



MALTA EU 2017

Think Ahead



“Preventive restructuring and second chance for entrepreneurs: what’s in it for SMEs?”

28 February 2017

REPORT



On 28 February 2017, ACCA (the Association of Chartered Certified Accountants) BusinessEurope, and UEAPME organised, under the auspices of the Maltese Presidency of the Council of the European Union, a multistakeholder conference called “**Preventive restructuring and second chance for entrepreneurs: what’s in it for SMEs?**” to discuss the insolvency proposals and what’s in them for SMEs.

After a welcome address by **Markus Beyrer**, Director-General of BusinessEurope and Keynote speeches from **Andreas Stein**, Head of the Civil Justice Unit for DG JUST, European Commission, who presented the proposal, and from **Angelika Niebler**, MEP & Rapporteur on insolvency for the European Parliament Legal Affairs Committee, **John Cullen**, ACCA Council member & Partner, at Menzies moderated a lively panel discussion entailing **Luc Hendrickx**, Director Enterprise Policy and External Relations at UEAPME, **Philip Oosterlinck**, who presented a real-life testimony of insolvency, **Gary Simmons**, High Yield Managing Director at AFME, and **Hilde Blomme**, Deputy-CEO of AccountancyEurope. Participants also heard concluding remarks from **Kevan Azzopardi**, Official Receiver, MFSA, Chairman of the Council Working Party on civil law matters (Insolvency) for the Maltese Presidency of the Council of the EU.

The debate revealed that:

- We must create a positive corporate culture in order to reduce the fear of failure and give companies a second chance.
- Assisting companies - especially SMES, the backbone of Europe’s economy - in financial distress to prevent insolvency, and providing a second chance to honest bankrupt entrepreneurs are vital to re-boost growth and investments in the EU.
- The European Commission proposal - and its holistic approach- is generally welcomed by stakeholders, who commended the preparatory work being undertaken before its publication.
- However, the debate also showed that insolvency is a complex area, deeply rooted in national legal traditions, which raises numerous challenges.



MALTA EU 2017

Think Ahead



BUSINESSEUROPE



Main highlights:

Markus Beyrer, Director-General BusinessEurope

- Insolvency is a very delicate subject that companies hope not to face during their lifecycle. The reality is, unfortunately, that half of businesses in the EU do not survive the first 5 years. This has an undeniable impact on growth and jobs.
- Although insolvency is commonly seen as a synonym of liquidation, it does not always imply the end of the road. Companies facing difficulties can often rely on pre-insolvency tools in the form of early warning systems and restructuring procedures to help them bounce back.
- In other parts of the world, like in the US, this is already part of the entrepreneurial reality. Failure does not mean “game over”. People are encouraged to start over and over again in order to succeed. In Europe, however, things are slightly different.
- The recent Commission proposal aims at making these pre-insolvency tools more accessible to companies throughout the single market. Small companies would in theory be the main beneficiaries of such a measure.
- Due to their lack of resources, SMEs tend to struggle more when they first encounter difficulties; whether to keep the flow of capital or to have a breathing space to offer creditors with a credible restructuring plan. BusinessEurope is generally supportive of the Commission approach and has recently prepared [comments on the proposal](#). BusinessEurope is particularly keen on the holistic approach taken which also covers efficiency of procedures (e.g. specialisation of courts) and digitalisation, going beyond traditional procedural law. The minimum standards approach of the proposal is the most appropriate.
- However, because insolvency is an area so complex and so deeply rooted in national legal traditions, the proposal presents numerous challenges and unanswered questions:
 - Should member states benefit from more options to be able to preserve some of their national features, many recently adopted and showing signs of success?
 - Where is the right balance between giving debtors the powers to act and protection during the restructuring and the need to protect creditors?
 - Are the safeguards for creditors sufficient?
 - Is the maximum discharge period of 3 years reasonable? Should there be more exceptions?



