To: Directorate General for Financial Stability, Financial Services and Capital Markets Union
Cc.: Directorate-General for Justice and Consumers, Civil Justice Unit
From: Bob Wessels, Dordrecht, The Netherlands
Date: 18 June 2020
Re: Feedback to 'A new Vision for Europe's capital markets', Final Report of the High Level Forum on the Capital Markets Union, June 2020

1 My name is Bob Wessels, emeritus professor of international insolvency law, University of Leiden. I am using the opportunity to provide feedback. For my background, see https://bobwessels.nl/about/. For some ten years I am an Expert advisor to the European Commission regarding matters of (international) corporate restructuring and insolvency.

2 The High-Level Forum on CMU, in its final report of the EU's capital markets union of June 10, 2020 (pages 114 and 115), sets out its 'Recommendation on Insolvency', inviting the Commission to (with letters I added):

A - Adopt a **legislative proposal for minimum harmonisation of certain targeted elements** of core nonbank corporate insolvency laws, including a definition of triggers for insolvency proceedings, harmonised rules for the ranking of claims (which comprises legal convergence on the position of secured creditors in insolvency), and further core elements such as avoidance actions.

B - Set up an expert group tasked with elaborating **common terminology** for principal features of the various national insolvency laws.

C - In cooperation with the EBA, analyse how the current bank supervisory reporting framework should be modified so that banks provide to supervisors the data on non-performing exposures that allows an analysis of the effectiveness of Member States' national insolvency systems. On the basis of this supervisory reporting data, EBA should start providing the Commission with bi-annual monitoring reports on the effectiveness of Member States' national insolvency systems.

3 I provide some feedback on these three (sub)recommendations.

A - Minimum harmonisation of certain targeted elements

4 The report itself, to my regret, does not take into account (or does not demonstrate to do so) the Commission's regulatory actions in the area of (cross-border) insolvency and restructuring taken in the second decade of this century. The HLF's view is based on the idea of (among other topics) 'insolvency' as being one of the obstacles for Capital markets integration without substantiating or solidly evidencing its view. The drafters of the report do not seem to have taken notice of the present status of insolvency and restructuring law in in the EU. I summarise that status below.

5 The insight that insolvency and restructuring law seriously matters for (cross-border) investors and that these laws differ significantly amongst EU Member States has prompted a variety of initiatives at the EU level, two of which I highlight here.

European Insolvency Regulation

6 First, after witnessing the success of the Brussels Convention on Jurisdiction and the Enforcement of Judgments in Commercial and Civil Matters of 1968,[1] which excluded insolvency and insolvency-related proceedings from its scope, the European Commission initiated the drafting process for a Convention on Bankruptcy, Winding-Up, Arrangements, Compositions and Similar Proceedings in 1980.[2] Under the auspices of the 'Council of Europe' a further developed draft text was reintroduced in 1990 as the Istanbul Convention on Certain Aspects of Bankruptcy[3] and it was an almost literal transcription of this text and its explanations that formed the content of the European Insolvency Regulation ('EIR 2000'), which went into force in May 2002.[4]

7 The experience told that harmonising substantive insolvency law in the EU was politically impossible and regarding matters of substance sheer impossible. Amongst others, positions of secured creditors and ranking of claims (including secured claims and tax claims) in national legal systems were (as to their basis in national laws, law, the influence of the general civil law system, their scope) very hard to compare. Instead, the EIR 2000 accepted the existing differences and limited its scope to rules on international jurisdiction, applicable law and recognition of court decisions in insolvency proceedings, which were initiated on another Member State. When the EIR 2000 was thoroughly reviewed and modernized in 2015,[5] the new EIR recast ('EIR 2015') broadened the scope of the Regulation beyond typical insolvency liquidation proceedings to also include national restructuring proceedings. It did not, however, provide for substantive harmonisation of existing national insolvency or restructuring law. Only in two areas with no national law in place in Member States – duties to cross-border cooperate between insolvency practitioners and courts and the rules on insolvent cross-border corporate groups – the EIR 2015 provides a few substantive provisions on cooperation and coordination.

