

The wider effect of European Union insolvency harmonisation efforts

Catherine Bridge Zoller writes on how European Union insolvency harmonisation efforts are also guiding reforms outside of the EU¹



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It has been five years since the introduction of the EU Directive on Preventive Restructuring (Directive) and most EU Member States have now transposed relevant provisions of the Directive into national law. However, this important pre-insolvency harmonising Directive is also influencing how policymakers and legislators approach insolvency reform outside the EU.

Insolvency is one of the areas of commercial law covered by the Legal Transition Programme at the European Bank for Reconstruction and Development (EBRD), a multilateral development bank, headquartered in London. The programme was established in the early years of the EBRD to support investment into former communist and socialist states transitioning to free market economies. This required a strong emphasis on reforms to secured transaction laws and insolvency regimes, which had lain dormant for almost 50 years.

Today the EBRD is active in 36 economies. On the European continent, it invests in 12 EU countries: Bulgaria, Croatia, Czechia, Estonia, Greece, Hungary, Latvia, Lithuania, Poland, Romania, Slovak Republic, and Slovenia.² Outside of Europe, the EBRD invests in the Caucasus, Central Asia, parts of the Middle East and North Africa.³ The EBRD has ceased all investments in Belarus and Russia following the Russian invasion of Ukraine. With a capital base of €22.3 billion at the end of 2023, the EBRD offers loans, mostly to the private sector and often

through financial institution intermediaries and invests in equity.⁴

Since 2019, the EBRD Legal Transition Programme has led three projects in partnership with national authorities and the EU Commission DG REFORM in relation to transposition of the Directive. These have covered aspects from the regulation of insolvency practitioners (Greece) to guidance on the advantages and disadvantages of different options provided by the Directive (Hungary) and the evaluation of existing restructuring tools against the requirements of the Directive (Latvia). Other projects since 2019, outside of the EU, have covered a diverse range of jurisdictions, including: Armenia, Kazakhstan, Serbia, Türkiye, Ukraine, Uzbekistan, and the West Bank. All these projects have, in some measure, been influenced by the Directive.

Adoption of the Directive

The timing of the Directive was prescient. From 2020, the world grappled with the Covid-19 pandemic and its devastating impact on society and businesses. The pandemic was followed by Russia's war against Ukraine and yet another war in the Middle East. Restructuring is, and remains, highly relevant for businesses, entrepreneurs, and consumers. Traditionally, however, many national insolvency systems have been used to liquidate rather than to restructure businesses. Formal restructuring tools are not always effective or – widely – used. This emphasis is slowly changing.

In the EU countries where the EBRD invests, there were significant differences in the timetable for adoption of the Directive. In relation to Title II of the Directive on preventive restructuring, there were the early adopters: Lithuania in 2020, followed by Greece, Hungary, and Croatia. All these countries met the original deadline of 17 July 2021 for the publication of “laws, regulations and administrative provisions” to comply with the Directive. A middle constituency of countries (Croatia, Estonia, Romania, and the Slovak Republic) met the extended deadline of 17 July 2022. Inevitably, there were some late adopters which all transposed the Directive in 2023, with only one country (Poland) that has not yet completed the process.

For some EU Member States, the transposition of the Directive was challenging. Insolvency frameworks and regulatory capacity are not evenly developed across national systems. Member States had to engage with the Directive and an original transposition deadline during a pandemic, while also contemplating what temporary emergency insolvency measures were required to prevent unnecessary insolvent liquidations. A Covid-19 Emergency Measures Survey conducted by the Legal Transition Programme in partnership with our Office of the Chief Economist, found that approximately half of EBRD economies of operations (18 in total) introduced emergency insolvency measures during the pandemic.⁵ This included nine EU countries, where the EBRD

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invested at the time, but not Bulgaria, Cyprus, or Greece, which in the latter case was in the process of amending its insolvency laws to align with the Directive.

Implementation trends

Some commentators have argued that the harmonisation effect of the Directive has been limited due to the many options it provides for implementation. Nevertheless, a few clear trends have appeared among the countries where the EBRD invests. For example, eight out of the 12 EBRD EU Member States (Bulgaria, Croatia, Estonia, Greece, Hungary, Latvia, Slovak Republic, and Slovenia)⁶ have opted for the new EU relative priority rule that allows shareholders or lower ranked creditors to retain value even if higher ranking creditors are not paid in full, over the absolute priority rule. This presumably reflects a practical need in many of these countries to bring the owners and managers of small businesses into the restructuring process. The trend contrasts with

larger EU economies, such as France, and Germany where absolute priority, and the non-satisfaction of lower ranking claims until higher ranking claims have been paid in full, has been the chosen option.

Another noticeable trend is that only debtors can initiate preventive restructuring in most countries. Creditors are precluded from doing so in Bulgaria, Croatia, Czechia, Hungary, Latvia, Romania, Slovak Republic, and Slovenia. Furthermore, there is a general reliance on the court for preventive restructuring in most EBRD EU Member States (apart from Greece and Romania where administrative authorities are involved in several out-of-court restructuring procedures). The provision on early warning systems has, however, generated more diverse results. Our initial research suggests that this is not yet operational in some countries, such as Croatia, Cyprus, and Hungary and has been interpreted through a mixture of self-assessment tools and public, including tax authority, systems.

