



### **Proposal for a directive on Insolvency, Restructuring and Second Chance**

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**The European Commission is for the first time presenting a set of European rules on business insolvency today.**

#### **How do the EU Member States' insolvency frameworks currently perform?**

The [2015 World Bank Doing Business Report](#) ranks countries according to the efficiency of their insolvency frameworks on a scale of 0-16. The EU average is 11.6, which is 5% below the OECD average for high income countries (12.2).

The efficiency of insolvency frameworks varies widely across EU Member States: some score below 8 in this report. World Bank indicators suggest that recovery rates vary between 30 % and 90% in the EU. Recovery rates are higher in economies where restructuring is the most common insolvency proceeding: in such economies creditors can expect to recover 83% of their claims, against an average of 57 % in liquidation procedures. The length of insolvency proceedings ranges from a few months to four years, with 14 Member States having procedures which last for two or more years.

Currently, in four Member States there is no possibility to access any type of defined procedure to restructure debts with creditors before their companies are actually insolvent or are already late with payments. In other five Member States there is the possibility to restructure before being insolvent, but under very strict access conditions.

Discharge periods for entrepreneurs in Member States range from 1 to 10 years, they are longer than 5 years in a substantial number of them and in a few Member States it is still impossible to obtain discharge at all. Discharge periods also often require repayment of a certain percentage of debts which makes the debt discharge impossible for many entrepreneurs who cannot ensure this partial repayment.

#### **What issues will be addressed by the Directive?**

With the current divergences between the EU's Member States' insolvency and restructuring frameworks, investors need to assess the impacts of different legal systems. This generates excessive costs and constitutes a barrier to cross-border investments in the Single Market.

Many viable companies are currently forced into insolvency because adequate restructuring options are not available at an early stage of a company's financial difficulties in every Member State. Restructuring also does not work for - companies operating across borders.

More efficient restructuring and insolvency frameworks can also contribute in a significant way to the efficient management of defaulting loans and avoiding the accumulation of such loans on banks' balance sheets. The high level of non-performing loans in some parts of the banking sector limits these banks' capacity to offer loans to households and companies.

A further problem is the lack or difficult access to second chance opportunities for entrepreneurs in many EU countries which prevents them from starting new activities and potentially creating new jobs.

#### **What are the objectives of the Directive?**

An EU-wide action will help all companies that are active on the EU's single market, either active in different EU countries or with different steps of their supply chains' spread out across the EU.

This initiative is a key deliverable under the Capital Markets Union [Action Plan](#) and the Single Market [Strategy](#). The Directive aims to reduce barriers to cross-border investment related to differences between the Member States' restructuring and second chance frameworks, and to increase investment and job opportunities in the single market. It will also reduce the number of unnecessary liquidations of viable companies, maximising value for creditors, owners and the economy as a whole, and increase the possibilities of cross-border restructurings. The Directive will reduce the costs and increase the opportunities for entrepreneurs to be given a fresh start. Finally, the Directive will improve the effectiveness of all restructuring, insolvency and second chance procedures with a view to reducing their length and costs.

#### **What will be the benefits for businesses and entrepreneurs?**

The Directive will ensure that entrepreneurs and businesses in financial difficulties can seek support at an early stage in order to keep their businesses going. They will benefit from a flexible and efficient restructuring framework to help them bring their company back on track. They will be able to keep control of their business and benefit from temporary breathing space from enforcement action to successfully negotiate a restructuring plan. This will support entrepreneurs and businesses in the first most challenging five years, as 50% of all businesses created in the EU don't survive in the first five years.

Under the proposed Directive over-indebted entrepreneurs will have access to full discharge of their debt after a maximum period of 3 years. This will remove the stigma of insolvency and business failure, increase the rate of self-employment and encourage entrepreneurship and innovation throughout the EU. At the same time, safeguards are put in place to avoid abuse and moral hazard.

### **What will be the benefits for employees?**

A prime objective of this initiative is to ensure that viable businesses in financial difficulties can prevent their insolvency and liquidation and thus preserve their employees' jobs by staying in business.

A significant part of the 1.7 million jobs which are lost to insolvency every year is expected to be saved. Moreover, it is estimated that offering a true second chance to entrepreneurs to restart business activities would create 3 million jobs across Europe.