European Restructuring Directive

8 This basic approach is also visible in the second EU legislative initiative in this field. In November 2016, the European Commission presented its 'Proposal for a Directive of the European Parliament and of the Council on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures and amending Directive 2012/30/EU' ('Proposal (2016)').[6] The aim was unaltered as Recital 1 explained: 'The objective of this Directive is to remove obstacles to the exercise of fundamental freedoms, such as the free movement of capital and freedom of establishment,

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[1] OJ L 299, 31.12.1972, p. 32–42, available at https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A41968A0927%2801%29.
[2] The text is available at http: //aei.pitt.edu/5480/ l /5480.pdf.
[3] The text is available at https://rm.coe.int/CoERMPublicCommonSearchServices/DisplayDCTMContent?documentId=090000168007b3d0.
[4] Council Regulation (EC) 1346/2000 of 29 May 2000 on insolvency proceedings, OJ L 160 of 30 June 2000. Denmark is not bound by it.
[5] Regulation (EU) 2015/848 of the European Parliament and the Council of 20 May 2015 on insolvency proceedings (recast), [2015] *OJ* L 141/19. It does not apply to Denmark. As of 26 June 2017 the EIR 2000 is repealed and the recast European Insolvency Regulation ('EIR 2015') has entered into force.
[6] See (COM)(2016) 723 final. See for all related documents http://ec.europa.eu/newsroom/just/item-detail.cfm?item_id=50043.

which result from differences between national laws and procedures on preventive restructuring, insolvency and second chance. This Directive aims at removing such obstacles by ensuring that viable enterprises in financial difficulties have access to effective national preventive restructuring frameworks which enable them to continue operating; that honest overindebted entrepreneurs have a second chance after a full discharge of debt after a reasonable period of time; and that the effectiveness of restructuring, insolvency and discharge procedures is improved, in particular with a view to shortening their length.'
The Proposal (2016) followed an earlier Recommendation of March 2014[7] that resulted in little legislative action in Member States. After intense debate in the European Parliament and with Council working groups, the 'Directive on Restructuring and Insolvency' ('Restructuring Directive') was adopted in 2019.[8] The implementation date is June 2021, with a possible extension to June 2021.

9 While the Restructuring Directive does establish basic principles for a discharge of former entrepreneurs and for the way insolvency courts and practitioners shall be treated under national law, it does not even attempt to harmonise traditional substantive insolvency law. Instead, the Restructuring Directive focusses on the establishment of a common legal framework in the EU that prevents formal insolvency proceedings under national law. Pre-insolvency court procedures shall be made available across Member States in which troubled businesses find support when negotiating a debt solution that would allow them to avoid formal insolvency proceedings. As these procedures need to fit within the existing national insolvency and restructuring laws, Member States were able to secure a wide range of optional provisions in the Restructuring Directive, in all around no less than seventy in number.

10 As a result, not many Member States may actually need to undertake a substantial law reform when implementing the Directive. Some, however, especially those with no pre-insolvency procedures in their law at all (as e.g. Germany or the Netherlands) will see relevant changes to their legal framework.

11 As to the issue of 'capital markets', the policy goal of establishing a CMU[9] has been included during the progress of the discussions regarding the Proposal (2016).[10] If I see it well recitals 8 and 11 of the Restructuring Directive refer to CMU, whilst – as mentioned under the HLF recommendation under A – 'the position of secured creditors' and 'ranking of claims' will experience influences from the national implementation of the frameworks included in the Restructuring Directive. The HLF does not provide its view on which elements are 'core', 'triggers for insolvency proceedings' or 'avoidance actions', where at least the last two are in many jurisdictions an intrinsic part of national laws related to civil, commercial or procedural

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[7] Commission Recommendation of 12.3.2014 on a new approach to business failure and insolvency, COM(2014) 1500 final. For a call for harmonising national insolvency law, plus related literature, see https://bobwessels.nl/blog/2016-01-doc5-to-harmonise-or-not-to-harmonise-insolvency-laws-in-the-eu-is-that-a-question/

[8] Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 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 amending Directive (EU) 2017/1132, OJ L 172/18.

