European Commission

Early restructuring and a second chance for entrepreneurs

A modern and streamlined approach to business insolvency

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Every year in the EU, 200 000 firms go bankrupt, resulting in over 1.7 million people losing their jobs.

A well-functioning insolvency framework is essential to support growth and business creation. That is why the European Commission is putting forward modern and streamlined insolvency rules that will facilitate restructuring, give businesses a second chance and improve the efficiency of restructuring, insolvency and debt discharge procedures.

The proposed approach is expected to:

- ✓ Cut down the number of jobs lost due to bankruptcy;
- ✓ Bring more legal certainty for cross-border investors;
- ✓ Turn bad debt into performing credit to facilitate lending;
- ✓ Allow entrepreneurs to restart business activities, to keep innovation going and create an additional three million jobs across the EU.

Why give businesses a second chance when they face insolvency?

✓ Good for companies and their employees

There are currently a high number of businesses going into liquidation that could have been saved with restructuring.

These liquidations also create knock-on effects as one in six corporate insolvencies happens due to the collapse of a partner company. Saving more companies will therefore bring benefits to the whole chain of trading partners and employees who will be able to keep their jobs.

Preventive restructuring is also particularly beneficial for the business environment of small and medium sized enterprises (SMEs). It can lead to the recovery of unpaid debts and more certainty in assessing risks as well as in investing and trading. As SMEs tend to possess limited financial buffers, they face high risks of being exposed to customers' or suppliers' insolvencies (cash flow issues).

✓ Good for investors and banks

When companies go into liquidation, the value of the company drops sharply and investors can expect to lose money.

The problem of loans not being repaid has worsened in recent years. High levels of private debt and non-performing loans are holding back bank lending and investment, and have negative impacts on job creation and growth.

Increased use of restructuring proceedings instead of liquidations will improve the recovery rate. The highest recovery rates for investors are recorded in economies where restructuring is the most common insolvency proceedings ([1]). Creditors typically get more money back from restructurings than from liquidations.

✓ Good for entrepreneurs and creating a healthy entrepreneurial environment

Many entrepreneurs in the EU are at risk of falling in a debt trap. In some Member States, entrepreneurs with unlimited liability make up more than half of all businesses. A bankruptcy would therefore mean they have to repay all debt from their private income. They can therefore not afford to make a fresh start when they are still left with debt. This prevents talented individuals from taking forward business ideas.

One out of two Europeans (49 %) stated that they would not start a business because of fear of failure ([2]). This is linked to the fear of social stigma and the inability to pay off debts which is more prevalent in Europe than in other parts of the world.

With better second chance provisions, the EU hopes to boost entrepreneurial activity in Europe.

Insolvency knows no borders - there is a need for cooperation at EU–level

About one in four bankruptcies involve creditors and debtors in more than one EU country, while more than one million SMEs in Europe are active abroad. Faced with different insolvency laws in every Member States investors find it harder to assess credit risks, in particular for cross-border investments.

In addition, insolvency proceedings in a cross-border context are often inefficient, complex, and expensive, in particular for SMEs. It usually takes about two years to resolve a domestic insolvency in the EU. Cross-border proceedings however take three years on average and are twice as expensive.

What benefits are these rules expected to bring?

- **More viable companies will survive.** Viable businesses will be rescued and only the non-viable ones will be liquidated. This could save a significant proportion of the 1.7 million jobs lost to insolvency in the EU every year.
- **More legal certainty for cross-border investors** thanks to similar rules on insolvency and restructuring across the EU. More cross-border risk-sharing and more liquid capital markets and diversified sources of funding for EU businesses will deepen financial integration, lower costs and increase the EU's competitiveness.

([1]) All figures are according to the World Bank report, *Doing Business 2017: Equal Opportunity for All*: http://www.doingbusiness.org/%7E/media/WBG/DoingBusiness/Documents/Annual-Reports/English/DB17-Report.pdf.

([2]) *Flash Eurobarometer 354 – Entrepreneurship in the EU and beyond*: http://ec.europa.eu/public_opinion/flash/fl_354_en.pdf

- **Increased recovery rates.** Early restructuring measures result in better recovery for lenders since rescued companies can repay their loans (at least in part) and continue to make a positive contribution to the economy.
- **More loans being paid back.** A solid restructuring framework will prevent bad debts from piling up by changing non-performing loans into performing ones, or alternatively by channeling non-viable companies to quick liquidation. Freeing-up capital disposed for non-performing loans could unlock new lending capacities of between EUR 167 – EUR 522 billion.
- **Increased rate of self-employment by offering a second chance to entrepreneurs.** A reduction in the period after which entrepreneurs can make a fresh start will increase the rate of self-employment. There is evidence that those starting for a second time learn from their mistakes and their next businesses are more viable.

  The number of entrepreneurs captured in a debt-trap will be reduced and they can re-integrate into economic life and support a dynamic and innovative business environment.

What will the new rules improve?

	Current situation today	With the new rules
Early warning	There are few early warning tools alerting debtors to the risk of insolvency and the urgency to act in order to avoid liquidation.	✓ Debtors will have access to early warning tools which can detect a deteriorating business and lead to more restructurings at an early stage. ✓ A new culture of preventive restructurings can develop.
Early restructuring	A lack of early restructuring procedures or inefficient procedures forces companies into formal insolvency proceedings. It is not possible to restructure a business before insolvency is already declared in several EU countries. In others, restructuring before being insolvent is not often used, as it is limited by very strict access conditions.	✓ Viable enterprises in financial difficulties will have access to early restructuring, wherever they are located in the EU.
Breathing space before enforcement	Individual creditors can hinder a restructuring procedure by seizing the debtor's assets as soon as the debtor is in financial distress (race to grab), leading to lower recovery for other creditors and lowering the prospects for successful restructuring.	✓ The debtor will benefit from a time-limited ''breathing space'' from enforcement action in order to facilitate negotiations and successful restructuring. As overall recovery rates increase in a restructuring scenario creditors profit as well.

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	Current situation today	With the new rules
Minority creditors	Dissenting minorities of creditors can unfairly obstruct the restructuring process (hold-out).	✓ Dissenting minority creditors and shareholders can be outvoted under strict conditions in order not to jeopardize restructuring, while safeguarding their legitimate interests.
Access to financing	Although access to fresh money is vital for the rescued company, new financing for companies in the process of early restructuring is not sufficiently encouraged or protected in most EU countries.	✓ New financing will be specifically protected increasing the chances to make the restructuring successful.
Court proceedings	In many countries, there are lengthy, complex and costly court proceedings.	✓ Flexible preventive restructuring frameworks will shorten court proceedings. Where necessary, the courts must be involved to safeguard the interests of stakeholders. ✓ The use of specialised practitioners and courts as well as purpose built technology will improve the efficiency of insolvency procedures and reduce their cost and length.
Discharge period	Discharge periods range from 1 to 10 years . They often require repayment of a certain percentage of debts which makes the debt discharge impossible for many entrepreneurs who cannot ensure this partial repayment.	✓ Honest insolvent entrepreneurs will have access to full discharge of their debt after a maximum period of 3 years without further conditions. There will be adequate safeguards to prevent abuse.