European Commission

INCEPTION IMPACT ASSESSMENT			
TITLE OF THE INITIATIVE	Initiative on insolvency		
LEAD DG – RESPONSIBLE UNIT – AP NUMBER	DG JUST (A1), 2016/JUST/025 – INSOLVENCY II	**DATE OF ROADMAP**	03/03/2016
LIKELY TYPE OF INITIATIVE	Legislative		
INDICATIVE PLANNING	*N/A*		
ADDITIONAL INFORMATION	*N/A*		

This Inception Impact Assessment is provided for information purposes only and can be subject to change. It does not prejudge the final decision of the Commission on whether this initiative will be pursued or on its final content and structure.

A. Context, Subsidiarity Check and Objectives

Context

- *How does this new initiative relate to past and possible future initiatives, and to other EU policies?*
- *Has existing policy been evaluated? Is it part of the REFIT agenda?*
- *Consider recently adopted initiatives whose effects will only materialize after their implementation and other initiatives under preparation (also of other policy fields) touching upon the same problem. Describe how policy coherence is ensured.*
- *See Toolbox Tool #1 'Principles of Better Regulation'*

Insolvency law in general and restructuring procedures in particular are important throughout the lifetime of a business and can become a catalyst to promote and encourage economic growth in EU as they inform investment decisions and businesses' access to funding. If before making an investment it is not possible to predict what will happen with the investment throughout its life-cycle, it is also not possible to predict, quantify and manage risks which can affect this investment. Disparate insolvency regimes in the EU create such an element of unpredictability for EU cross-border investments.

Regulation (EU) 848/2015[1], which will enter into application in June 2017, deals with the private international law dimension of insolvency (uniform rules on conflicts of jurisdiction, applicable law and recognition of cross-border judgements arising from insolvency proceedings). Notwithstanding its useful impact in clarifying these issues in cross-border insolvency proceedings, it does not touch upon the substantive insolvency laws of Member States as such. In addition, in a number of cases, the rules contained in this Regulation may involve the application of the laws of more than one Member State when several companies and/or their establishments are involved in the insolvency. In such a situation the differences among the substantive insolvency laws of the Member States may make the coordination of different proceedings and applicable laws more difficult.

Given the widely differing substantive laws of Member States[2] in 2011, the European Parliament adopted a Resolution on insolvency proceedings[3]. It included recommendations for harmonising specific aspects of substantive insolvency law and company law. A study commissioned by the European Parliament[4] had shown that disparities between national insolvency laws can create obstacles, competitive advantages and/or disadvantages and difficulties for companies with cross-border activities or ownership within the EU. That study concluded that ‘there are certain areas of insolvency law where harmonisation is worthwhile and achievable', which would increase the efficiency of restructuring procedures and the returns to creditors.

The Commission Communication of December 2012[5] highlighted certain areas where differences between domestic insolvency laws could hamper the establishment of an efficient internal market. Those differences affect the principle of free movement, in particular free movement of capital, competitiveness, and overall economic stability. It indicated a step-by-step approach starting with the modernisation of the Regulation (EC)

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[1] Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings OJ L 141, 5.6.2015, p. 19.

[2] Both the Regulation (EC) No. 1346/2000 as well as the new Regulation (EU) 848/2015 which will replace the first as of June 2017 recognise the fact that substantive insolvency laws of Member States are largely disparate (recital 11 of Regulation (EC) No. 1346/2000 and Recital 22.of Regulation (EU) 848/2015.

[3] Report with recommendations to the Commission on insolvency proceedings in the context of EU company law (2011/2006(INI)).

[4] Harmonisation of Insolvency Law at EU level, Directorate General for Internal Policies of the European Parliament, PE 419.633.

[5] European Commission: Communication "A new European approach to business failure and insolvency" COM(2012) 742.

No. 1346/2000 (accomplished by the adoption of Regulation (EU) 848/2015) and reflecting on ways forward to deal with the disparities between substantive insolvency laws.

In this perspective, the Commission adopted on 12 March 2014 a Recommendation on a new approach to business failure and insolvency[6] addressed to the Member States concerning the national rules on insolvency (the "Insolvency Recommendation"). The Insolvency Recommendation aims at encouraging Member States to adopt a framework based on EU-level minimum standards for (1) preventive restructuring procedures enabling debtors in financial difficulty to restructure at an early stage with the objective of avoiding their insolvency, and (2) discharge periods for honest bankrupt entrepreneurs which would allow them to have a second chance. The Insolvency Recommendation also suggests that its main principles could also be applied to consumer insolvency. The Member States were invited to implement the Insolvency Recommendation by 14 March 2015.

On 30 September 2015 the Commission published the Capital Markets Union Action Plan[7] which indicated, amongst other things, that the Commission would consult on the key insolvency barriers and take forward a legislative initiative on business insolvency, addressing the most important barriers to the free flow of capital and building on national regimes that work well. In the framework of the economic analysis accompanying the Capital Markets Union Action Plan[8], a report on the follow-up to the Insolvency Recommendation was published[9].

The evaluation concluded that the Insolvency Recommendation has been partially taken up by some Member States, including by those receiving insolvency-related recommendations in the context of the European Semester exercise addressing macro-economic imbalances. Even those Member States which have taken up the European Commission Insolvency Recommendation did so in a selective manner, meaning that differences remain.

