Navigating the perfect storm: Reflections on cross-border corporate insolvency regimes in the EU by a relative outsider

Jasper Aerts gives his view on cross-border corporate insolvency regimes in the EU

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The past decade has seen a global economy that appears to be perpetually on the brink of yet another crisis

In the world of international finance, the complexities of corporate insolvency regimes, particularly in a cross-border context, are akin to navigating a treacherous sea.[1]

With the increasing likelihood of further insolvencies and bankruptcies, we are bracing for a perfect storm. As a former insolvency practitioner and trustee, someone who has been at the helm of the legal restructuring team in a global commercial bank, and now leading the legal division of the European Stability Mechanism ('ESM'), my panel discussion at the occasion of the 2023 Annual Congress of INSOL Europe on the harmonisation of cross-border insolvency regimes in the EU struck a chord with me.[2] As a relative outsider to the active corporate insolvency practice, it may be worthwhile to paint the broader picture of why this is important.

The complex world of cross-border insolvency

Cross-border insolvency is a multifaceted issue. When a business or individual is facing financial distress that crosses national boundaries, it becomes a complex legal puzzle. The laws and regulations governing insolvency differ significantly from one EU member state to another. This diversity can often lead to inefficiencies and legal complications that make it difficult to achieve fair and consistent outcomes for all stakeholders involved.

As an insolvency practitioner, I would often find myself indeed grappling with the intricacies of different national insolvency laws when dealing with cross-border cases. This patchwork of rules can impede timely resolutions and the recovery of assets. Harmonisation could streamline these processes, making it easier to administer insolvency proceedings, ensuring equitable treatment of creditors and enhancing the prospects of rescuing viable businesses. It is furthermore widely acknowledged that commercial banks strategically utilised forum-shopping and COMI-shifts as necessary to achieve the most financially advantageous restructuring outcomes.

The EU's harmonisation efforts aim to create a more stable, predictable, and efficient insolvency framework. This is invaluable for insolvency practitioners, creditors, and debtors alike, as it simplifies the process and minimises uncertainties, ultimately reducing costs. And although full harmonisation in the EU may seem Utopian, plus we should also reflect on actual implementation and enforcement of the rules ('*capacity building*'), minimum harmonisation would be imperative. It is time we conclude harmonisation efforts.

The need for harmonisation

The past decade has seen a global economy that appears to be perpetually on the brink of yet another crisis. The International Monetary Fund (IMF) has repeatedly emphasised the seriousness of these "*crisis-upon-crisis*" scenarios,[3] underscoring the need for effective mechanisms to address the financial turmoil that has become a norm. With the world economy hanging by a thread, and with the '*higher for longer*' interest rate risks,[4] one could expect to see more insolvencies, not just in the corporate sector, but also in households. Many businesses are indeed still reeling from the effects of the COVID-19 pandemic, and the increasing cost of living (did someone say inflation?) is putting households under more and more pressure. And then we also have geopolitical tensions and raging wars to complicate things even further.

It is in this tumultuous environment that harmonising the cross-border insolvency regime within the EU takes on heightened significance.

The importance of harmonisation

Reflecting on the above, finalising the harmonisation of cross-border insolvency laws within the EU is therefore essential for several reasons:

1. **Enhanced economic resilience:** harmonised insolvency frameworks would promote financial stability and economic resilience. It can help expedite the recovery of distressed companies, protect creditors and maintain trust in the financial system;
2. **Cross-border cooperation:** in a union like the EU, where cross-border investments and trade are common, a consistent approach to insolvency is imperative. This streamlines the process and reduces the risk of forum shopping and legal conflicts;
3. **Encouraging investments:** harmonisation provides legal certainty to investors, but also credibility and predictability. This is especially crucial for attracting foreign investment, which can be a lifeline for economies during crises; and

4. **Efficient crisis management:** harmonisation allows for swift, efficient, and transparent crisis management, which is crucial in the financial distress environment we find ourselves in today.

Safeguarding financial stability

At first glance, the ESM may appear disconnected from corporate entities or corporate insolvency. Established amidst the "height" (or perhaps "depth") of the euro debt crisis, the ESM's primary mandate is to safeguard the financial stability of the countries of the euro area. Endowed with a capital base exceeding EUR 700 billion, it stands as the world's largest capitalised international financial institution. The ESM primarily engages with sovereigns on the lending side and invests its EUR 82 billion paid-in capital in highly rated instruments issued by supranational entities and sovereigns, excluding corporates.

However, an effective corporate insolvency regime and the streamlining of insolvency rules hold significance for the ESM for several reasons. It aligns with broader objectives such as:
(i) fostering the Banking Union;
(ii) promoting the Capital Markets Union; and
(iii) ensuring overall financial stability.

