more comprehensive and ambitious across the three dimensions as compared with Option 1.

A cost-effectiveness analysis of each of the two options pointed to Option 1 as the preferred option. Although a more comprehensive harmonisation resulting from Option 2 would yield greater benefits with regard to the specific objectives, the associated costs would be higher, especially in terms of potential inconsistencies with other areas of law. Instead, Option 1 would deliver comparable benefits at a lower cost.

According to the impact assessment, the directive could increase recovery rates by up to 1.5 percentage points (150 basis points), which could not only potentially reduce the funding costs by the same extent but also increase cross-border portfolio asset holdings. All in all, direct and indirect benefits are expected to exceed €10 billion per year.

Nevertheless, companies may incur some indirect costs due to a higher liability of directors, but most of the costs would be limited and would be borne by the Member States.

The changes the proposal would bring

The proposal aims to enhance and harmonise three aspects of insolvency law:

- the recovery of assets from the liquidated insolvency estate;
- the efficiency of proceedings; and
- the predictable and fair distribution of recovered value among creditors.

Firstly, the proposal addresses insolvency proceedings and the way information on available assets would have to be traced and obtained from banks and national registries. Tracing would be conducted by the designated court (Title III, Chapter 1), empowered to 'access and search its national centralised account' established pursuant to Article 32a of Directive 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing.

The designated courts would be entitled to access and search, directly and immediately:

- bank account information listed in Article 32a of Directive 2015/849 on money laundering, to trace the assets of the insolvent company. The courts would do so 'upon request of the insolvency practitioner' (Article 14 of the current proposal).

- beneficial ownership information registers (Article 17 of the current proposal) referred to in Directive 2015/849 on money laundering, which provide information about the beneficial owners of companies, legal entities, trusts or legal arrangements registered in the national registers of EU countries, Iceland, Liechtenstein or Norway, through the 'Find beneficial ownership information' service. This service registers, examines and stores information about companies as regards their legal form, seat, capital and legal representatives, and makes this information available to the public.

In addition, the proposal establishes 'pre-insolvency' proceedings, whereby a 'monitor' is appointed – who may later serve as an 'insolvency practitioner'. The first task of the monitor is to look for a buyer of the company. The court appoints a monitor (Article 22) at the debtor's request, and an insolvency practitioner once the liquidation phase is opened (Article 25).

The monitor conducts the 'pre-pack proceedings' provided for in Article 19(a), with the aim of finding a buyer. The debtor remains in possession of all its assets and day-to-day operations (Article 22(4)). The monitor recommends the best bidder (Article 22(2)(c)) and the court authorises the sale once the liquidation phase has started (Article 26(1)).

The proposal also aims to render the winding up of insolvent microenterprises more efficient[7] and to simplify the associated proceedings (Title VI). In particular, an insolvency practitioner is only appointed on the request of one of the parties *and* the cost is covered by the insolvency estate or by the requesting party.

Title VII contains provisions on the establishment of the creditors' committee. While it is up to the creditors to decide whether to establish a creditors' committee, the Member States are given discretion in national law to exclude the possibility of establishing such a committee when the cost of setting it up and operating it is not justified (Article 58). The creditors' committee is appointed by the creditors or the court (Article 59). The number of its members ranges between three (minimum) and seven (maximum) (Article 61).

The rights and duties of the creditors' committee are stated in Article 64. In particular, creditors must have 'at least' the following rights and powers:

- the right to hear the insolvency practitioner at any time;
- the right to appear and to be heard in insolvency proceedings;
- the power to request relevant and necessary information from the debtor, the court or the insolvency practitioner at any time during insolvency proceedings;
- the right to receive notice of and be consulted on matters in which the creditors represented by the creditors' committee have an interest, including the sale of assets outside the ordinary course of business;
- the power to request external advice on matters in which the creditors represented by the creditors' committee have an interest.

Member States may also entrust the creditors' committee with the power to approve certain decisions or legal acts.

Advisory committees

Discussions at the European Economic and Social Committee (**EESC**) are ongoing. The committee plans to adopt its opinion on the proposal in its March 2023 plenary session. In a previous opinion adopted in 2017 on the Commission's proposal for a directive on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures (2016(COM) 723), the EESC supported the move towards a regulation that would entail the 'maximum possible harmonisation of current systems'.

The Committee of the Regions was not asked to provide an opinion.

National parliaments

The deadline for the submission of reasoned opinions on the grounds of subsidiarity is 20 March 2023. No subsidiarity concerns have been raised so far.