Also the Single Market Strategy[10] indicates that the Commission will support bona fide entrepreneurs and propose legislation to ensure that Member States provide a regulatory environment that is able to accommodate failure without dissuading entrepreneurs from trying new ideas.

The Banking Union Communication[11] issued on 24 November 2015 confirms that (i) there is a need for greater convergence in insolvency law and restructuring proceedings across Member State, (ii) the inefficiency and divergence of insolvency laws make it harder to assess and manage credit risk, and that (iii) enhancing legal certainty and encouraging the timely restructuring of borrowers in financial distress is particularly relevant for the success of strategies to address the problem of non-performing loans in some Member States.

Furthermore, the recently published "Five Presidents' report" of 22 June 2015 on "Completing Europe's Economic and Monetary Union"[12] lists the area of insolvency law among the most important bottlenecks preventing the integration of capital markets.

Also Council Conclusions on the Commission Action Plan on building a Capital Markets Union[13] referred to the insolvency initiative and invited the Commission to consult the Member States in order to identify business insolvency law-related barriers to the development of a single market for capital.

Issue

- *Describe the reasons behind the initiative. What is the issue/problem(s) it is expected to tackle?*
- *Describe the size of the problem and its main drivers.*
- *Describe who is affected and how (stakeholder mapping)*
- *Explain why this is a problem at EU level and describe how it is likely to develop in the future in case no policy action is taken.*
- *See Toolbox Tool #11 'How to analyse problems'*

The **lack of efficient restructuring framework and inefficient insolvency proceedings** for companies and natural persons leads to a high amount of accumulated private debt. The latter is rising in the EU, unlike in the US. or Japan, where it is decreasing[14]. One of the consequences is the sub-optimal level of investment in the Single Market and the loss of entrepreneurship opportunities. Differences between national insolvency laws and

[6] C(2014) 1500 final, 12.3.2014.
[7] Action Plan on Building a Capital Markets Union, COM(2015) 468 final, 30.9.2015
[8] Economic Analysis accompanying the Action Plan on Building a Capital Markets Union, SWD(2015) 183 final, 30.9.2015
[9] Evaluation of the implementation of the Recommendation of 12 March 2014 on a new approach to business failure and insolvency, 30.9.2015, http://ec.europa.eu/justice/civil/commercial/insolvency/index_en.htm
[10] COM (2015) 550 final, 28.10.2015
[11] COM(2015) 587 final, 24.11.2015
[12] Completing Europe's Economic and Monetary Union, Report by Jean-Claude Juncker (in close cooperation with Donald Tusk, Jeroen Dijsselbloem, Mario Draghi and Martin Schulz, 22 June 2015 (http://ec.europa.eu/priorities/economic-monetary-union/docs/5-presidents-report_en.pdf)
[13] 10 December 2015.
[14] IMF: Euro Area Policies – Selected Issues, IMF Country Report No. 15/205, July 2015.

systems in the EU also contribute to this situation by high costs related to insolvency proceedings with cross-border elements. The impossibility of or long delays in discharging debts lead to difficulties in making a new start, especially for small entrepreneurs, and resources being caught up for a long period in unproductive activities. This, in turn, leads to an insolvency stigma and losses of growth, jobs and competitiveness.

The absence of efficient restructuring framework and insolvency proceedings increases the risk that companies become insolvent, leading to lengthy insolvency proceedings which often do not save a viable company that could have been saved if an efficient restructuring framework had existed. Without such frameworks there are smaller prospects for the recovery of assets. Many Member States do not have such frameworks. The 2015 World Bank "Doing Business Report" ranks countries on the strength of their insolvency frameworks on a scale of 0-16. The EU simple average is 11.6, which is 5% below the OECD average for high income countries (12.2). Some Member States score below 8[15]. Despite ongoing efforts to improve European insolvency and restructuring procedures, important differences persist across Member States. World Bank indicators[16] suggest that recovery rates vary between 30% in Croatia and Romania and 90% in Belgium and Finland.

Without such efficient frameworks, the level of private debt remains high. Studies and data from the International Monetary Fund[17] suggest that high indebtedness of EU companies and the problem of non-performing loans represent an investment barrier and prevent economic growth. As recognised in the Green Paper on a Capital Market Union (CMU)[18] and the Capital Market Union Action Plan, non-efficient insolvency regimes discourage investors from investing in the EU.

The debt overhang and high level of non-performing loans hurt the EU economy for at least three reasons. First, there is less credit available to the economy, since markets are unable or unwilling to lend to firms having non-performing loans or charge high or prohibitive rates. Second, lagging debt restructuring leads to lower investments since highly indebted companies have to use all profits created for repayment of old debts instead of for new investment. Third, excessively leveraged banks and firms are vulnerable to economic or financial shocks[19]. Thus, banks' balance sheets remain under pressure from a high number of non-performing loans in an environment in which monetary and fiscal stimuli are weakened. .

Differences in insolvency regimes have an impact on investment decisions in the Internal Market. When considering a particular insolvency regime, an investor considers both the expected outcome (for example, recovery rates for creditors based on historical data and experience) and the speed and cost of the process. The bigger the differences between the systems are, the longer and more costly it will be to achieve a satisfactory outcome for investors, but also for other stakeholders.