Andreas Stein, Head of Unit of the Civil Justice Unit, DG JUST, European Commission

- The SME perspective in the proposal is unique. SMEs are affected by all the different parts of the proposal: in their capacity as creditors, debtors, as those who would benefit from a second chance, and those in need of more efficient insolvency and restructuring procedures.
- Looking at SMEs from the debtor perspective, in the context of preventive restructuring procedures, in many Member States a possibility for preventive restructuring does not exist, or where it exists, the procedures are often complex and costly. SMEs are usually not the main clients of such procedures.
- The Commission built into the proposal a number of features that should make these procedures available in every member state. The goal is to give a chance for those companies that have a prospect for return to viability.
- The proposal foresees early warning tools. This is particularly relevant for SMEs. These tools make companies aware of situations of financial difficulty that urgently calls for action and make available information on restructuring procedures. There is an option for member states to limit the availability of early warning tools and information on restructuring proceedings to SMEs.
- Another important aspect of the proposal is the ease or difficulty of entering into restructuring. In many member states, in order to qualify for restructuring, a viability test needs to be carried out. This can be a big obstacle for companies due to costly assessments. The Commission made a conscious choice to not make the viability test a requirement in order to enter into restructuring procedures.
- Court involvement can also be a vital issue for SMEs. Whenever creditors' interests are affected, the procedures need to be subject to court supervision. The EC proposal recognises that. However, in many cases court procedures are constructed in such a way that there are formalities and additional obstacles that make it harder for companies to benefit from the procedures. There is a provision in the proposal that obliges member states to limit the court involvement to the extent that is appropriate and necessary to safeguard creditors' interests.
- The proposal prohibits an automatism that implies the need to automatically appoint an insolvency practitioner in all restructuring procedures, thus avoiding further additional costs in situations where an insolvency practitioner is not indispensable. There is also a provision in the proposal that obliges member states to make a model restructuring plan available.
- As creditors, SMEs could strongly benefit from wider range of restructuring procedures. It would increase their recovery rates which are significantly higher in Member States where restructuring is the most likely result. We shouldn't neglect the fact that in the EU about 1 in 6 insolvencies is triggered by an insolvency of another company. SMEs are often the victims of this ripple effect.
- Companies that are run by fully personally liable entrepreneur are usually SMEs. Insolvency is too often considered a failure or a death sentence not only for the company but also for the entrepreneur. Statistics show that a second attempt is on average considerably more successful than the first because people learn from their mistakes.



- The Commission concluded that 3 years is a balanced solution when it comes to the maximum discharge period. The proposal allows a lot of flexibility for Member States in the design of the second chance procedure.
- There is a chapter in the proposal on the efficiency of the proceedings. It is obvious that SMEs do not have the same resources as big corporations. Anything that speeds up insolvency or restructuring, uses modern technology and keeps costs down, will be beneficial to SMEs.
- The proposal does not impose a particular type of creditors' committees and is quite flexible in this regard. The proposal only implies the obligation to distinguish between secured and unsecured creditors. It is justified to treat these two types of creditors separately due to their different situations and interests.

Angelika Niebler, MEP & EP's Legal Affairs Committee, Rapporteur on insolvency

- It is very important to stress what crucial role SMEs play in our economy. It is a fact that SMEs account for more than 99% of all enterprises in the EU. In other words, for every square kilometre, the EU has an average of 5 SMEs. Only half of enterprises survive less than five years. Around 200,000 companies are facing insolvency every year throughout the EU. This leads to a loss of about 1.7 million jobs per year. With its proposal, the Commission hopes to prevent insolvency by undertaking early restructuring measures. We need to do whatever we can to provide support for SMEs. A proper environment and legal framework must be arranged in order for SMEs to cope with difficulties in their way.
- Experience shows that businesses usually come to politicians when they encounter issues. They often ask for help in facilitating their cross-border activities.
- The European Parliament is still to advance on the assessment of the proposal. The EP is debating the split of committees' competences. The Committee on Economic and Monetary Affairs (ECON) and the Committee on Employment and Social Affairs (EMPL) have strong positions, however, Company law is a legal issue and it should be kept in the Legal Affairs (JURI) Committee.
- The European Commission did a good job in explicitly stating and emphasising that workers' rights to information and consultation, as protected by article 29 of the Charter of Fundamental Rights, will not be affected by the proposal. It is important to note and spread the message that this is not the right place to talk about the workers' rights because they are not affected by the proposal.
- The discharge period is another important issue that needs to be discussed in detail. We need to help SMEs in investing in other member states and their cross-border activities.
- The Commission proposal has a lot of potential to be a very good piece of legislation. It may help businesses to survive financial troubles and encourage young entrepreneurs to create a start-up. It will be a great tool to promote entrepreneurship and fight the stigma of failure. We must create a positive corporate culture in order to reduce the fear of failure and give companies a second chance. This is the only way to ensure growth and employment in Europe. As the Rapporteur in the European Parliament's Legal Affairs Committee, I will work intensively on this proposal in the coming months.



