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REGULATORY SCRUTINY BOARD OPINION

Enhancing the convergence of Insolvency laws

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Brussels,
RSB

Opinion

Title: Impact assessment / Enhancing the convergence of Insolvency laws

Overall 2nd opinion: POSITIVE

(A) Policy context

Clear and effective insolvency laws are important criteria for investors when deciding whether and where to invest. Discrepancies between the applicable rules in different Member States create potential barriers to the free movement of capital in the internal market and this uncertainty risks discouraging cross border investments and negatively affecting competition and competitiveness.

This initiative aims to create more predictable conditions for cross-border investment in the EU by harmonising targeted aspects of substantive insolvency law.

(B) Summary of findings

The Board notes that the report has been substantially redrafted.

The Board gives a positive opinion. The Board also considers that the report could further improve with respect to the following aspect:

- (1) The analysis of the Member States' judicial systems does not fully take into account all factors likely to affect court capacity.**

(C) What to improve

(1) The report assesses for which Member States judicial bottlenecks are more likely to be an issue as a result of the expected increase of Micro and Small Enterprise (MSE) cases due to the introduction of the MSE regime. It could also assess the impact of the expected increased number of Small and Medium Enterprises with cross-border investors as a result of other EU legislation such as the creation of the European Single Access Point for company data. The report could also explain how Member States could improve court capacity to absorb the potential increased number of insolvency cases.

(2) The report should further elaborate on Commission's plans to collect monitoring data for future evaluation. It should better explain the sources of data and the arrangements needed for the data collection.

The Board notes the estimated costs and benefits of the preferred options in this initiative, as summarised in the attached quantification tables.

(D) Conclusion

The DG should take these recommendations into account before launching the interservice consultation.

If there are any changes in the choice or design of the preferred option in the final version of the report, the DG may need to further adjust the attached quantification tables to reflect this.

Full title	Impact Assessment on an initiative to increase the convergence of substantive corporate (non-bank) insolvency laws
Reference number	PLAN/2020/8631
Submitted to RSB on	14 September 2022
Date of RSB meeting	Written procedure

ANNEX: Quantification tables extracted from the draft impact assessment report

The following tables contain information on the costs and benefits of the initiative on which the Board has given its opinion, as presented above.

If the draft report has been revised in line with the Board's recommendations, the content of these tables may be different from those in the final version of the impact assessment report, as published by the Commission.

I. Overview of Benefits (total for all provisions) – Preferred Option		
Description	Amount	Comments
Direct benefits		
Reduction of costs to the judicial system at Member State level <u>Who benefits:</u> public sector (courts, insolvency practitioners)	Approximately EUR 1.9 billion of cost savings from simplification of insolvency proceedings.	The amount is obtained as 40% lower judicial costs times 1.4% judicial costs times 130 000 insolvency cases times average claim of insolvency case (see further detail below the table). This is a point estimate that is determined by these assumptions. The use of alternative assumptions leads to a higher or lower values (see text below), but it is not possible to attach probabilities to alternative scenarios. These cost savings would accrue for the judicial system (insolvency practitioners, courts) and stem from simplification of procedures at Member States level, hence they , do not count under the one in, one out commitment.
Higher recovery value <u>Who benefits:</u> creditors, i.e. the financial sector, the public sector, other non-financial corporations and households proportional to their claims to the debtor	Approximately EUR 4.9 billion out of which approximately EUR 1.9 billion are due to legal cost savings from simplification of insolvency proceedings.	A 1.42 percentage point increase (Error! Reference source not found.) times notional amount times 130,000 insolvency cases per annum, table in annex 4.1. The notional amount is the average claim of 2.6 million EUR derived as 3.5 million EUR average for Germany corrected for the lower GDP per capital in the EU-27 compared to Germany (75%). Part of this are legal cost savings described above that are expected to be passed on to the creditors.
Simplified insolvency procedures for micro and small enterprises <u>Who benefits:</u> owners / entrepreneurs behind micro and small enterprises	Potentially sizeable, but cannot be reliably estimated.	Owners of MSEs would benefit from a dedicated simplified insolvency procedure. In most cases, this would enable an orderly winding down of distressed micro- and small businesses as costs of normal insolvency procedures were not proportionate for them. This would also accelerate debt discharge and help create a second chance for these entrepreneurs. Insolvency experts surveyed in Deloitte/Grimaldi (2022) suggest average cost savings of about 12%. EBA (2020) shows judicial costs of 3.5% for SME loans, compared to 1.4% for corporate loans.