In the context of 28 divergent insolvency regimes in the EU, foreign investors are facing high costs of assessing the associated risks, as suggested by the respondents in the public consultation on Building a Capital Markets Union. National proceedings in a purely national context could be efficient, but with foreign investors, contactors or employees and the possible interplay of different legal systems, it leads to delays and the reduction of recovery rates. Moreover, since a number of business contracts are secured with securities being traded in the world market, more uniform insolvency framework rules would contribute to a level-playing field, which would then make the securities market more predictable and henceforth encourage investment in the EU.

In addition, differences in insolvency regimes might lead to a relocation of the company concerned and hence to the application of a different insolvency regime than originally expected by creditors. This adversely affects minority creditors even though the restructuring itself could be beneficial to the body of creditors and the company as a whole. Additional costs for creditors after the relocation, i.e. costs of legal advice and the costs related to a shift in centre of main interests, may be a barrier for creditors to properly manage their interests in recovering the debt especially when the recovery of debt is relatively low.

In conclusion, lengthy, inefficient, and costly insolvency proceedings in Europe are often deemed by analysts to be one of the root causes of insufficient post-crisis debt deleveraging in the private sector[20]. The comparison with the U.S. - which has a uniform bankruptcy regime regulated at the federal level - suggests that the problem of non-performing loans is more difficult to resolve without effective restructuring and insolvency tools. High levels of non-performing loans then undermine the capacity of banks to lend in recovery which is likely to disproportionately affect SMEs that are more dependent on bank finance. This can also discourage the timely

[15] World Bank: 2015 Doing Business Report – Going Beyond Efficiency, http://www.doingbusiness.org/reports/global-reports/doing-business-2015

[16] Economic Analysis accompanying the Action Plan on Building a Capital Markets Union, SWD(2015) 183 final, 30.9.2015, p. 76.

[17] IMF: Euro Area Policies – Selected Issues, IMF Country Report No. 15/205, July 2015.

[18] COM(2015) 63 final, 18.2.2015.

[19] Idem.[20] European Commission – Directorate General Economic and Financial Affairs: Insolvency frameworks in the EU, Note to the Economic Policy Committee, 9 December 2015

[21] Impact Assessment accompanying the Commission Recommendation on a New Approach to Business Failure and Insolvency, SWD(2014) 61 final, 12.3.2014.

[22] Flash Eurobarometer 354, ENTREPRENEURSHIP IN THE EU AND BEYOND, June - August 2012.

[23] The over-indebtedness of European households: updated mapping of the situation, nature and causes, effects a,d initiatives for alleviating its impact, Civic Consulting for the European Commission, 2014, p. 32, http://ec.europa.eu/consumers/financial_services/reference_studies_documents/docs/part_1_synthesis_of_findings_en.pdf

[24] Also a high within country heterogeneity can be observed.

restructuring of viable companies in financial distress, including of cross-border groups of companies. It is estimated that in the EU, 200,000 firms go bankrupt per year (600 a day), resulting in direct job losses of 1.7 million every year[21]. More accessible and simplified debt restructuring procedures for SMEs could be also beneficial in terms of increasing the availability and cost of credit to start-ups

It takes a long time or may even be impossible in the EU to discharge debts. The risk of bankruptcy is what Europeans fear most about setting up a new business. In Flash Eurobarometer[22], 49% of Europeans have declared that they would not start a business because of the fear of failure. That fear is justified given that 50% of businesses do not survive the first 5 years of their existence and that in many Member States it takes a long time for a bankrupt person to obtain a discharge of debt. Also evidence suggests that failed entrepreneurs learn from their mistakes and are generally more successful the second time around. Restarters usually experience faster growth than newly established companies and after five years their start-ups have better survival rates.

Last but not least, households are a key source of funds to finance investment, but also remain under debt overhang pressure. EU-SILC survey data shows that, in 2011 and across the EU area as a whole, one in almost nine of those surveyed (11.4%) had been in arrears with payments over the previous 12 months on rent/mortgage, utility bills and/or hire-purchase/loan agreements due to financial difficulties. However, more than three in ten of those surveyed in Bulgaria, Greece and Romania were in this situation.[23] The situation in the EU shows high cross-country heterogeneity[24] with the household sector effectively deleveraging only in a subset of countries. In other countries, this sector is likely to be caught in a debt trap. Households with lower income or wealth appear to be affected by the debt overhang which has a negative impact on household spending and hence aggregate demand.

Subsidiarity check

- *Indicate the legal basis giving the EU the right to act*
- *If your policy field falls under the exclusive competence of the EU, use the standard formulation: "The initiative falls under the exclusive competence of the EU according to Article xx of the Treaty on the Functioning of the European Union (TFEU). Therefore, the subsidiarity principle does not apply".*
- *Necessity check & Added-value test*
- *See Toolbox Tool #3 'Legal basis, subsidiarity and proportionality'*

The legal basis for this initiative is Article 114 TFEU.

The discrepancies between the Member States' insolvency legislations create barriers to the free movement of capital, goods and services in the internal market. If no action is taken, differences between the Member States' insolvency laws will continue to create legal uncertainty and additional costs for investors, members of companies and other stakeholders in assessing their risks and barriers to the efficient restructuring of viable companies in the EU, including cross-border enterprise groups. Creditors located in one Member State suffer losses (e.g. sub-optimal recovery of debts) due to the insufficient procedures in another Member State. While only about 25% of bankruptcies have a direct cross-border element, the effect of a bankruptcy of one company on companies located in other Member States could be significant. In practice the vast majority of businesses are in a chain with at least one company which has cross-border activities[25].