Unlike for corporates, there exists no generally agreed insolvency regime for sovereigns. Sovereign debt restructuring and corporate insolvency procedures are two distinct processes, each with unique characteristics and implications. While clearly distinct (different entities, legal framework, creditor hierarchies, enforcement mechanisms, etc.), there are notable parallels between the two (debt overhang and distress, negotiation dynamics, creditor- and investor impacts, etc.). The lack of legal certainty and standardised procedures for the sovereign context can lead to prolonged negotiations, creditor disputes and market volatility, thus undermining financial stability. Conversely, well-defined corporate insolvency frameworks provide a more predictable and orderly resolution process, mitigating systemic risks and preserving investor confidence, hence boosting financial stability.

Since its inception in 2012, the ESM has spearheaded advancements in debt management standards for the euro area countries. For instance, euro area member states committed to incorporating uniform Collective Action Clauses (CACs) in their future bonds. These clauses establish common language agreed upon by euro area member states, forming an integral part of bond terms. CACs dictate how a member state can amend the terms of its sovereign bonds, including restructuring its debt. Standardising CACs across the euro area was swiftly and efficiently achieved through their inclusion in the ESM's founding treaty as the relevant legal instrument.[5]

The discussion surrounding CACs for the euro area often recalls the retrofitting[6] of these clauses in Greek government bonds during the landmark 2012 Greek debt restructuring operation, known as the Greek private sector involvement operation.[7] Despite being subject to legal disputes, including rulings by the CJEU and ECHR,[8] this mechanism was essential to prevent further financial woes for Greece at that time. Coupled with fresh financial support from the ESM, it played a crucial role in ensuring financial stability for the euro area.

Capital Markets Union, Banking Union and financial stability

The stability of corporate entities directly impacts the overall economic health of the euro area. Instances of corporate insolvency can trigger chain reactions, affecting creditors, investors and the broader financial system. Secondly, the efficiency and effectiveness of insolvency regimes influence investor confidence and cross-border investment flows. Inconsistencies or inefficiencies in these regimes can deter investment and exacerbate financial instability. The interconnectedness between corporate insolvency regimes in the euro area and financial stability underscores the need for coordinated efforts to mitigate systemic risks.

A robust and resilient Capital Markets Union (CMU) is essential for a thriving European economy. The CMU aims to create a single market for capital, ensuring that funds flow efficiently across the EU. A harmonised insolvency regime is a crucial pillar in achieving this goal. It would foster investor confidence, facilitate cross-border investment, and bolster the European Economy as a whole.

In parallel with harmonisation, the EU has been working on strengthening its Banking Union, which includes initiatives to reduce Non-Performing Loans (NPLs). In addition, the ESM is tasked to act as the common backstop to the Single Resolution Board, the centralised bank resolution authority in the EU. These initiatives will help create a healthier banking system, free-up more bank lending to the corporate sector and provide a more secure environment for businesses and individuals seeking credit.

All these efforts taken together will fortify the European financial landscape, fostering trust and reducing systemic risks.

Conclusion

The harmonisation of cross-border insolvency regimes in the EU is an important step in ensuring the resilience of our financial systems. While sovereign debt restructuring and corporate insolvency procedures are distinct processes, they share commonalities in their underlying dynamics and implications for financial stability. This ties directly with the core mandate of the ESM to safeguard the financial stability of the euro area. In the wake of the unprecedented "*crisis-upon-crisis*" phenomenon highlighted in IMF reports, the need for uniform, efficient, and transparent insolvency frameworks is more pronounced than ever. It is our collective responsibility to work towards this goal, ensuring the stability and resilience of our economies, and ultimately, the well-being of our companies and citizens. We must be prepared to set sail on these uncharted waters, navigate the challenges that lie ahead to weather this perfect storm and reach calmer shores. ■

Footnotes:

1 The views expressed in this article are the author's and not those of the ESM.

2 See the opening panel debate at the INSOL Europe Annual Conference (Amsterdam 2023) on "Making insolvency more efficient: the European Union Insolvency Trilogy". The term refers to the European Insolvency Regulation, EU Directive on Restructuring and Insolvency and the EC proposal harmonising certain aspects of Insolvency Law.

3 See the 2022 Annual Report of the IMF, available at: <imf.org/external/pubs/ft/ar/2022/>.

4 See Kalen Anev Janse, 'Outside of the box: World economy heads for soft landing amid uncertainty International Monetary Fund/World Bank meetings conclude' (*ESM Blog*, 18 October 2023), available at: www.esm.europa.eu/blog/outside-box-world-economy-heads-soft-landing-amid-uncertainty-international-monetary-fundworld.

5 Recital 11 and Article 12(3), ESM Treaty. For more on CACs, see Section 6 in Jasper Aerts and Pedro Bizarro, 'The reform of the European Stability Mechanism' (2020) 15(2) *Capital Markets Law Journal* 159–174.