Better coordination among creditors <u>Who benefits:</u> creditors, in particular cross-border creditors	Cannot be estimated	Creditor committees would allow creditors to cooperate and more effectively coordinate their decisions and would help cross-border investors to be better represented. This on one hand contributes to higher recovery value (quantified above) but also presents a benefit of its own.
Indirect benefits		
Lower debt funding costs <u>Who benefits:</u> companies, including SMEs	Approximately EUR 1.6 billion	Under the assumption that a 1.4% increase in the recovery rate (table 7 in section 7.2) triggers 1.4 basis points lower funding costs on 1855 billion EUR NFC liabilities in form of debt securities and EUR 9592 billion in loans 2020 (Eurostat)
Higher productivity growth <u>Who benefits:</u> broader society including both private and public sector	Approximately EUR 7.2 billion	0.5% higher productivity growth from fewer zombie firms (as suggested in OECD 2017), assuming insolvency rules reduce the share of zombie firms by 10%. A higher or lower share would increase respectively reduce the productivity gains proportionately, but there is no possibility to attach probabilities to different assumptions
Lower information and learning costs for cross-border investment <u>Who benefits:</u> cross-border creditors	Potentially sizeable, but cannot be estimated	There is neither statistical data nor a suitable methodological approach to quantify these benefits. However, based on the findings of the HLEG on CMU and stakeholder views, benefits in this area are potentially sizeable.
Higher chances of timely selling going concern parts of a distressed business <u>Who benefits:</u> companies, including SMEs, their investors and employees	Cannot be estimated	The harmonised pre-pack procedure would increase the chances of timely selling of going concern parts of the distressed company's business, enabling to preserve value for its shareholders and employees.
Administrative cost savings related to the 'one in, one out' approach*		
N/A ¹	N/A	N/A

¹ As explained in section 8, none of the cost savings identified in this table are applicable for the "one in, one out" commitment.

II. Overview of costs – Preferred option							
		Citizens/Consumers		Businesses (notably insolvent businesses and creditors)		Administrations	
		One-off	Recurrent	One-off	Recurrent	One-off	Recurrent
Preferred option (as an aggregate)	Direct adjustment costs	none	none	Familiarisation with new rules (creditors, businesses at risk of insolvency, lawyers and consultants; no estimate available)	none	none	none
	Direct administrative costs	none	none	none	none	Creation of factsheets on key characteristics of insolvency framework: EUR 67,000-90,000 ²	Updating the factsheets - negligible costs
	Direct regulatory fees and charges	none	none	none	none	none	none
	Direct enforcement costs	none	none	none	none	none	none
	Indirect costs	none	none	Further internal procedures and an information flows for	Higher liability of directors of companies may be reflected in	none	Potentially more insolvency cases, estimated at approximately

² See below under “expected costs” for an explanation.

This opinion concerns a draft impact assessment which may differ from the final version.

				distressed companies to enable due diligence in case of pre-pack sale (conditional on company opting in for a pre-pack sale, no estimate available)	higher wage demands, more difficult recruitment of directors, company procedures/information flows or higher liability insurance costs (no estimate available).		EUR 0.9-2.0 billion ³ and more disputes on asset seizures (no estimate possible).
<i>Costs related to the 'one in, one out' approach</i>							
Total	Direct adjustment costs	none	none	Familiarisation with new rules	none		
	Indirect adjustment costs	none	none	none	none		
	Administrative costs (for offsetting)	none	none	none	none		

³ See below under “expected costs” and Annex 4, Section 3.2.



Brussels,
RSB

Opinion

Title: Impact assessment / Enhancing the convergence of Insolvency laws

Overall opinion: NEGATIVE

(A) Policy context

Clear and effective insolvency laws are important criteria for investors when deciding whether and where to invest. Discrepancies between the applicable rules in different Member States create potential barriers to the free movement of capital in the internal market and this uncertainty risks discouraging cross border investments and negatively affecting competition and competitiveness.