The report on the follow-up to the Commission Recommendation shows that all Member States have not fully adopted the approach recommended. This means that without action at EU level significant differences between Member States would continue to exist and will continue to create legal uncertainty and additional costs for investors looking to move their capital across borders in the internal market, and continue to create barriers to the efficient restructuring of viable companies in the EU, including cross-border enterprise groups. These problems will not be remedied by Member States acting alone. The lack of action at EU level would lead to the consequences described above.

As regards the necessity and added value, most of the views received under the CMU Green Paper consultation supported an approach which would concentrate on certain specific aspects of substantive insolvency laws where, in their view, an action at EU level could bring an added value in relation to business insolvency. The Financial Services Users Group (FSUG) also supports an initiative on personal insolvency of natural persons.

In this context, the Action Plan on Capital Markets Union indicated the launch of a legislative initiative on business insolvency, including early restructuring and second chance, which will seek to address the most important barriers to the free flow of capital, building on national regimes that work well drawing on the experience of the Insolvency Recommendation.

[25] Commission Staff Working Document, Impact Assessment accompanying Commission Recommendation.
on a New Approach to Business Failure and Insolvency, SWD(2014) 61 final, 12.3.2014.
[26] COM(2015) 630 final, 10.12.2015.

The Commission has also flagged the issues around consumer insolvency in the context of the Green Paper on Retail Financial Services.[26] The Green paper indicated that there are still substantial divergences in relation to insolvency regimes of natural persons across the EU. This creates additional risk for firms wishing to enter a cross-border business relationship with customers, particularly in relation to the provision of credit, if lenders are unable to assess and quantify the outcome of insolvency proceedings.

Main policy objectives

- *What is the initiative aiming at? What should be achieved?*
- *What is the link to the problem (coherent intervention logic)?*
- *Beware of too specific objectives which could pre-empt a 'preferred' option*
- *See Toolbox Tool #13 'How to set objectives'*

The general objective is to boost cross-border investment, encourage entrepreneurship and consumption and removing the insolvency stigma. This should result in more growth, jobs and improved competitiveness.

The specific objectives are to contribute to the reduction of private debt in the EU, to increase the levels of debt recovery, to keep more viable companies as on-going concern, reduce the costs related to the cross-border dimension of insolvency proceedings and make it easier to start a new business/receive funding or make a new investment. This means that, on the one hand, viable businesses in distress can be rescued, and on the other hand that unviable firms can be liquidated more efficiently.

The operational objectives are the creation of an effective restructuring framework, or at least the common principles governing such a framework, make national laws more uniform giving bankrupt, but honest entrepreneurs who operate without limited liability, a second chance by discharging debts in a reasonable time period.

In respect to the household debt overhang, the objective would be to facilitate the economic recovery by easing consumption and promoting retail investment.

B. Option Mapping

- *What are the various ways to achieve the policy objectives? What legislative and non-legislative instruments could be considered? Always consider 'no EU action resp. no change in EU action' (baseline)*
- *Consider options which have been proposed by stakeholders and/or are likely to be proposed during the legislative process but do not discard a priori options with little support or facing strong opposition*
- *See page 23 of the Guidelines and Toolbox Tool #14 'How to identify policy options' and Tool #15 'The choice of policy instruments'*

Baseline scenario – no EU policy change

- *The "baseline scenario" should always be developed and used as the benchmark against which the alternative options should be compared. As such, it should take account of both national and EU policies in place and reflect possible developments of these in the absence of new EU-level action. It should also try to anticipate important technological or societal developments such as the pervasive role of the internet and other ICTs.*

In March 2014 the Commission issued a Recommendation on a new approach to business failure and insolvency. The Recommendation set out a series of common principles for national insolvency procedures for businesses in financial difficulties with the objective of encouraging viable businesses to restructure at an early stage so as to prevent insolvency.

Following that Recommendation a few Member States have undertaken reforms, but have chosen selectively among its provisions.

Notwithstanding that some implementation of the Insolvency Recommendation has occurred, this has remained partial, so there will be continuing divergences of approaches of Member States to the efficient restructuring and insolvency proceedings which amplify the negative effects of debt overhang and impede an effective allocation of the capital in the EU.

A significant number of respondents to the CMU Green Paper consultation[27] recognised that the variation in national approaches creates investor uncertainty when assessing the risks of investing in a particular market, and a number of them advocate an approach aiming at least at the identification of common principles in the area of insolvency at the EU level.

In the insolvency areas outside the scope of the Insolvency Recommendation, no approximation has so far taken place. In these areas Member States have their national legislation which results in large divergences

[27] Feedback Statement on the Green Paper "Building a Capital Markets Union" (Question 29), SWD(2015) 184 final, 30.9.2015, p. 59 and foll.

