

A SWOT-test of insolvency reform: Lessons for emerging and developing economies

Paul Omar comments on the effect of the accelerated pace of reforms across Europe



PAUL OMAR
Technical Research Coordinator,
INSOL Europe and occasional
Consultant, International Financial
Corporation (a Division of the
World Bank)

The speed of reforms across the world in insolvency law is truly breath-taking. In Europe and neighbouring countries, the pace has accelerated of late. Countries, such as Armenia, France, Greece, Latvia, Poland and Romania, *inter alia*, have within the past decade carried out reforms, many under very challenging economic conditions.

Within the European Union, the presence of texts such as the Recast European Insolvency Regulation and the soon-to-be adopted Directive on Preventive Restructuring add a veneer of complexity and a cross-border dimension to the map of domestic procedures. Changes to insolvency law rarely take place without consideration of background economic circumstances, though reforms to domestic rules have on occasion been situated in the context of other structural changes to the justice system or to financial frameworks.

Strengths

At the local level, many of these reforms have taken place with project assistance from international institutions, including the European Union, the Council of Europe, EBRD, World Bank and IMF. With the profusion of international actors able to assist, national reform strategies are able to rely on considerable expertise and skills built up over time, some of which have been translated into guidelines, best practices and recommendations serving as useful benchmarks for the reform

process. Though the various players have different strategies and motives for providing assistance, overall there is considerable advantage for countries in having access to the expertise the international organisations can marshal, which can also be accompanied by technical and financial assistance to ensure projects happen successfully.

Weaknesses

Not all is so positive in the reform process, however. There are some weaknesses in the quest for ideal insolvency processes, particularly when that occurs against a challenging economic climate, in which insolvency is often seen as a regulatory tool to help resolve not just the financial difficulties faced by businesses, but also the need to ensure market stability and exit for failed firms. The tendency to use insolvency law as a tool for economic control can lead to iterative reforms as the economic cycle fluctuates, with the unintended consequence that the law does not have sufficient time for the reforms to bed in before new reforms need to take place. On occasion, the comparison process which informs legislators and policy-makers of developments elsewhere that may be worth emulating leads to adoption of models that may not be wholly appropriate for transplant.

In any case, Parliamentary scrutiny can be problematic where reforms are of a very technical nature and not amenable to the cut and thrust of political debate. The role of legislators can be quite limited,

especially where reform is driven by projects supported by the international institutions with considerable expert input meaning that texts can only be dissected with difficulty. However, more pressing issues can arise with respect to stakeholder engagement in the process, especially when it is intended to occur. Often, consultation occurs at an early stage to ensure stakeholder buy-in with input from practice, judiciary and (occasionally) academia informing the shape of reforms. At other times, though, engagement can be an afterthought, with pressure from key groups sometimes prompting a last-minute realisation that their views might need to be ascertained to help the reforms stand a better chance of acceptance and eventual success.

Opportunities

Some of the scope of the reform process can, nonetheless, also provide opportunities. There can be some experimentation with some insolvency law models (albeit conditioned by the risk-averse nature of politics). As economies develop and become more complex, countries can move away from the “one size fits all” approach and develop more sophisticated responses to the need of particular constituencies, such as MSMEs, industrial groups, financial institutions etc. While punctual reforms are always desirable and recourse to legislation too frequently is not, periodic intervention is possible in a system that retains some flexibility to anticipate when reforms may be necessary, as



THE TENDENCY TO USE INSOLVENCY LAW AS A TOOL FOR ECONOMIC CONTROL CAN LEAD TO ITERATIVE REFORMS AS THE ECONOMIC CYCLE FLUCTUATES



opposed to reacting to fluctuations and stresses in the economic and/or financial systems. As for the content of the reforms, given how rescue and restructuring are the watchwords of today, such interventions in the context of a flexible system can see how best to develop procedures to reflect these imperatives.

Threats

There are nonetheless a few threats to the system overall. The first is related to the role of insolvency, whether it is simply a private, though collective, form of dispute resolution, provided by the state as an efficient tool to enforce obligations, or whether its use as an economic tool, with consequent public policy overtones, creates a dissonance in the role of the state as system-provider and user. This also demands a closer understanding of the overall imperatives of

insolvency, in particular how to reconcile Government oversight and involvement with all that means in terms of how the state often translates its views on social policy into the insolvency framework. Further, the political and economic sensitivities of insolvency can get in the way of a rational debate about the extent of possible reform and development. In the context of reform, the state's attitude to improving the infrastructure it provides, particularly judicial processes and enforcement through the courts, also plays a role: if the state does not carry out sufficient capacity building, this will hinder the success of the reforms.

Conclusion

In summary, there is much more work to be done, particularly as far as issues, such as stakeholder buy-in, capacity building and the general provision of resources for

an effective insolvency framework, are concerned. There certainly needs to be more engagement with stakeholders at an early stage and perhaps not just by domestic institutions, but also the international bodies involved in many of these reform projects. Overall, more education and training for debtors and other stakeholders alike in basic business concepts and the function of insolvency cannot hurt. ■



AS ECONOMIES DEVELOP AND BECOME MORE COMPLEX, COUNTRIES CAN MOVE AWAY FROM THE “ONE SIZE FITS ALL” APPROACH AND DEVELOP MORE SOPHISTICATED RESPONSES



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