[9] Launched with the so-called Five Presidents Report mid 2015, see my blog on https://www.leidenlawblog.nl/articles/european-monetary-union-and-insolvency.

[10] For my views of January 2017 on "Capital Markets Union (CMU): Insolvency Law Chapter", given for the European Parliamentary Financial Services Forum (EPFSF) (see www.epfsf.org), see https://bobwessels.nl/blog/2017-02-doc2-notes-for-ep-on-proposal-restructuring-directive/.

law, as such in many respects are hard to compare[11], let alone that Member States until now have not demonstrated the willingness to give any room for non-national legislative proposals. It would have been helpful to have the HFL's views as to the desired minimum harmonisation in more detail in the light of the current status of EU insolvency and restructuring laws. The same applies for (HFL's 'Feasibility', 5th bullet) the desired 'flanked measures' to incentivise Member States to enhance judicial capacity in the field of insolvency through training and specialisation, as the Restructuring Directive explicitly addresses that issue.

12 In addition, some matters mentioned under other Recommendation by the HFL need to be viewed through an insolvency-lens, as under the application of both instruments mentioned above these matters will be affected. As examples I mention 'securitisation' (definition; international private law consequences; relation with banking resolution laws), 'crypto/digital assets' (legal qualification as ownership/property or as obligatory relationship), the position of intermediaries (acting on their own behalf or on account of its principal) and access to the cloud in insolvency situations (by the debtor itself or (exclusively) by an appointed insolvency practitioner).

13 Finally, it is important to note that in all Member States secured rights, whilst have a strong position based on mandatory law, will be based on contracts. When contractual positions may be under strain, especially for a longer period – COVID-19 is an obvious example – a contractual party my defend a position which may affect (the execution of) existing secured rights (I do not touch upon the behaviour of lenders in the creation of future secured rights in these circumstances). Secured rights based on existing contracts may be influenced under national law related to rules regarding 'hardship' (or: *force majeur*), changes of circumstances (sometimes: *imprévision*), applying good faith norms between parties (in Dutch: *redelijkheid en billijkheid*; in German: *Treu und Glauben*) or abuse of rights (or: *abus de droit*).

B - Common terminology

14 Beyond these vibrant legislative developments, the European Law Institute (ELI) – an independent non-profit organisation established in 2011 to initiate, conduct and facilitate research, make recommendations and provide practical guidance in the field of European legal development[12] – initiated a study on 'Business Rescue in Insolvency Law' in 2013, published its key results in 2017 and its full study in 2020. I am the study's co-author.

15. The study ran from 2013-2017. It is founded on comparative analysis of 13 EU jurisdictions, selected to be a representative sample of the legal traditions and a range of insolvency and restructuring laws and practices across Europe. The sample includes major EU economies (Germany, France, UK, Italy, Poland, Spain, The Netherlands, Belgium, Austria), a representative of the Nordic States (Sweden), the Baltic States (Latvia) and representatives of smaller economies (Hungary, Greece). The national reports are based on extended

[11] See e.g. I.F. Fletcher and B.Wessels, Harmonization of Insolvency Law in Europe, Report 2012 for the Dutch Assocation of Civil Law, Deventer: Kluwer 2012. The Report includes a seven-step agenda for harmonisation of insolvency in the near future (see HLF's Expected Benefits, 3rd bullet).

[12] On its website (www.europeanlawinstitute.eu) it adds: 'Building on the wealth of diverse legal traditions, its mission is the quest for better law-making in Europe and the enhancement of European legal integration. By its endeavours, the ELI seeks to contribute to the formation of a more vigorous European legal community, integrating the achievements of the various legal cultures, endorsing the value of comparative knowledge, and taking a genuinely pan-European perspective. As such its work covers all branches of the law: substantive and procedural; private and public.'

