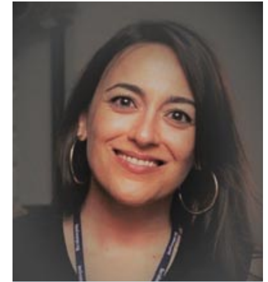
A closer look at...

Record low number of insolvencies: Calm before the storm?



EMMANUELLE INACIO
INSOL Europe Conference Technical and Training Course Director

European Governments are still providing financial support to businesses and national provisions amending or impacting insolvency law have mostly been extended

In order to prevent viable businesses affected by the COVID-19 pandemic to go insolvent, most European countries have provided them with temporary support measures such as tax deferrals, social security charges and loan repayments, guaranteed loans, etc.

Most European countries also adopted new provisions amending or impacting their respective insolvency frameworks. These temporary national reforms are aimed to increase the success of the temporary support initiatives and affect mostly insolvency proceedings and the rights of creditors.

In this regard, INSOL Europe is collaborating with LexisNexis on a COVID-19 tracker of insolvency reforms globally[1], which is regularly updated and already covers 36 jurisdictions in Europe and beyond. Moreover, INSOL Europe, in partnership with LexisNexis, organised weekly 20-minute webinars titled "**COVID Coffee Breaks**"[2] available for members and non-members of INSOL Europe. In these webinars, INSOL Europe Country Coordinators, contributors to the INSOL Europe/LexisNexis tracker of insolvency reforms globally and INSOL Europe Working Groups are invited to share their personal experiences and views on the current COVID-19 crisis and highlight the reforms and challenges of the national insolvency law framework addressing the current crisis in their own jurisdictions.

We learned from the INSOL Europe/LexisNexis COVID Coffee Breaks that many European countries have been particularly reactive, introducing temporary changes, such as Germany, France, the UK and others. These temporary national reforms mainly suspend the possibility for creditors to file for the insolvency of their debtor, suspend the debtor's duty to file for insolvency and correlated debtor's liability, extend the time limits of insolvency proceedings and/or grant the debtor a moratorium. However, none of these temporary changes in insolvency frameworks have the same end date.

Calm

At the time of writing, European Governments are still providing financial support to businesses and the national provisions amending or impacting insolvency law have mostly been extended, which explains the record low number of formal insolvency proceedings across Europe.

Indeed, from January to August 2020, France has seen its insolvencies falling by an estimated -36% compared to 2019 and The Netherlands by -7%. From January to June 2020, the UK has seen its insolvencies falling by an estimated -20% compared to 2019 and Germany by -6%[3].

Storm

However, most temporary government financial support measures and national insolvency measures will cease to apply by the end of 2020. As in past financial crises, massive numbers of insolvencies are expected.

According to the Euler Hermes Report of 24 September 2020[4], the gradual phasing out of temporary policy measures designed to support companies will lead to a major trend reversal in business insolvencies, with a +31% increase expected by the end of 2021 compared to 2019. This trend reversal will begin in the last quarter of 2020 in most countries and accelerate in the first half of 2021 amid the gradual withdrawal of various support measures and the zombification of many companies.

Unlike in the 2007-2009 financial crisis, however, this time all regions and economies are likely to post double-digit increases in insolvencies by 2021. This would lead insolvencies to increase by +10% in 2020 and by +19% in 2021 compared to 2019. The largest increase will be recorded in North America (+64% by the end of 2021), while the bulk of the rise in 2020 was +39%. In Western Europe, the rise in insolvencies by 2021 will exceed +32% and Central and Eastern Europe will be of over +34%.

On the one hand, the Nordic countries, Italy, Spain and Portugal will see a stronger rise in insolvencies in 2020. Indeed, they have been less impacted by lockdowns of insolvency courts, they have not implemented major temporary changes in insolvency frameworks (e.g. Sweden, Ireland) and the rise of the number of insolvencies will start from a low/stable level of

insolvencies in 2019 (e.g. Italy, Portugal). *De facto*, Italy, Spain and Portugal have all enacted temporary changes in insolvency laws, but not all companies are expected to use this opportunity and a rebound, right after the end of these adjustments, is expected. Italy would post a +18% rebound in 2020, from a -2% decline in 2019, and Spain a +20% surge after +6% in 2019. Both countries will see a continued rise in the number of insolvencies in 2021 (+8% and +17%, respectively), pushing their annual number of insolvencies up to 2014-2015 levels (to 14,000 and 5,850 cases, respectively).

On the other hand, the remaining countries, or one out of three, should record a delayed acceleration in business insolvencies, with a stronger rise seen in 2021 than in 2020. This is due to the major effects of lockdowns on insolvency courts activity (with the suspension of judicial functioning) and some changes in insolvency laws playing up to the end of 2020 or even until further notice.

Insolvencies are expected to gain traction with the end of the suspension rule in the last quarter of 2020 and the first half of 2021 and the lack of recovery momentum.

In the UK, where companies already took a hit on their activity and margins prior to the crisis due to Brexit, and where the length and strictness of the lockdown have been stronger, insolvencies would rebound again by +43% by 2021 to 31,500 annual cases –less than the 2009 level. In France, massive insolvencies are expected in the last quarter of 2020 and first half of 2021, also due to the gradual easing of supportive measures: the final outcome would be a +25% increase by 2021 to a record high level (64,300 cases in 2021). Extrapolating the commercial debt at risk from additional insolvencies, the economic cost of additional bankruptcies in 2020 could be as much as EUR4.2bn, and EUR5.7bn in 2021. In total, over 2020-21, COVID-19 would have brought EUR10bn liabilities to the economy or 0.4 GDP points. Germany will show more resilience, notably thanks to stronger initial conditions, a shorter and less strict lockdown, and the earlier opening of the economy, on top of a larger fiscal stimulus. However, we expect insolvencies to rebound from their historical low level reached at the end of 2019, by +12% near the end of 2021[5].

Besides, the probability of a no-deal Brexit at year-end has considerably increased (45%) and this could cause a serious economic disruption…

To be continued… ■

Most temporary government financial support measures and national insolvency measures will cease to apply by the end of 2020

Footnotes:

1 The LexisNexis PSL/INSOL Europe Tracker of Insolvency Reforms is available at: www.insol-europe.org/technical-content/covid193

2 The INSOL Europe COVID Coffee Breaks are available at: www.insol-europe.org/publications/web-series

3 www.eulerhermes.com/en_global/news-insights/economic-insights/Living-on-with-a-Covid-19-hum.html

4 www.eulerhermes.com/en_global/news-insights/economic-insights/Living-on-with-a-Covid-19-hum.html

5 www.eulerhermes.com/content/dam/onemarketing/ehndbx/eulerhermes_com/en_gl/erd/publications/pdf/Final-2020_07_16_InsolvencyTimeBomb.pdf