MALTA EU2017

Think Ahead



BUSINESSEUROPE



PANEL DISCUSSION

John Cullen – ACCA Council member & Partner, Menzies

- As an insolvency practitioner, I advise companies and people on a day to day basis, dealing with their financial stress. That financial stress may be current, they may be suffering right now. Or they might think that sometime in the future, they could have a problem. And my job is to try to provide the best advice to either avoid it, or help them through it. I have two favourite parts. The first one is dealing with **the roots of the stress** caused by financial problems. I can go in and help solve those financial problems and, therefore, their associated stress. Stress is like a disease. It affects your working life, it affects your sleeping life, it affects your social life. My second favourite part of working in insolvency is **saving jobs**.
- The UK benefits from an already well developed regime, but things are not perfect and more needs to be done. And across the EU as a whole, we currently observe a significant variance in survival rates of struggling businesses, from 5 to 80% of businesses entering formal insolvency processes. This means that the European Commission and the co-legislators could usefully act to improve these rates by harmonising the existing insolvency regimes, using features and best practices from the member states showing the best survival and growth rates.
- The Directive is especially intended to benefit less resourceful SMEs, a welcomed objective. But it also raises challenges and concerns, as insolvency rules affect a plethora of stakeholders (creditors, debtors, shareholders, courts, etc), and are deeply intertwined with many other areas of law. It is vital that all stakeholders join forces to help design a fair and balanced preventive restructuring and second chance framework.

Philip Oosterlinck, DYZO

- Philip presented a case study of an SME. He joined the company of his family and became CEO in 1998.
- When the company started facing some difficulties, Philip decided to deal with the situation himself by first contacting his bank and the creditors instead of undergoing the insolvency procedure. His goal was to always be very transparent and to have clear objectives.
- The company, nevertheless, failed and faced insolvency. All personal debts and bank guarantees were paid off in two years. The cost of the insolvency was enormous.



- Failure for SMEs means death due to high costs. Discharge period of 2 or 3 years is often too long. Transparency is crucial because as entrepreneur you have to rebuild your life.
- Failure can put entrepreneurs into a state of stress for multiple years. Entrepreneurs are afraid to make decisions and take chances because they are afraid about their future. It greatly impacts their personal life and the life of entrepreneurs' families. There is also a lot of concern about the employees of the company. They need to get informed.
- We need to create conditions for people to start again. It is important to recognise both parts of the failure – the legal one and the emotional one.
- We need to focus on prevention - if people get proper help on time, insolvency can be avoided and collateral damage be minimized.
- The EU can help during this process in creating a network and by being a facilitator.
- Philip now works as consultant for SMEs and as freelancer for DYZO, an organisation supported by the Flemish government.