Throughout the preventive restructuring procedures, workers will enjoy full labour law protection of their rights as guaranteed by the existing EU legislation. Where their claims and interests are affected by a restructuring plan, workers will have the right to vote on it. Where a restructuring plan entails decisions likely to lead to substantial changes in work organisation or in contractual relations, the workers' rights to information and consultation guaranteed by [Directive 2002/14 on the information and consultation of employees](#) remain untouched. Rights of collective bargaining and collective action are also guaranteed by the Charter of Fundamental Rights. Workers' outstanding claims, such as wages, are fully protected during restructuring. Workers are in principle exempted from the stay of enforcement. That way, workers can continue to enforce their claims against the employer throughout the restructuring period.

Member States only have the possibility to apply a stay of enforcement where they protect workers' claims by other means. For example, under current EU law, Member States have to put in place guarantees of the payment of workers' claims in the event of the employer's formal insolvency proceedings. Where Member States choose to extend the coverage of such guarantees also to preventive restructuring procedures they could apply the stay for as long as the guarantee lasts, but only up to the amount that the guarantee covers.

### **What will be the benefits for consumers?**

The proposal does not create obligations for Member States in the area of consumer insolvencies. However, Member States may, apply the provisions on debt-discharge for entrepreneurs to consumers. This is a non-binding provision, but the Commission encourages them to do so. Insolvent private individuals could then benefit from a discharge period of a maximum of three years, encouraging debt repayment without hindering the right to a decent life. Consumer discharge has an impact not only on consumer welfare, but also on economic productivity. Consumers that are locked in debt for sustained periods of time will not be able to significantly contribute to the economy, neither in production, nor consumption.

### **What will be the benefits for investors?**

Investors will benefit from this initiative in several ways. First, recovery rates should increase once mechanisms to detect financial difficulties and restructure at an early stage are in place. Second, the proposed harmonisation measures will reduce the burden of risk assessment when considering investing in another EU country or in several Member States. This will incentivise cross-border investment. Finally, the reduction of the length of procedures will increase predictability for investors.

### **What will be the benefits for the banking sector in the context of their non-performing loans?**

The level of non-performing loans, which increased rapidly in most Member States following the economic crisis, remains high. High levels of non-performing loans have a direct consequence on banks' capacity to support growth. The resilience of non-performing loans in the European Union shows that further action needs to be taken. Measures to increase the effectiveness of restructuring, insolvency and second chance frameworks would contribute to a more efficient management of defaulting loans. They would also reduce accumulation of non-performing loans on bank balance sheets. Finally, they can also serve to avoid future build-up of non-performing loans. In this way, reforms of insolvency laws can complement other ongoing reforms at EU level in the banking sector and as regards capital markets.

## **What should the role of courts be in insolvency procedures?**

Involving courts in restructuring may raise costs and as a consequence discourage restructuring. The proposed framework only involves courts or administrative authorities to the extent necessary to protect the interests of creditors and other interested parties. This will help reduce the length and costs of procedures for debtors as well as creditors. It will also reduce the workload of courts in EU countries where insolvency proceedings are very cumbersome.

The reduction of court formalities will not have an impact on creditors' rights since the confirmation of the restructuring plan by a court or an administrative authority is always ensured when dissenting parties' rights are affected and where the restructuring plan provides for new financing.

## **Will the proposal harmonise core aspects of the insolvency frameworks?**

The proposal sets common principles and, where necessary, more targeted rules. It focuses on the key priorities of making sure that effective frameworks for preventive restructuring, insolvency second chance frameworks, as well as discharge procedures are available. In addition, it introduces measures to increase the efficiency – and in particular reduce the length – of all insolvency procedures.

The proposal does not harmonise core aspects of formal insolvency procedures such as conditions for opening insolvency proceedings, definitions of insolvency or ranking of claims. This minimum approach is important since some Member States already have well-functioning systems in place. The proposal gives Member States the flexibility to achieve the objectives by applying the rules in a way that is suitable in their national contexts so it can be integrated into existing social security frameworks, financial regulations and business law.

## **What is the scope of the proposal?**

The proposed Directive will apply to entrepreneurs, be they incorporated or not. It will apply both to large, medium, small or micro-enterprises engaged in business, trade or other professional activities. The proposed Directive will not apply to financial institutions since these are subject to dedicated sectorial rules. The proposal will also not interfere with purely contractual restructurings based on the agreement of all parties involved which take place outside a specific restructuring procedure.

## **What is the link between this proposed Directive and the Insolvency Regulation?**

The [Insolvency Regulation](#) focuses on resolving the conflicts of jurisdiction and laws in cross-border insolvency proceedings and ensures the recognition of insolvency-related judgments across the EU. It does not harmonise the substantive insolvency laws of the Member States. The proposed Directive focuses on harmonising the principles of restructuring proceedings and second chance frameworks. The two instruments will complement each other.