Restructuring benchmarks: EU and non-EU

Outside EU borders, the Directive has been influential as a restructuring benchmark, including for countries on the EU accession path, such as Moldova and Ukraine which have been active in reforming their insolvency legislation. Because of its design and optionality, the Directive is more useful for law-making than the pre-insolvency regime of any single country. It is more prescriptive than international insolvency standards, which are necessarily crafted in a very balanced way. The EBRD has relied on the Directive as one of the main benchmarks for its Business Reorganisation Assessment.⁷ We use the results of the Assessment (and indirectly the Directive) to propose reforms that support early, preventive business restructuring.

The Directive has pushed for a consensus on long-standing issues that policymakers and the EBRD Legal Transition Programme have been seeking to

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address for some time. A major achievement is how it articulates the need for pre-insolvency procedures in the early restructuring and rescue of debtor businesses, without the need for full court involvement. In many emerging economies, court involvement brings greater legal certainty and protection from third parties. Multi-creditor workouts and restructurings based on pure contract law are uncommon. Thus, pre-insolvency procedures play a critical role.

The Directive has also shaped the role of the restructuring moratorium and the need for the inclusion of secured creditors in the restructuring process. Outside of the EU, some insolvency laws continue to limit the effects of the moratorium on secured creditors. Historically, many national insolvency procedures could only bind and affect secured claims if secured creditors gave up their security. This was unrealistic and meant that secured creditors did not participate in restructurings in practice. The Directive's emphasis on flexible plans, where a debtor and its advisors can select which affected creditors to invite to a

restructuring, is also welcome as part of efforts to streamline and improve the efficiency of preventive restructuring.

Training and capacity building

An important part of the Directive, which supports the work of institutions such as the EBRD, is Title IV. This addresses the insolvency ecosystem. While broad brush in nature, this section confirms the importance of specialist knowledge and skills for judges and insolvency practitioners. Several EBRD insolvency technical assistance programmes – for example, in Armenia and Serbia – have developed specialised capacity building programmes for practitioners and judges and have improved the regulatory oversight of insolvency practitioners. This year we are working closely with the Bankruptcy Supervision Agency (BSA), the main supervisory authority for insolvency practitioners, to deliver a comprehensive 2024 official training programme for insolvency practitioners, as well as with the Judicial Training Academy on a judicial roundtable to discuss the alignment of Serbian legislation with the Directive.

In Serbia, with donor support from Luxembourg, we have also worked with the BSA on a concept, methodology and roadmap for the BSA's expected future role as the official authority for insolvency statistics. The optional and mandatory data fields for Member States in the Directive have been an essential reference point. Comprehensive, updated, and de-aggregated insolvency data is important to have a full picture of the insolvency system and some objective measurement of its performance in practice. However, in practice many countries do not publish insolvency data, or such data is incomplete or out-of-date.⁸ Relatively few economies have a fully public, searchable digital insolvency register. This lack of

public data and information on insolvency reduces transparency and public understanding of insolvency.

Summary

EU institutions can mandate certain rules and laws for Member States. The difficulty in economies outside the EU where the EBRD operates is that there is no such driving force. However, the EU with its 27 Member States has been persuasive in raising the importance of pre-insolvency and the need to improve national insolvency systems for the benefit of all procedures. The Directive represents an ambitious project to partially harmonise and, in some countries, fill a void in the laws and mechanisms for dealing with pre-insolvency financial distress. It will be interesting to follow the impact of the Directive on non-EU insolvency systems, as well as in the EU, in the years to come. ■

Footnotes:

- 1 This article reflects the opinions of its author and does not necessarily reflect the views of the EBRD. The terms and names used in this article to designate geographical or other territories, political and economic groups, and units, do not represent and should not be interpreted as expressions or direct or implied position, approval, acceptance or expression of opinion of the EBRD or of its members on the status of any state, territory, group and unit, or the determination of its borders or sovereignty.
- 2 Non-EU European states where the EBRD invests include: Albania, Bosnia and Herzegovina, Georgia, Kosovo, Montenegro, Moldova, North Macedonia, Ukraine, and Serbia.
- 3 The EBRD is expanding operations in Africa and expects to start investing in the coming years in six sub-Saharan countries: Benin, Cote d'Ivoire, Ghana, Kenya, Nigeria, and Senegal.
- 4 On 15 December 2023, the Board of Governors of the EBRD resolved to increase the EBRD's paid-in capital by €4 billion to provide significant and sustained investment for Ukraine's real economy, both in wartime and in reconstruction, and help support the EBRD's priorities in all economies where it operates.
- 5 See: <https://ebrd-restructuring.com/Survey-of-Covid-19-Emergency-Measures-in-the-EBRD-Regions>
- 6 Cyprus, which until recently was an EBRD country of operation, also adopted this model.
- 7 See: www.ebrd-restructuring.com
- 8 EBRD Business Reorganisation Assessment, Annex 13 (Data Transparency Factor).