6 Meaning changing its domestic laws to alter the terms of the relevant sovereign bond contracts retroactively and unilaterally.

7 For the most complete overview, see Jerome Zettelmeyer et al., 'The Greek debt restructuring: an autopsy' (2013) 28(75) *Economic Policy* 513-563. Further Greek restructuring operations followed after the 2012 one, which are described in greater detail in my contribution in Chapter 3, in Fabian Amtenbrink and Christoph Herrmann (eds), *The EU Law of Economic and Monetary Union* (OUP, 2020) (979-1024) and in Jasper Aerts, Gabriela Olariu and Efstathios Sofos, V*oluntary debt restructuring: the 2017 Greek €29.6 billion bond exchange explained* (ESM Discussion Paper No. 15, March 2021).

8 Judgment in Case C-308/17 *Leo Kuhn v Hellenic Republic.*

The harmonisation of cross-border insolvency regimes in the EU is an important step in ensuring the resilience of our financial systems

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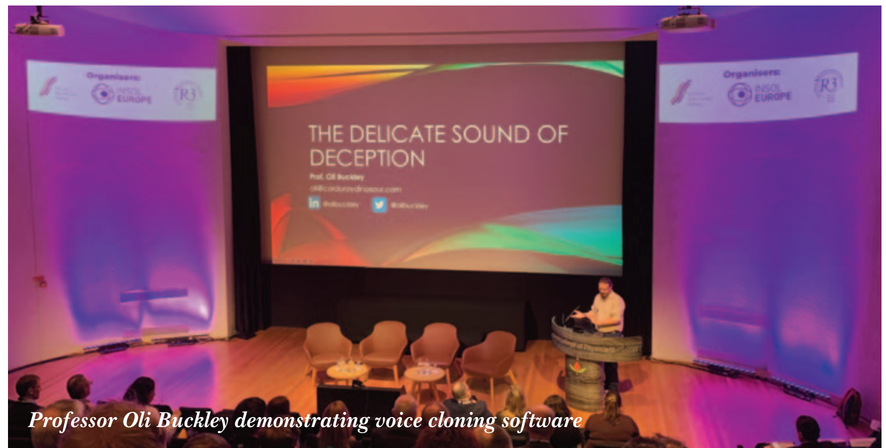
Seeing is believing... The 4th Joint Fraud Conference triumphs again in London

Report by Carmel King & Bart Heynickx, Co-Chairs of the INSOL Europe Anti-Fraud Forum

The fourth annual Fraud Conference took place on 29 February, welcoming 160 delegates to the Royal College of Physicians in London. A collaboration between INSOL Europe's Anti-Fraud Forum, the Fraud Advisory Panel and R3, this year's theme was "The Future of Fraud: Is Seeing Believing?" with the event bringing together a range of counter-fraud specialists from policy makers to insolvency and asset recovery experts to academics.



Professor Oli Buckley demonstrating voice cloning software

The opening keynote by **Professor Oli Buckley** (UEA) on AI and Deepfakes provided much food for thought, being something of a beginner's guide to creating voice clones. **Arun Chauhan** (Conference Chair) and **Frances Coulson** (INSOL Europe Vice President) were most surprised to find their voices cloned from brief, publicly available samples. The use of AI by both bad actors and as a tool to combat fraud was explored over the course of the day, with a subsequent session exploring the latter.

A breakout panel facilitated by **Bart Heynickx** (INSOL Europe Anti-Fraud Forum Co-Chair) considered international collaboration across a range of jurisdictions including the UK, Belgium, Netherlands and UAE. Participants included INSOL Europe members **Luke Harrison** and **Ferry Ortiz Aldana**. Other panels throughout the morning included a consideration of large collapses, such as FTX and Wirecard; a discussion about luxury goods, counterfeiting and provenance, and the disruption of rogue companies and directors.

During the course of the afternoon, **Frances Coulson** facilitated an in-depth exploration of the failure of public bodies to behave in a fiscally responsible manner, focussing on the Thurrock Council controversy and its consequences. **Penny Dunbabin** (Home Office) provided a brief run-through of the new "failure to prevent" guidance, which provided a jumping-off point for a debate chaired by **Carmel King** (INSOL Europe Anti-Fraud Forum Co-Chair) on whether the Economic Crime and Corporate Transparency Act and similar legislation are likely to prove effective.

The final session of the day was a much-anticipated update on the Post Office scandal. **Kay Linnell**, who had spoken on this topic alongside colleagues at the Fraud Conference 2022, received rousing applause for a compelling account of this ongoing pursuit of justice and restitution.

As ever, the networking lunch and closing reception offered delegates the opportunity to catch up with old friends and to meet some new contacts. A forward-facing conference considering many of the topics most important to the future of our profession left delegates plenty to talk about!