between national insolvency frameworks.
Options of improving the status quo
• *Describe possible options or explain why this is not relevant*
1. A minimum harmonisation directive focusing on specific aspects of insolvency based on broad common principles and rules which would reduce the differences between national insolvency regimes while strengthening weaker regimes. Such a directive would cover the matters covered by the Insolvency Recommendation, but could also cover some procedural aspects of formal insolvency proceedings (e.g. rules on opening of insolvency proceedings, filing of claims, restructuring plans, involvement of creditors, ranking of claims, avoidance actions) as well as measures aimed at reducing the length and costs of proceedings for SMEs (e.g. use of standard forms, use of distance means of communication). 2. A full harmonisation instrument, covering in detail the main insolvency procedures. This option was recognised as being the most effective by several respondents to the consultation on the Green Paper on the Capital Markets Union[28]. However, it is ambitious given the interplay with other national policy objectives, values and national traditions. If feasible, it would inevitably be a project for the long term. 3. Some responses to the Green Paper consultation have suggested that a 29th regime sitting alongside national insolvency regimes into which creditors could opt or which could apply automatically as from a certain date might be an option to consider. The responses also highlight that this approach brings extra complexity as well as enforcement difficulties. In order to achieve its objective, such a 29th regime would have to be a comprehensive and self-standing set of rules, akin to full harmonisation, so that creditors opting into it would no longer need to have recourse to national insolvency laws. Many of the same considerations mentioned above in relation to full harmonisation would apply here as well. Any proposed option will comply with EU state aid rules, e.g. as regards credits or claims of public bodies and, where possible, contribute to their smooth, improved and/or more even application by Member States. The scope of the harmonisation of insolvency laws could capture: 1) Preventive restructuring procedures and a discharge of debt (second chance) for entrepreneurs as provided for by the Insolvency Recommendation 2) key areas of insolvency beyond the scope of the Insolvency Recommendation as concerns **Corporate insolvency:** - common minimum rules for directors' duties and liabilities in anticipation of insolvency, as well as their disqualification due to breach of those duties; - common minimum rules for the ranking of claims in insolvency and avoidance actions, with a view to bringing more legal certainty in cross-border flow of capital; - a simplified approach to SMEs insolvency, for example by providing standard forms for filing claims and putting in place electronic means to reduce costs; - common minimum rules for insolvency practitioners with the aim of allowing both easier exercise of this profession in different Member States and set standards ensuring proper conduct of these professionals; - protection of investors' rights by ring-fencing securities from the insolvency regimes of intermediaries with whom investors deposited their securities. **Insolvency of natural persons :** - provisions on the availability of insolvency procedures, both debt restructuring and liquidation procedures; - provisions on the discharge of debt of natural persons other than entrepreneurs after a reasonable period of time (no more than 3 years, as for entrepreneurs).
Alternative policy approaches
• *Describe e.g. different policy content / approaches to reach the objective or explain why this is not relevant*
The Commission has been looking at insolvency in the context of the European Semester aiming at correcting certain macro-economic imbalances. Several Member States[29] received specific recommendations on reforming their insolvency framework, not least in terms of increasing debt deleveraging tools for both corporate and

[28] Feedback Statement on the Green Paper "Building a Capital Markets Union" (Question 29), SWD(2015) 184 final, 30.9.2015, p. 59 and foll.
[29] 2015: Bulgaria (Specific Country Recommendation n°5), Croatia (Specific Country Recommendation n°6), Portugal (Specific Country Recommendation n°4), Slovenia (Specific Country Recommendation n°3).

consumer debtors, reducing the length of proceedings for example by introducing out-of-court tools, improving the professionalism of insolvency professionals and generally improving the efficiency of the court system.

The country specific recommendations addressed to certain Member States in the framework of the European Semester cannot by their nature trigger a coherent EU wide reform in terms of substantive law. Most of these recommendations can only lay down specifications aimed mainly at correcting macro-economic instability risks without being able to reduce in a coordinated way the differences between national procedures that give rise to distortions in investment and location decisions. Also they address only a small number of Member States and, thus, cannot achieve a consistent solution to an EU-wide problem.

Also a legislative instrument, such as directive which would only be addressed to certain Member States would not contribute to the desired uniformity and level playing field. In addition, instead of reducing the cost for investors and stakeholders it risks to create even a more complex legal environment.

Alternative policy instruments

- *Describe e.g. non-regulatory alternatives; self- or co-regulation: market-based solutions, regulatory alternatives; international standards, and their mix or explain why this is not relevant*

A soft law instrument aimed at increasing the transparency of national insolvency laws could be considered useful in areas which are not appropriate for approximation but which are nevertheless important for investors, for example the definition and consequences of insolvency, or the treatment of certain claims (employment, tax claims) in insolvency proceedings. Such a soft law instrument could draw inspiration from existing global instruments such as the UNCITRAL Legislative Guide on insolvency proceedings. However, in the CMU Green Paper consultation none of the respondents indicated that market developments would be able to resolve the identified issues since the area of insolvency law is a highly regulated domain[30].

While it is clear that the Insolvency Recommendation has provided useful focus for those Member States undertaking reforms in the area of insolvency, it has not succeeded in having the desired impact in facilitating the rescue of businesses in financial difficulty and in giving a second chance to entrepreneurs because of its only partial implementation in a significant number of Member States, including those having launched reforms. These differences in the implementation of the Commission Recommendation lead to a continuing legal uncertainty and additional costs for investors in assessing their risks and continuing barriers to the efficient restructuring of viable companies in the EU, including cross-border enterprise groups.