questionnaires. The final analysis included national laws and comparative studies from all EU Member States, and, therefore, also covers developments in states in the Northern and Eastern region of Europe, which are absent in the national reports. The authors considered it both appropriate and necessary to take account of the considerable volume of work (laid down in international instruments, recommendations and guidelines) that has already been carried out in the field of restructuring in recent years by a number of international non-governmental organisations, e g UNCITRAL, EBRD and World Bank.
The ELI Business Rescue Report was unanimously approved by ELI in 2017. It consists of 115 recommendations which are developed on some 400 pages.[13]

16 The Report contains recommendations on a variety of themes affected by the rescue of financially distressed businesses. The ten chapters in the Report cover: (1) Actors and procedural design, (2) Financing a rescue, (3) Executory contracts, (4) Ranking of creditor claims; governance role of creditors, (5) Labour, benefit and pension issues, (6) Avoidance of transactions in out-of-court workouts and pre-insolvency procedures, and possible safe harbours, (7) Sales on a going-concern basis, (8) Rescue plan issues: procedure and structure; distributional issues, (9) Corporate group issues, and (10) Special arrangements for small and medium-sized enterprises (SMEs) including natural persons (but not consumers).[14]

18 A learning experience during the development of (now) the European Restructuring Directive has been that the European Commission's introduction (by way of a Recommendation in March 2014) of its new policy to prevent business failures also introduced several new terms. As a matter of fact, words and terms used in matters of insolvency and restructuring, compared with national legislation and international instruments covering these themes, resulted in a delta with a bewildering variety of technical terms and expressions used in the various texts. In the ELI Business Rescue Report, a Glossary of Terms and Expressions has been developed with the aim of promoting the development of a uniform European legal terminology in matters relating to restructuring and insolvency. The Glossary contains around 160 terms serving the homogeneity of workout, pre-insolvency (restructuring) and insolvency processes and should assist insolvency practitioners, courts and legislators in their work.

19 The HLF's suggestion to arrive at a common terminology that allows for a meaningful comparison between various jurisdictions and which could prepare long-term discussions about future harmonisation, therefore, is a valuable one. Its recommendation could have been taken at heart by HLF itself, as presently it may be doubted which meaning of 'insolvency' is

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[13] The source of the report and the suggested citation is: Wessels, Bob and Madaus, Stephan, Business Rescue in Insolvency Law - an Instrument of the European Law Institute (September 6, 2017). Available at SSRN: https://ssrn.com/abstract=3032309, or alternatively: http://www.europeanlawinstitute.eu/fileadmin/user_upload/p_eli/Publications/Instrument_INSOLVENCY.pdf. For the full report, including national reports, see Bob Wessels and Stephan Madaus (reporters and editors), Rescue of Business in Europe – A European Law Institute Instrument, Oxford University Press 2020, 1434 pp. ISBN 978-0-19-882652-1.

[14] As indicated, the European Commission introduced by way of a Recommendation in March 2014 its new policy to prevent business failures and insolvency leading to recent proposals on preventive restructuring frameworks and second chance for entrepreneurs. Evaluating and comparing this European initiative with national legislation and international instruments covering these themes, a delta with a bewildering variety of technical terms and expressions used in the various texts resulted. In our report, a Glossary of Terms and Expressions has been developed with the aim of promoting the development of a uniform European legal terminology in matters relating to restructuring and insolvency. The Glossary contains around 160 terms serving the homogeneity of workout, pre-insolvency (restructuring) and insolvency processes and should assist insolvency practitioners, courts and legislators in their work.

laid down in the report, and it seems (see 'Issue at stake' and 'Justification') that the terms 'creditor' and 'investor' are used as having a similar meaning.

C - Analysis of the effectiveness of Member States' national insolvency systems

20 As will be clear from the above, during the last decade European Insolvency Law is undergoing a rapid transformation. Generally, insolvency law deals with companies that somehow lost out in the market economy. Although insolvency laws' domain is largely limited to dealing with insolvent companies, the rules also have effect outside these specific cases. It is widely held that changes in the outcome of insolvency procedures, effect the behaviour of companies, shareholders and (future) creditors prior to insolvency. A higher and more certain return in case of insolvency liquidation, for example by allowing unimpeded security rights, are held to result in cheaper terms of borrowing and thereby by expansion of available credit. More credit, in turn is held to be the oil of the economy and therefore fuel economic growth.
A popular way at evaluating insolvency laws is looking at the pay out in actual procedures. The higher (and faster) the average pay-out, the better the regime performs. I think that recommendation C is based on this premise.