## **Will all entrepreneurs be discharged of their debts after a maximum period of 3 years?**

over-indebted entrepreneurs will have access to automatic discharge of their debt after a maximum period of three years. Any disqualifications from taking up or pursuing a business linked to the over-indebtedness will also end on this date. Member States may put in place adequate safeguards to prevent abuse, such as excluding access to discharge or laying down longer discharge periods or disqualification periods in justified circumstances, for example where the debtor acted dishonestly or in bad faith. Longer or indefinite disqualification periods may also apply where ethical rules of a profession have been violated or in cases of criminal convictions.

Member States will be able to impose repayment obligations as a condition for obtaining a full discharge. But any such partial repayment obligation must take into account the individual situation of the entrepreneur and must be proportionate to his or her disposable income during the discharge period.

## **What does the proposal foresee to help detect financial difficulties? ?**

The proposal aims at developing a culture of resorting to preventive restructuring as early as possible. Under the proposal, Member States will have to give businesses access to early warning tools, which can detect financial difficulties in order to take appropriate action at an early stage. These tools may include accounting, reporting and monitoring duties, as well as early warning mechanisms by third parties.

## **Will the proposal create a new procedure for early restructuring?**

The proposal aims at putting in place common core elements for preventive restructuring frameworks. These frameworks can consist of one procedure or of several procedures or measures that can be combined by the business owner in financial difficulties. EU countries which have such a procedure in place may choose to amend their existing framework without the need to create an entirely new procedure. Member States which do not have such a procedure in place will have to implement one.

**Does the proposal contain any principles for facilitating the continuation of debtor's businesses while restructuring?**

The proposal sets up a 'debtor in possession' procedure. It allows a business owner in financial difficulties to remain in control of the assets and the day-to-day operation of their business. The appointment of an administrator will not be obligatory in all cases. In either case businesses will continue to operate while being restructured.

**Will it be possible for creditors to enforce their individual claims during the restructuring process?**

The proposal gives a debtor a time-limited "breathing space" (stay) from enforcement actions to successfully achieve the negotiations on a restructuring plan. However, creditors will be able to lift the stay under certain conditions.

The stay can initially be no longer than four months. It can be extended under certain conditions if there is sufficient progress in the negotiations on a restructuring plan but the maximum total duration of the stay cannot exceed 12 months.

**Will dissenting minority creditors be able to block a restructuring procedure?**

Dissenting minority creditors and shareholders will not be allowed to obstruct the adoption of restructuring plans of a viable business ("hold-out"), provided that their legitimate interests are protected. The proposal sets out the conditions under which a judicial or administrative authority can confirm a restructuring plan that is not supported by all classes of creditors.

**Does the proposal provide any kind of protection for new financing and interim financing?**

New financing (i.e. financing which is necessary to implement the restructuring plan) and interim financing (allowing the business to continue to operate during the negotiation of the restructuring plan) will be protected under specific conditions in order to support the restructuring process of the company while negotiations are ongoing. This incentivises new lenders to financially support a restructuring plan and should ensure that a restructuring plan can successfully be implemented.

**Does the proposal include any rules on courts or insolvency practitioners?**

The proposal provides that judges and practitioners in the field of restructuring and second chance must receive the proper training. The members of the judiciary in charge must have the necessary expertise and specialisation. Practitioners must be appointed in a transparent way, must be subject to appropriate oversight and their remuneration should incentivise a timely and efficient resolution of procedures. This should enhance the effectiveness of the insolvency procedures and reduce their costs and length. The proposal does not create or regulate a profession of insolvency practitioners.

**Does the proposal include any rules on reducing the length of insolvency procedure?**

The proposal provides for flexible preventive restructuring frameworks and reduces court formalities where necessary and appropriate for safeguarding the interests of all stakeholders. It contains several concrete provisions aimed at reducing the length of restructuring procedures, most notably the limitations on the stay period. The specialisation of judges and practitioners and the use of digital technologies in the context of restructuring, insolvency and second chance is also expected to lead to a considerable shortening of these procedures.

**How will the Commission assess that EU countries apply these principles?**

The Directive, once adopted by the co-legislators, will have to be transposed into national law in all Member States. Moreover, it lists a number of statistics the EU countries will have to collect, e.g. the number of preventive restructuring procedures, the length of insolvency procedures. EU countries will then communicate these statistics to the Commission every year.

**For further details:**

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