This initiative aims to create more predictable conditions for cross-border investment in the EU by harmonising targeted aspects of substantive insolvency law.

(B) Summary of findings

The Board notes the additional information provided in advance of the meeting.

However, the Board gives a negative opinion, because the report contains the following significant shortcomings:

- (1) The report does not provide sufficient evidence of how current insolvency proceedings negatively affect cross-border investment in the single market. It does not convincingly demonstrate why the EU should intervene now. The analysis of how divergent the situation is in Member States is insufficient.**
- (2) The report does not clearly set out the articulation between the initiative and the 2019 Restructuring and Insolvency Directive. It does not clearly identify the remaining gap after the latter is transposed in July 2022.**
- (3) The report does not sufficiently assess the impacts on the capacity of Member State's judicial systems, resulting from the expected increased number of cases involving SMEs and how this may affect the expected benefits.**
- (4) The report does not provide a balanced assessment of options and is geared towards the preferred option. It does not present clearly the trade-offs that policy makers face.**
- (5) The report does not present a robust assessment methodology nor sets out clearly the underlying assumptions. The SME test is missing.**

(C) What to improve

- (1) The report should set out the policy context more clearly, in particular by identifying those factors that have changed since the 2019 Restructuring and Insolvency Directive was agreed. It should explain how a gap has emerged [since then,] what that gap is, its magnitude and set out a clear and unambiguous rationale for action at this juncture. It should identify with evidence those specific aspects of national insolvency laws that present major hurdles to cross-border investment, for which harmonisation would have a clear EU added-value and hence could significantly contribute to the creation of a Capital Markets Union.
- (2) The evidence is weak in the problem analysis. The report should better demonstrate how important insolvency procedures are in terms of influencing cross-border investment decisions as opposed to other factors. It should be more transparent and indicate how robust the available evidence is on how insolvency regimes affect cross-border investment decisions. It should seek to significantly strengthen and supplement the limited evidence presented. At the same time, it should avoid over-reliance on a few available evidence sources (e.g. the insolvency practitioner survey given potential conflict of interest).
- (3) The report should further elaborate both the institutional differences between jurisdictions (e.g. the applicable rules, quality of the judiciary in dealing with insolvency cases and insolvency practitioners) and the differing levels of judicial capacity. It should examine how these impact insolvency outcomes and affect cross-border investment. The report should better explore what the implications of these divergences across Members States would have as potential constraints in terms of any proposed harmonisation given that the presence of such potential bottlenecks in the judiciary might hide a procedural delay thereby undermining the legal security that the initiative seeks to provide. This impact needs to be considered in the report and quantified as much as possible.
- (4) The presentation of options pre-empts the preferred one. The report should therefore provide a more balanced and evidence-based assessment of options and bring out more clearly the trade-offs that policy makers face. Later when comparing the options the relative scoring of the preferred ‘targeted’ and the alternative ‘fully harmonised’ options should be better grounded in the available evidence and adjusted accordingly as well as better explained.
- (5) The report should critically review the cost and benefit estimates and better account for uncertainties. Before applying scoring schemes and weighting of aggregate costs and benefits, the impact analysis should check the plausibility of what the different measures contribute and be comprehensive. The report should analyse in a more nuanced way to what extent simplified insolvency procedures for Micro and Small Enterprises may contribute to bottlenecks in the judicial system of Member States and thus risk the realisation of envisaged benefits. This uncertainty should be reflected in the analysis as the current modelling assumes no effect on capacity of courts.
- (6) When it comes to administrative costs and savings, the report should clearly indicate which of those costs and savings are to be considered in the scope of the One In, One Out approach. The report should include a proportionate SME test to indicate impacts and assess the proportionality of measures for SMEs.
- (7) The report should explain how the data collection for effective progress monitoring will be ensured.
- (8) Views from stakeholders, also dissenting ones, should be included throughout the report, especially in the problem definition, impacts and preferred option.

Some more technical comments have been sent directly to the author DG.

(D) Conclusion

The DG JUST must revise the report in accordance with the Board's findings and resubmit it for a final RSB opinion.

Full title	Impact Assessment on an initiative to increase the convergence of substantive corporate (non-bank) insolvency laws
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