21 This approach, however, overlooks that insolvency procedures – even more after the implementation of the Restructuring Directive as per 2021 – increasingly are a viable business strategy and thereby one of the alternatives on the table in thinking about the future of the business. The basic premise of more efficient insolvency laws, ie that each creditor or equity provider, should receive the highest possible value as to its claim as soon as possible against as little costs as possible, is gradually losing its value for answering the question how to assess and analyse Member States' national insolvency systems in terms of quality and effectiveness. In practice, evaluating the merits and risks of so-called pre-packs (leaving out national differences of this instrument) has mainly been regarding the issue of whether in a specific case the highest price and subsequently pay out to creditors can be realized. The effects of pre-packs and other asset-sales, however, cannot simply be judged by the answer to whether the highest price possible has been paid. The question is also whether insolvency procedures become an attractive alternative to restructure the business and shed debt and how this affects other stakeholders. I therefore have my reservations in a reorting system based on measuring effectiveness of national insolvency systems.

To conclude my limited feedback:

'Harmonisation of certain core areas will increase legal certainty in areas which are significant to investors when pricing the risks of cross-border investments', is described as the main expected benefit of the HLF's 'Recommendation on insolvency'.

The developments shortly described above demonstrate that the EU legislator is determined to solve the difficulties resulting from diverse insolvency and restructuring laws by harmonising restructuring efforts, which on a Member State's level of national law will be laid down in restructuring and/or insolvency laws. Many of the European instruments related to restructuring are rather new and have not been embedded in many national legal systems for long, so harmonisation in this area seems feasible. Consequently, the scope of the EIR 2015 was extended to cover all of these laws regardless of whether they provide for insolvency or pre-insolvency procedures. This basic approach was meant to understand restructuring law as a part

of insolvency law and has led to the introduction of insolvency principles to restructuring law and procedures. The HLF stresses 'cross-border' investments. Today's insolvency law, during the last decade, has gradually extended beyond its traditional scope of treating insolvent debtors, especially by liquidation of its assets. Tools and procedures aiming to prevent the insolvency of a debtor have been included to the scope of relevant insolvency law sources and will be developed based on insolvency law ideas. This development requires attention and, to some extent, opposition.[15]

In a cross-border setting the implementation of the Restructuring Directive may lead to tools of which it is uncertain whether they will be regarded as 'insolvency proceedings' under the EIR 2015. These tools and instruments will oftentimes affect secured rights, however whether they will receive recognition in other Member States depend on other factors (listing on Annex A of EIR 2015 and Member States requesting for such listing). The cross-border effectiveness of such instruments could therefore very well be doubtful, to the detriment of the main benefit the HLF wishes to achieve.[16]

Overall, it is unfortunate that the HLF does not sufficiently align its proposals with the current status of European insolvency law. It is also difficult to determine whether the HLF is been able to appreciate the extremely difficult harmonization process in the area of law. The challenge for the Commission will, however, primarily be how to convert the unilaterally presented interest of investors in case of a debtor's default in an efficient CMU into an instrument of European insolvency law, as insolvency law inherently takes into account all interests involved.

Regards,

Bob Wessels

[15] For further details, see Stephan Madaus, Leaving the Shadows of US Bankruptcy Law: A Proposal to Divide the Realms of Insolvency and Restructuring Law, Eur Bus Org Law Rev (2018) 19:615-647.

[16] Signalling this structural flaw in the EIR 2015 and suggesting solutions, see Stephania Bariatti, et al, Part 1: Scope of Application, Pre-Insolvency / Hybrid Proceedings, in: The Implementation of the New Insolvency Regulation. Recommendations and Guidelines, JUST/2013/JCIV/AG/4679 (March 2017), 1ff.; Bob Wessels, International Insolvency Law Part II. European Insolvency Law, Deventer: Kluwer, 4th ed., 2017, para. 10425u et seq.