Luc Hendrickx, Director Enterprise Policy and External Relations, UEAPME

- People are not often willing to talk and raise awareness about failure. This should be more welcomed and encouraged in our society.
- The Commission proposal does not mention enough the importance of this proposal for SMEs. Preventive measures should receive the main attention. Problems in companies should be detected early and appropriate assistance should be provided. Preventive measures should focus on businesses in difficulties that can be helped without having to resort to restructuring measures because they are often too expensive or too long.
- UEAPME hasn't yet finalised its position on the EC proposal but the Commission proposal is a positive and balanced one.
- Article 6 of the proposal foresees that Member States shall ensure that debtors, who are negotiating a restructuring plan with their creditors, may benefit from a stay of individual enforcement actions if and to the extent such a stay is necessary to support the negotiations of a restructuring plan. UEAPME believes that we need more stringent conditions for access to the procedure because it has impact on the creditors.
- The proposal foresees second chance possibility for companies and the discharge period. The majority of organisations within UEAPME think that the period of 3 years is too long and it should be shortened to 1 year. German and Austrian organisations, however, do not agree with 1 year discharge period.
- Many bankruptcy procedures are relatively simple, especially when a SME is the debtor. The principle should be that a honest entrepreneur should be discharged within one year after the opening of the procedures. Think small first approach should be applied.
- The proposal should limit the discharge procedure provisions to honest entrepreneurs and there should be a presumption of honesty - dishonesty should be proven.
- We should think further and look at the reasons of bankruptcy. Once again UEAPME calls, therefore, on the Commission to strengthen the Late Payment Directive. Late payment is one of the main reasons for bankruptcy.



- We should discuss more the psychological impact and stigma of failure. Around 47% of Europeans are reluctant to order from previously failed businesses. We need to raise awareness at national level as foreseen in the Small Business Act in 2008. Projects of exchange of best practises between entrepreneurs should be encouraged.
- SMEs are often reluctant to seek advice; it is the role of business organisations to insist on entrepreneurs to ask for advice and help. Sometimes SMEs fail because they grow too fast, therefore business organisations need to underline that growth is necessary but it has to be at a pace that the company is able to follow.

Gary Simmons, AFME

- AFME supports the European Commission's proposed Directive on insolvency reform. There are several positive aspects of the proposed Directive:
 - reducing uncertainty and costs for investors;
 - making it easier to assess risks and therefore helping to reduce the cost of credit;
 - increasing investment;
 - helping to develop more mature and more liquid European capital markets;
 - lowering current barriers to the efficient restructuring of viable companies in the EU.
 - making it more likely that a viable company will be able to restructure rather than going into liquidation
 - providing entrepreneurs with a second chance, and helping to remove the stigma that is sometimes attached to business failures
- In some areas of the proposed Directive doesn't go enough and some improvements could be made:
 - **Creditor rights** - National European laws vary with respect to the right of a creditor to propose a viable restructuring plan. The Directive should make it clear that creditors with a remaining economic interest in the company are able to structure and propose a restructuring plan for a viable debtor. In addition, with respect to new and interim financing, more consideration should be given to protection of existing creditor rights, particularly with respect to secured creditors.
 - **Stay of individual enforcement actions** - Further consideration should be given to the appropriate length of the stay provision both to ensure that the stay is fair and does not unduly prejudice the relevant parties. The stay provision should not be so long that it ties up financing or otherwise discourages investment. The length of the stay provision should also be consistent with other regulations. For example, under the existing Capital Requirements Regulation (CRR), a bank has to consider a repayment claim as in default if the debtor is past due more than 90 days (Article 178 CRR). This appears to be inconsistent with a four month stay period.
 - **Provisions that are not sufficiently prescriptive** – certain provisions provide that Member States or judicial and administrative officials “may” take or decline to take certain actions. In some of these cases. These provisions would be more effective, and it would make it likely that the stated purposes of the Directive will be reached, if these actions (or inaction) were required to be taken, rather than left to the discretion of the relevant parties.