Alternative/differentiated scope

- *Consider differentiated scope e.g. is the "think small first" principle taken into account; are micro-enterprises excluded from the scope of any proposed legislation or explain why this is not relevant*

As regards preventive restructuring procedures due to certain often non-negligible costs which a successful restructuring requires, they would most probably not be accessible *de facto* to a significant number of micro-enterprises since the costs of such restructuring would exceed the value of a number of microenterprises in financial difficulties. Hence, for such microbusinesses in distress liquidation through quick and effective insolvency procedures would be the most likely outcome. This, by contrast, emphasises the importance of second chance for single entrepreneurs who would often qualify as microenterprises.

Options that take account of new technological developments

- *All new initiatives should be "digital and internet ready" and operate effectively both in the digital and the physical worlds*
- *Describe possible options or explain why this is not relevant*

The initiative will encourage Member States to implement distance means of communication in order to improve creditor participation in insolvency proceedings, such as distance voting and possibly the use of multilingual standard on-line forms for filing of claims.

Preliminary proportionality check

- *Even when the EU has exclusive competence or the subsidiarity test is positive, any EU action must be proportionate i.e. not go beyond what is necessary to solve the problem. Outline the proportionality of the foreseen EU action.*
- *See Toolbox Tool #3 'Legal basis, subsidiarity and proportionality'*

Common principles or minimum standards directing a more effective insolvency law that allows swift recovery or liquidation in a predictable and transparent manner would facilitate debt restructurings and the reallocation of

[30] Feedback Statement on the Green Paper "Building a Capital Markets Union" (Question 29), SWD(2015) 184 final, 30.9.2015, p. 59 and foll.

funds to their most productive use. Such principles would allow taking into account the sensitivity of insolvency frameworks and aim therefore at attaining common objectives but leaving the means to the Member States. The proposed legislative instrument will focus on specific aspects of insolvency, based on commonly agreed principles and rules which would reduce the differences between national insolvency regimes while strengthening weaker regimes.

C. Data Collection and Better Regulation Instruments

Data collection

- *What information and data are required? How and when will they be gathered?*
- *How far can available data be used (e.g.: available evaluations, impact assessment analysis or studies)?*
- *See Toolbox Tool #2 'Evidence Based Better Regulation'*

Within the outlined context, DG JUST will gather and analyse data on the existence and magnitude of problems associated with the discrepancies between the Member States substantive insolvency regimes, including preventive restructuring proceedings and the resulting barriers which those discrepancies create for the internal market and in particular for the cross-border flow of capital, as well as on analysing the economic and social impacts of the policy options to address the problems identified.

The key measurable indicators of the strength of insolvency frameworks appear to be the (i) recovery rate, (ii) the length of insolvency proceedings, and (iii) their costs, as well as (iv) the proportion of businesses in difficulties rescued compared to the number of liquidated businesses. The first three indicators can be elicited from the insolvency section of the annual Doing Business Report of the World Bank and from insolvency reporting mechanisms administered by some Member States at the national level. The latter can also provide information on the proportion of business rescued in relation to the number of liquidated businesses and also by providing the number of rejected applications for insolvencies of natural persons indicate an approximate number of persons caught in a long-term debt trap in individual Member States.

Moreover a number of existing studies and papers can be used to inform the impact assessment report, for example:

- IMF: Euro Area Policies – Selected Issues, IMF Country Report No. 15/205, July 2015, Euro Area Policies, IMF Country Report No. 15/204, July 2015.

- Study on Consumer Protection Aspects of Financial Services, European Parliament (London Economics), February 2014

- COMMISSION STAFF WORKING DOCUMENT IMPACT ASSESSMENT accompanying the document Commission Recommendation on a New Approach to Business Failure and Insolvency, SWD(2014) 61 final

- Commission Report on the application of Council Regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings, COM(2012)743, 12/12/2012

- Study on a new approach to business failure and insolvency. Comparative legal analysis of Member States' relevant provisions and practices, JUST/2014/JCOO/PR/CIVI/0075, University of Leeds, forthcoming

- Study on a new approach to business failure and insolvency – Comparative legal analysis of the Member States' relevant provisions and practices, INSOL Europe, December 2013

- Study on directors' duties and liabilities, London School of Economics, April 2013

- Bankruptcy and second chance for honest bankrupt entrepreneurs, ECORYS, due end 2014

- Pilot Project: Promoting protection of the right to housing. Homelessness protection in the context of evictions, FEANTSA, on-going, due in 2016 (see Terms of Reference available at: http://ec.europa.eu/social/main.jsp?catId=624&langId=en&callId=387&furtherCalls=yes)

- Report on overindebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives, for alleviating its impact, Civic Consulting, 2014

- Report on the treatment of the insolvency of natural persons, The World Bank, 2012

- Garrido, Jose M., 2012, "Out-of-court Debt Restructuring," World Bank Studies No. 66232, January (Washington, D.C.: World Bank)

- IMF STAFF DISCUSSION NOTE Tackling Small and Medium Sized Enterprise Problem Loans in Europe, Wolfgang Bergthaler, Kenneth Kang, Yan Liu, and Dermot Monaghan, March 2015

- Barkbu, Bergljot, Jassaud, Nadège and Kenneth Kang, 2013, "Strategy for Fostering A Market for Distressed Debt in Italy," IMF Country Report No. 13/299 (Washington, D.C.: International Monetary Fund), pp. 71-8.

- Liu, Yan and Christoph B. Rosenberg, 2013, "Dealing with Private Debt Distress in the Wake of the European Financial Crisis: A Review of the Economics and Legal Toolbox," IMF Working Paper No. 13/44 (Washington,

D.C.: International Monetary Fund).

