

The COVID-19 pandemic: A nucleus for significant reform

Catherine Bridge Zoller, keynote speaker at our EEC conference in October, reports on the background to the recent insolvency assessment on formal business reorganisation procedures



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On 1 September, the European Bank for Reconstruction and Development (EBRD) launched an insolvency assessment on formal business reorganisation procedures in partnership with UNCITRAL, the International Law Development Organisation, INSOL Europe and INSOL International and in cooperation with the European Commission.¹

The EBRD assessment was conducted by the Legal Transition Team, a small team of lawyers who are part of the Office of the General Counsel and work on legal reform and capacity building projects that support the Bank's investments. On 8 September we had a formal event to celebrate the launch and we were delighted that INSOL Europe's President Piya Mukherjee could join our panel discussion with Francis Malige, EBRD head of Financial Institutions and Professor Rodrigo Olivares-Caminal from Queen Mary Centre for Commercial Law Studies on "Restructuring in the COVID-19 era: where do businesses need support?".

Assessments are at the centre of the EBRD's efforts to foster investor-friendly, transparent and predictable legal environments. They are regularly carried out by the EBRD Legal Transition Team in commercially important legal fields to help highlight areas where a country's legal or institutional framework needs improvement. While assessments are not transaction specific, they aim to identify the reforms that

are needed to support the transactions managed by lawyers within the banking teams of the Office of the General Counsel.

In the current economic environment, the EBRD assessment is of utmost importance. Many businesses around the world have been severely affected by the coronavirus pandemic. While some businesses will be able to agree on a restructuring with their creditors, others will require formal legislative tools, including a moratorium on creditor action, to negotiate and agree a restructuring. Many will need further liquidity. There is general agreement that the crisis is particularly hard on small and medium sized enterprises (SMEs), because of their small operating margins and lack of reserves to withstand the downturn in business activity without government support. The crisis is also especially challenging for emerging economies with limited resources and without a developed legal infrastructure that supports business.

Online questionnaire

The EBRD assessment covered all economies where the EBRD invests and extends to countries outside the EBRD regions for benchmarking purposes.² The assessment included an online questionnaire, targeted at respondents with a legal background in restructuring and insolvency, to collect information on the state of business reorganisation frameworks in a given jurisdiction. The questionnaire was open to the

public and was accessed on the new EBRD assessment website (www.ebrd-restructuring.com). The questionnaire was also accompanied by a short survey on non-performing loans (NPL) addressed to financial institutions and their advisors to identify potential obstacles for NPL resolution in the banking sector, which will suffer a deterioration in loan portfolios as a result of the economic crisis. We invited members of INSOL Europe and their contacts with relevant knowledge to participate in the assessment. The questionnaire remained open until November 2020 but is now closed.

The EBRD assessment on business reorganisation was expected to uncover many areas for improvement of national insolvency legislation and greater harmonisation with international standards of best practice. Many countries still have old-fashioned insolvency systems that are geared towards liquidation and closure of the business rather than to helping debtors to survive. Weaknesses in formal reorganisation procedures have a negative impact on informal, out-of-court restructuring, since there is no credible threat or majority creditor led alternative to a fully consensual deal. Even in more advanced economies within the European Union (EU), there are significant gaps in formal reorganisation frameworks that can undermine the prospects of a successful business restructuring. For example, in some countries secured creditors are not required to be part of a reorganisation procedure and can enforce their security without restriction. Alternatively, it may be



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impossible under national legislation to compromise secured creditor claims within a reorganisation procedure without secured creditor consent, effectively resulting in a veto by individual creditor.

Cultural change

Within the EU, the culture around business reorganisation procedures will change significantly following the Directive on Restructuring and Insolvency, published in June 2019. The Directive highlights a number of key features of any legislative framework that seeks to promote business rescue, including a requirement for there to be a procedure that allows the debtor to remain in possession, a moratorium on all creditor action (including enforcement of any security by secured creditors) to support the restructuring and protection for new financing provided in the context of a restructuring. The Directive is an ambitious effort to shift the emphasis of insolvency systems in favour of early, pre-insolvency restructuring. While the Directive is inspired by Chapter 11 of the United States Bankruptcy Code, it has certain notable differences. It is a minimum harmonisation measure and will not result in a uniformly applicable approach to restructuring across the EU. However, the flexibility of the Directive and the fact that it is based on concepts and high-level principles means that it can be useful for national authorities

outside the EU, who are considering longer term reforms to their insolvency legislation to support businesses. The EBRD Legal Transition Team has been able to draw upon the Directive and its experience of transposition of the Directive in Hungary and Latvia for the purpose of the assessment. In parallel, we have updated our Core Principles of an Effective Insolvency System in consultation with INSOL Europe, the World Bank and UNCITRAL, to reflect the greater emphasis on business restructuring. These principles provide a high-level overview of the standards that insolvency systems should meet.

The COVID-19 crisis

The coronavirus pandemic has brought many challenges to society and the economy. Its effects in certain areas, including work and digitalisation, may be long-lasting. For policymakers working in the field of insolvency and debt restructuring, the COVID-19 crisis offers an opportunity for significant reform. Much needs to be done in the EBRD regions to strengthen national reorganisation frameworks and to provide businesses and their creditors with the tools to achieve a successful restructuring. The EBRD assessment will help national authorities to think beyond emergency short-term legislation to the longer-term reforms necessary to help

businesses return to viability and to protect jobs. ■

Update

Final country results and a cross-jurisdictional analysis will be published on the EBRD assessment website in the first quarter of 2021 at: www.ebrd-restructuring.com

INSOL Europe members can watch a recording of Catherine Bridge Zoller's presentation at the EICC conference in which she announced some preliminary results, on our website at: www.insol-europe.org/publications/online-conference-videos



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Footnotes:

- 1 By 'reorganisation procedures' we understand any legislative procedure(s) for restoring financial stability of a business, including any early, preventive or pre-packaged reorganisation procedure or general reorganisation-type insolvency procedure, which involves the restructuring of the debtor's assets and liabilities or any other part of its capital structure.
- 2 The economies covered by the assessment where the EBRD invests include Albania, Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Bulgaria, Croatia, Cyprus, Egypt, Estonia, Georgia, Greece, Hungary, Jordan, Kazakhstan, Kosovo, Kyrgyz Republic, Latvia, Lebanon, Lithuania, Moldova, Mongolia, Montenegro, Morocco, North Macedonia, Poland, Romania, Russia, Serbia, Slovak Republic, Slovenia, Tajikistan, Tunisia, Turkey, Turkmenistan, Ukraine, Uzbekistan, West Bank and Gaza.