- **Uncertainty over responsibilities or affected parties** – certain provisions provide that a particular action will be triggered by a particular state of affairs, or a specific conclusion about the rights of the parties. In many of these cases, however, it is unclear how, and by whom, it is decided whether the relevant state of affairs exists. In some cases, it is also unclear exactly which parties should be considered in assessing any effect on stakeholder rights.
- **Cross-class cramdown** - Article 11(1) on cross class cramdown permits a judicial or administrative authority to take specific actions if certain conditions are met. These actions should be automatic if the relevant conditions are met, both from a certainty and a timeliness perspectives.
- Many SMEs are run by directors that don't necessarily have great knowledge about the complications and intricacies of insolvency laws and they also might not have the financial capacity to hire lawyers, advisors and others that have the relevant expertise, particularly if there is a cross border aspect to the business. Harmonisation of minimum standards would simplify the process of understanding and navigating insolvency laws and procedures.
- More specifically, many of these directors will have invested their personal wealth into the company and will be personally liable for business debts or malfeasance. This might make directors overly cautious when it comes to trying to rescue the company, and might result in the liquidation of SMEs that could otherwise be viable. A safe harbor for directors might help to overcome this reluctance and over cautiousness.
- Not allowing ipso facto clauses to affect a proceeding as it might help a viable SME to stave off an automatic default or being kicked out of its premises by its landlord because it has entered into restructuring proceedings.
- **COMI shifts** - It's less likely that an SME would have the expertise or financial ability to take advantage of COMI shift opportunities and therefore they might remain subject to the arguably less favourable local regime. Harmonisation of minimum standards would make it less necessary for a European to shift its COMI and, if effective, increase the probability that a viable SME would be able to restructure rather than going into liquidation
- **Second Chance** - The proposed Directive is intended to both give an honest entrepreneur a second chance after a business failure, and also to help remove the stigma that might paint such an entrepreneur as a failure or loser, which stigma can follow an entrepreneur for a long time. This is seen in the provisions related to discharge periods, for example. This would encourage European entrepreneurs to start businesses, both first time and subsequently.
- **Encouraging Investment** - It is hoped that the implementation of minimum insolvency standards across Europe will eventually provide greater certainty to investors in assessing credit risk, lower the cost of credit and encourage greater investment in Europe. All of these things should incentivise investment in SME's and make it easier for entrepreneurs to obtain financing and investments in their businesses.
- Insolvency reform has been discussed for over 15 years in Europe, and we have been hearing the same arguments related to the difficulty and complicated nature of any attempt to harmonise insolvency laws, the effect of any change on national laws or other areas of law, and an inability to "legislate culture". These arguments are a big reason why more substantive progress



hasn't been made in this area. We have to start somewhere at the proposed directive is a good start.

Hilde Blomme, Accountancy Europe

- The Commission's proposal is a positive development for the European economy as the main focus is on preventive measures and entrepreneurship. Hopefully this can be preserved in the upcoming debates on the business insolvency.
- Accountancy Europe supports the Commission's initiative to set minimum requirements for an effective insolvency framework within the European Union.
- In order to get the most benefits from the proposal, it is important that there is appropriate assistance available for companies facing financial troubles, also to ensure a possibility for honest entrepreneurs for a second chance. This is crucial to boost growth and investment in the EU.
- We need to focus more on SMEs and help them overcome the fear of insolvency. The proposed directive has the potential to do that.
- Accountancy Europe has published a paper on the contribution of the accountancy profession in [EU Business insolvency](#), based on the internal survey carried out among Accountancy Europe members. Key conclusions:
 - Insolvency proceedings vary depending on a jurisdiction;
 - Entrepreneurs seek for an advice at a very late stage in the process due to lack of anticipation and/or lack of awareness on availability of a professional advice;
 - insolvency proceedings often are lengthy and costly due to lack of efficiency of the proceedings and bureaucratic mechanisms;
 - Bankruptcy results in lack of debt forgiveness, which prevents entrepreneurs from getting a second chance.
- Accountants can have a key advisory role in all stages of preventing, restructuring and providing a second chance:
 - Preventing: Monitoring and reviewing financial performance, alerting a business owner in case of risks/signs of financial distress.
 - Restructuring: Assisting with restructuring process specially thanks to having the right experience and expertise at hand.
 - Second chance: Assisting with restarting a business, in particular, with preparation of a business plan, cash flow forecasting, internal control processes.
- Accountants are well placed to assist SMEs at an early restructuring phase. Having the relevant experience at hand, accountants are able to help entrepreneurs to interpret financial performance of an enterprise and to alert them in case of arising financial problems to take an early action.