Next to the aforementioned papers and studies and the study on economic aspects of differences in the EU insolvency regime, a number of other studies which are currently on-going or which are about to be launched will feed into the impact assessment report, namely:

- Comparative study on substantive insolvency law, Leeds University (DG JUST)

- The Annual Report on European SMEs: Work Package 1 - Section "What is the situation as regards the availability of a ´second chance´ for honest failed/bankrupt entrepreneurs in the EU (DG GROW),

- European Principles and Best Practices for Insolvency Practitioners, (commissioned by INSOL Europe), Leiden University.

Consultation approach

- *Describe the key elements of the proposed consultation strategy. Which stakeholders and information gaps will be targeted (consistency with "who is affected" - part A) and over which time frame?*
- *A standard sentence 'The launch of stakeholder consultations related to this initiative will be announced in the consultation planning that can be found at http://ec.europa.eu/yourvoice/consultations/docs/planned-consultations_en.pdf. If the consultation has already been launched or is already closed a link to the relevant website should be included.*
- *See Toolbox Tool #50 'Stakeholder Consultation Tools'*

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The consultation strategy will consist of a minimum 12-week internet-based open public consultation of all interested stakeholders, more generally investors, insolvency practitioners, judges, businesses in general, Member States, consumers and consumer organisations, trade unions, civil society, academia. The open public consultation should be launched in the first half of 2016. Stakeholders will be invited to provide feedback in relation to the initiative.

An Expert Group gathering expertise from independent experts in the field was set up in the fourth quarter 2015 and an dialogue with the Member States' experts undertaken in due time.

Will an Implementation plan be established?

X☐ Yes ☐ No

- *If no implementation plan will be established substantiate why.*
- *See Toolbox Tool #32 'The Implementation Plan'*

D. Information on the Impact Assessment Process

- *See Toolbox Tool #4 'What steps should I follow for an IA?'*
- *When will the IA work start?*
- *When will you set up the ISG and what DGs will be invited? Please write here the full name of the DGs allowing external stakeholders to understand who'll be involved in the preparation.*

The impact assessment process is due to start first quarter of 2016 with the launch of a study on economic aspects related to insolvency.

An ISG was established in 4th quarter of 2015. The following services were invited: the Secretariat General (SG), the Legal Service (SJ); the Directorate-General for Financial Stability, Financial Services and Capital Markets Union (DG FISMA); the Directorate-General for Economic and Financial Affairs (DG ECFIN); the Directorate-General for Taxation and Customs Union (DG TAXUD); the Directorate-General for Internal Market, Industry, Entrepreneurship and SMEs (DG GROW), the Directorate-General for Competition (DG COMP); the Directorate-General for Trade (DG TRADE); the Directorate-General for Employment, Social Affairs and Inclusion (DG EMPL); the Directorate-General for Mobility and Transport (DG MOVE).

E. Preliminary Assessment of Expected Impacts

- *See Toolbox Chapter 3 'How to identify impacts in IAs, evaluations and Fitness Checks' and Toolbox Chapter 8 'Methods, Models and Costs & Benefits*
- *For each type of impacts (grey rows): describe for each option (if possible) or for the overall initiative the expected impacts (positive and/or negative), give an indication of their significance and explain who would be affected and how.*

- *If a type of impact is not expected, please explain.*

Likely economic impacts

A better insolvency framework may contribute to better re-allocation of capital and more growth and jobs. A study of the European Parliament[31] found that harmonising insolvency processes would increase the efficiency of the restructuring process and increase returns to creditors and that 'there are certain areas of insolvency law where harmonisation is worthwhile and achievable'. An approximation of the Member States' bankruptcy systems has also been recommended, with a view to removing the barriers to the flow of capital in the European Union, by the Organisation for Economic Cooperation and Development in its 2014 Economic Review for the European Union[32], by a High Level Expert Group on SME and Infrastructure Financing as well as by the Association for Financial Markets in Europe. Fostering of write-offs of non-performing loans can free up considerable capacity for new lending. The proportionate boost to credit supply would be the greatest for countries like Ireland, Italy and Spain. However, in absolute terms, the boost to credit supply is also very large for a core economy like Belgium, France, and Portugal[33]. A reform of European insolvency laws could contribute significantly to equity as well as debt market development, financial stability, and economic growth.

Furthermore, a greater alignment towards effective and predictable insolvency procedures would enable investors more accurately to assess investment risk. The schemes under which the assets in the insolvency proceedings are distributed amongst investors must be predictable, reasonably rapid, independently conducted and supervised (especially as to asset valuation). At the same time, the holding of the insolvency procedure to ransom by particular groups of creditors should be prevented. Steps to align better substantive insolvency laws across Member States would increase legal certainty for investors and facilitate cross-border investments. Member States with effective and predictable insolvency laws are likely to more easily attract investors and flows of market-based finance. The importance of predictability and coherence of insolvency regimes is most important in a situation when the investment is not secured (collateralised).

As recognised by the International Monetary Fund, insolvency law also plays an important role in a post-crisis deleveraging process and the efficient reallocation of capital in the European economy[34], in particular in situations where macro-economic factors, such as low inflation, do not appear to contribute to the overall debt reduction in the Eurozone. An effective insolvency law should be able to speedily and efficiently liquidate unviable firms and restructure viable ones to enable such firms to continue operating. At the same time, it should maximise the value received by creditors, shareholders, employees, tax authorities, and other parties concerned.