Stakeholders' views[8]

In a 2016 report for the European Parliament Policy Department, the Centre for European Policy Studies (CEPS) argues that to benefit from a capital markets union, insolvency frameworks would need to remove sources of cost unpredictability in cross-border insolvency procedures, which are often hidden in national insolvency laws or not sufficiently dealt with in the current EU framework. In addition, the harmonisation of insolvency laws can produce positive impacts on the banking union; in particular, the harmonisation of hierarchies of claims can positively affect the functioning of the resolution mechanism.

Legal firm Kirkland & Ellis LLP, London, believe that the convergence of EU insolvency laws in the directive should facilitate the understanding of insolvency processes and assist in maximising recovery values of insolvency estates. However, the firm fears that imposing an obligation on directors to file for insolvency without undue delay may hamper rescue efforts in practice.Legal firm Clifford Chance share the view that there would be benefits stemming from the proposal, arguing that it would harmonise some key areas of EU insolvency law and saying that it is 'really welcome'. The law firm also supports the view that enhanced predictability and efficiency of the insolvency regime would not only avoid disorderly wind-downs but also 'simplifies and encourages greater investment in the first place, by reducing the risks and improving recoveries, this in turn provides greater access to funding'.

Finally, in a reaction blogpost, legal firm Allen & Overy provide an opinion on the possible impact in France, Germany and the Netherlands. In France, the directive may lead to a shift in the concept of the 'hardening period'. In Germany, the pre-pack process is attracting particular interest as a new restructuring tool. The proposal falls short of the expectations of the German restructuring market as regards directors' duties and creditor protection. Finally, the special provisions for microenterprises would have an impact on German insolvency practice. In the Netherlands, the director's duties will be of particular interest, since the Dutch regime does not oblige directors to file for insolvency at any given point in time. Therefore, if adopted, the insolvency directive would trigger a remarkable shift in Dutch restructuring practice. The Dutch stakeholders take the pre-pack proposals seriously and are likely to welcome clarity in this respect.

Legislative process

In Parliament, the referral was announced in plenary on 26 January 2023 and the file was assigned to the Committee on Legal Affairs (JURI), with Pascal Arimont (EPP, Belgium) as rapporteur. The Committees on Economic and Monetary Affairs (ECON) and on Internal Market and Consumer Protection (IMCO) have been asked to give opinions; IMCO has decided not to give an opinion. The Council started discussions on the proposal on 12 December 2022.

EUROPEAN PARLIAMENT SUPPORTING ANALYSIS

Stamegna C., New EU insolvency rules give troubled businesses a chance to start, briefing, EPRS, 2018.
Frizberg, D., Harmonising certain aspects of insolvency law, EPRS, Briefing, Initial Appraisal of a European Commission Impact Assessment, 2023.

OTHER SOURCES

Harmonising certain aspects of insolvency law, Legislative Observatory (OEIL), European Parliament.

European Commission, Proposal for a Directive of the European Parliament and of the Council harmonising certain aspects of insolvency law, COM(2022)0702, December 2022.

European Commission, Impact Assessment Report Accompanying the document Proposal for a Directive of the European Parliament and of the Council harmonising certain aspects of insolvency law, Staff Working Document 2022(SWD) 395, December 2022.

European Commission, Executive summary of the Impact Assessment Report Accompanying the document Proposal for a Directive of the European Parliament and of the Council harmonising certain aspects of insolvency law, Staff Working Document 2022(SWD) 396, December 2022.

ENDNOTES

1 Recommendation 2014/135/EU; see also the overview provided by the Commission.

2 The proposal does not define insolvency but refers to Directive (EU) 2019/1023, whose Article 2(2) establishes that the concept of insolvency is to be understood as defined by national law.

3 A bankruptcy discharge releases the debtor from personal liability for certain specified types of debts, so that the debtor is no longer legally required to pay any debts that are discharged.

4 The approximation of laws is the process by which EU Member States change their national laws to enable the free market to function properly.

5 Averages weighted by loan size vary between 5.0 % (Poland) and 97.7 % (Denmark), with the EU average equal to 26.2 %.

6 See also the executive summary of the impact assessment.

7 The term microenterprise is used within the meaning of the Annex to Commission Recommendation 2003/361/EC, which defines a microenterprise as 'an enterprise which employs fewer than 10 persons and whose annual turnover and/or annual balance sheet total does not exceed EUR 2 million' (Annex, Article 2(3)).

8 This section aims to provide a flavour of the debate and is not intended to be an exhaustive account of all different views on the proposal. Additional information can be found in related publications listed under 'European Parliament supporting analysis'.

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