CONCLUDING REMARKS

Kevan Azzopardi, Official Receiver, MFSA, Chairman of the Council Working Party on civil law matters (Insolvency), Maltese Presidency of the Council of the EU

- All businesses, especially SMEs, facing or likely to face financial difficulties need to seriously consider its options and restructure its business if possible at an early stage in order to survive. This helps saving jobs, thus achieving lower



unemployment rates, it directly helps trade and investment, which ultimately results in a healthier economy. In order for this to function properly, comprehensive national pre-insolvency and insolvency frameworks that support businesses during difficult times, with well-trained practitioners, as well as a specialised Judiciary, need to be in place.

- At EU level, other issues come into play and without going into the developments which led to this proposal but will pick upon the European Commission's conclusion had concluded that its Recommendation of 12 March 2014, on restructuring and second chance had failed to achieve the necessary results **in terms of sufficient harmonisation of national insolvency regimes**.
- This stems out from the fact that Member States take different approaches to rescue viable businesses. Such frameworks may be successful at national level, but divergences amongst different Member States **create barriers to cross border trade** and also for the creation of jobs within the single market.
- This Proposal is a first of its sort in the field of insolvency, in that it is the first instrument which deals with substantive law at EU but also at national level.
- In broad terms the proposal seeks to address certain important areas within this unfortunate phase of a company. It is a unhappy situation for business to be in. Therefore it is important to make restructuring especially for SMEs user-friendly. The European Commission is confident that this Directive would have the effect of helping:
 - Companies identify a deteriorating business through early triggers, allowing them to restructure at an early stage through the implementation of a restructuring plan;
 - In worst case scenarios, honest entrepreneurs will have access to efficient insolvency national frameworks, with the possibility of a full discharge of their debts within a maximum period of 3 years following liquidation, and subject to certain requirements;
 - Today we witnessed different views on the length of this discharge period. Honest entrepreneurs strive to honour their responsibilities. Not only to their creditors but also to their employees.
 - Workers will directly benefit whenever jobs are saved, but also through the protection of existing EU labour legislation. They will have the possibility of enforcement of their wage claims as pointed out by Mr Hendrickx and by Honourable MEP Niebler notwithstanding any stay of proceedings, whenever their claims are not guaranteed through other measures by the MS;
 - The European Commission is also confident that the proposed Directive will have a positive impact towards reducing non-performing loans, thus benefiting the banking sector within the single market;
 - Creditors in general are also set to benefit though involvement in the procedures and plans and hopefully through better recovery rates in cases of early detection, but also through the 'no creditor worse off' principle;
 - All parties may benefit from an increase in the efficiency of restructuring, insolvency and second chance through interaction with trained practitioners and members of Administrative Authorities, and specialised Judges;
- The proposal makes specific reference to SMEs and that when applying certain parts of the proposal MS may limit its application to SMEs. It is acknowledged that SMEs often do not have the necessary resources, especially when facing financial difficulties, to cope with high restructuring



costs. They face difficulties in seeking professional advice and it is common for them to procrastinate especially due to the costs. SMEs as creditors stand to benefit from the safeguards within the proposal. Therefore, primarily MS need to make access to early restructuring tools easily accessible to SME. But also early triggers need to be in place in order to flag deteriorating businesses at an early stage. Early warning could come in the form of a flag by accountants, tax and social security authorities. This may be another area of involvement for the accounting profession in addition to their involvement in seeking manners in which to rescue viable businesses, as well as to offer a second chance to honest entrepreneurs.

- The Maltese Presidency's general objective with regards to the proposal is to achieve good progress and create a constructive environment for efficient negotiations in the working party meetings, and this by scheduling a good number of working meetings in order to be able to make progress in the discussions of the proposal.
- In terms of the progress on this proposal, it is acknowledged that we are still at an early stage of the discussions. However we note that the objectives of the proposal were welcomed by Member States both at political as well as at technical level. As the saying goes, the devil lies in the detail, and it is here that we have to work in order to ensure that we achieve a good instrument which strikes an appropriate balance between the parties concerned. This needs to allow enough flexibility in order not to interfere extensively with well working national frameworks.
- This proposal is of high interest to different sectors, such as the financial and banking sector, which will follow closely the developments of this proposal and will contribute whenever necessary.