In addition, common principles or minimum standards directing a more effective insolvency law that allows swift recovery or liquidation in a predictable and transparent manner would facilitate debt restructurings and the reallocation of funds to their most productive use. This would also increase the likelihood that viable businesses do not end up in inefficient liquidations, consequently aiding the return to economic growth.

Last but not least, the orderly deleveraging of households debt overhang would improve the prospects of the economic recovery in the EU by easing consumption, and also would promote retail investment contributing to the development of the economy.

Likely social impacts

Effective rescue and second chance provisions may have a positive influence upon employment and entrepreneurship. Rescuing viable companies rather than liquidating them can reduce the amount of jobs lost and unemployment in general. Second chance for honest but bankrupt entrepreneurs is an important incentive for individuals to re-enter the jobs market and the productive economy. Several respondents to the CMU Green Paper consultation highlighted the resulting complexity involved in approximating substantive laws in the area of insolvency which may touch upon the functioning of tax and social security systems of Member States.[35]. This suggests the necessity of adopting a pragmatic line identifying on the basis of a thorough impact assessment specific areas where common principles/minimum standards would be appropriate in order to achieve CMU objectives, whilst leaving the details of implementation to Member States to fit in with their national frameworks.

When assessing the impact of the envisaged initiative to improve substantive insolvency regimes, the final impact assessment report will pay a particular attention to fundamental rights in order to ensure that the proposed schemes fully respect the rights and principles set out in the Charter, in particular those in Article 17 (right to property), Article 16 (freedom to conduct a business), Article 15 (freedom to choose an occupation and right to engage in work), Article 47 (2) (right to a fair trial) as well as Article 8 (protection of personal data) and Article 7 (respect for private and a family life). The basic rights and freedoms protected by the Treaties in particular the free movement of persons, services and establishment, are also relevant for this measure.

Likely environmental impacts

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[31] INSOL Europe, Harmonisation of Insolvency Law at EU level, 2010, PE 419.633.
[32] OECD, ECO/EDR(2014)6, 23 December 2013.
[33] IMF: Euro Area Policies, IMF Country Report No. 15/204, July 2015, p. 24.
[34] IMF: Euro Area Policies – Selected Issues, IMF Country Report No. 15/205, July 2015, p. 69 and foll.
[35] Feedback Statement on the Green Paper "Building a Capital Markets Union" (Question 29), SWD(2015) 184 final, 30.9.2015, p. 59 and foll.

No.
Likely impacts on simplification and/or administrative burden
Yes. Reduction of the length and costs of insolvency proceedings could contribute to simplification of insolvency proceedings and alleviate the administrative burden on corporations as well as individuals.
Likely impacts on SMEs
Companies in financial difficulties which do not have effective early restructuring possibilities in their home country have an incentive to relocate to Member States which have more effective systems; however, the high costs of relocating make it impossible for SMEs who are debtors to benefit from better restructuring possibilities in other Member States which means that bigger companies which can afford to take such measures will have a competitive advantage. Having effective insolvency and restructuring procedures available in the Member States where SMEs are located will help them overcome such disadvantages which are due to their small size. SMEs who are creditors will also benefit from better insolvency procedures in respect of their debtors since they will likely enjoy higher recoveries of their claims.
Likely impacts on competitiveness and innovation
Excessive liquidations and excessively long discharge periods cause small firms and entrepreneurs to shy away from innovation as their financial resources are tied to the repayment of past bad debts often resulting from investments to non-viable business models which cannot be redirected to more viable and innovative investments. Moreover, such entrepreneurs are often stigmatised and do not want to experiment one more time. In contrast, a restructuring and second chance framework encourages greater innovation and a start-up culture. In addition, as mentioned in the Banking Union Communication,[36] inefficiency and divergence of insolvency laws make it harder to assess and manage credit risk. Finally, the comparison with the U.S. demonstrates that the problem of non-performing loans is more difficult to resolve without effective restructuring and insolvency tools[37]. Enhancing legal certainty and encouraging the timely restructuring of borrowers in financial distress can be particularly relevant for the success of strategies to address the problem of non-performing loans, particularly in some Member States.
Likely impacts on public administrations
• *See Toolbox Chapter 4 Tool #33 'Transposition checks'*
Beyond legislative approximation, there remains the risk of disparate enforcement cultures. In order to attain the outlined economic objectives, enforcement of those common rules by qualified insolvency practitioners and judges would need to be boosted in several Member States. Existing enforcement shortcomings could be addressed by adjacent measures aimed at improving the qualifications of insolvency practitioners and the training of judges. In addition, the problem of lengthy insolvency proceedings highlighted by some respondents to the Green Paper will continue to be addressed by the tools available within the European Semester process.
Likely impacts on third countries, international trade or investment
The initiative will stimulate international investment from third countries into the EU, as investors will likely face fewer obstacles when entering the EU market.

[36] COM(2015) 587 final, 24.11.2015, p. 10.
[37] Liu, Yan and Christoph B. Rosenberg, 2013, "Dealing with Private Debt Distress in the Wake of the European Financial Crisis: A Review of the Economics and Legal Toolbox," IMF Working Paper No. 13/44 (Washington, D.C.: International Monetary Fund).